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 business (that is, it needs a different infrastructure). Through our work and research, we have identified a specific progression of infrastructure development that needs to occur to support organizational success. This progression is embedded in a "stages of organizational growth" framework that will be the subject of Chapter 3 and Chapter 4.

Building a sustainably successful business, then, involves understanding and effectively managing these stages of growth. The remainder of this book is intended to provide CEOs and their leadership teams with the information that they need to effectively develop and manage their company's infrastructure.

Transitions Required for Continuing Success: An Overview Case Example

As an introduction to the remainder of this book and to illustrate the personal and organizational transitions that typically occur as a company grows, this section presents a case study of an entrepreneur, Robert Mason and his company, Medco. Although the case selected is that of a medical products company, the issues faced by the entrepreneur and the company cited here are similar to those faced by CEOs in diverse organizations with revenue ranging from $1 million to substantially more than $1 billion. In brief, it has been selected as a prototype of a widespread phenomenon, not one that is limited to certain companies or industries.

Medco's Early History

Bob Mason, the founder of Medco, began his career as a salesman for a major medical products manufacturing and marketing firm. He worked hard to learn all he could about the industry, and discovered that the company for which he was working was not adequately meeting all of its customers' needs, and that there was an untapped market for medical products. So he decided to start his own company, a medical products business.[8]

Apparently Bob's belief about the demand for his products was accurate, because within a few years, his business began to experience rapid growth. Within five years, the company had reached more than $20 million in annual revenues, and it was estimated that within four more it would achieve $50 million in yearly sales.

The Onset of "Growing Pains"

When Medco reached $20 million in sales, and Bob Mason was feeling good about that, he also became aware that the business was beginning to experience certain organizational problems, which are what we term "growing pains," as described below:

Many People Were Not Aware of What Others Were Doing. A significant number of people did not understand what their jobs were, what others' jobs were, or what the relationships were between their jobs and the jobs of others. This problem resulted, in part, from a tendency to add personnel without developing formal descriptions of roles and responsibilities. Since employees were added on an ad hoc basis whenever a staff shortage seemed imminent, there was often little time to orient them to the organization's operations or to train them adequately in what their own responsibilities would be. Indeed, there was no formal training program.

Some people were given job descriptions, but did not adhere to their specified roles. Others were given a title, but no explicit responsibilities. Surprisingly, many individuals often did not know to whom they were to report, and managers did not know for which employees and activities they would be held accountable. People learned what they were supposed to do on a daily basis; long-range planning was nonexistent.

Interactions between Departments Was Also a Problem. Managers often did not understand what their responsibilities were and how what they were doing fit in with the firm's overall operations. New departments were created to meet Medco's product and marketing needs, but many managers were not aware of how these departments fit in with the rest of the organization. One manager complained, "People sit outside my door, but I don't even know what they do." Another new manager described his introduction to Medco as follows: "I was walked to an area and was told: 'It's your department. Run it.'"

This lack of formal roles and responsibilities made it easy for personnel to avoid responsibility whenever a task was not completed or was completed unsatisfactorily. This also led to duplication of effort between departments. Since no one knew precisely whose responsibility a particular task was, two or more departments or people often would complete a task, only to find that it had already been accomplished by someone else.

People Felt There Were Not Enough Hours in the Day. Most employees felt overloaded. They commonly stayed after hours to complete their work. Department managers, in particular, felt that their workload was too great and that deadlines were unrealistic.

This situation resulted, in part, from the lack of adequately developed day-to-day systems to support Medco employees' work. The accounting, operational planning, and communication systems were adequate for a small company, but quite inadequate for one as large as Medco had become. Systems for purchasing, inventory control, and even distribution were either poorly developed or nonexistent.

People Spent Too Much Time Putting Out Fires. Perhaps the best indication that Medco was beginning to choke on its growth was that employees spent an increasing amount of time dealing with short-term problems resulting from the lack of long-range planning. This was particularly evident in the constant lack of space within the company's headquarters. It appeared to most employees that as soon as the company increased its office space, the space already was filled, and it was time to begin planning for another move. It seemed that there was never enough space or equipment to support the company's staff adequately. When they worked at the firm's headquarters, salespeople usually arrived early to ensure they would be able to find a vacant desk from which to make their calls. Employees who did not go out into the field attempted to handle the cramped space by creating "schedules" for using phones, computers, and even desks.

Employees Began to Feel That Medco Never Planned, It Simply Reacted. A joke around the company was: "At Medco, long-range planning means what I am going to do after lunch." This was caused partly by the changes in the marketplace and the new demands placed upon the company. It also resulted from the tendency of entrepreneurial companies like Medco to spend most of their time simply staying afloat without keeping an eye on the future.

Employees began to think that, simply because crisis is the norm at the company, that is the way they should operate. They began to call themselves "the fire fighters," and even took pride in their ability to deal with crises.

There Were Not Enough Good Managers. Most managers at Medco were promoted to their positions in recognition of service. Some were good managers, but most were described by their direct reports as "good technicians who lack people skills." Further, they were seen as clones: Many employees believed that management had one and only one way of doing things, and that to deviate from the norm would result in adverse consequences.

Plenty of people had the title "manager," but relatively few really behaved as managers. After promotion, many people simply kept doing the things they had done in their former roles. They were poor delegators, often doing the work themselves rather than assigning it to others. As a result, employees came to believe that their managers did not trust them.

Bob Mason was a strong individual who wanted things done his way, and he wanted to control almost everything. He recognized this, referring to himself as "someone who sticks his nose into everything." Few decisions were made without Bob's approval or review. As a consequence, one of two things tended to happen concerning managers: (1) the stronger managers tended to butt heads with Bob and ultimately left; and (2) the remaining managers were slowly marginalized. Those managers who decided not to leave Medco tended not to take Bob on, at least directly, and they had little real authority and certainly no power. Inadvertently, Bob had created an organization of "managerial pygmies." In effect, Bob was a victim of his own need for control. This phenomenon is part of what we have previously termed the "*entrepreneur's syndrome*."[9]

When Business Plans Were Made, There Was Very Little Follow-Up, and Things Did Not Get Done. As is true of many small and growing firms, Medco had traditionally operated on an ad hoc basis. No formal strategic planning system was needed, since Bob had provided all of the organization's direction. Further, the informal structure had allowed Medco's employees the freedom to generate new product and marketing ideas.

As the company grew, however, Bob and his senior management team began to realize that they needed to monitor its operations. Unfortunately, Medco had not developed the systems necessary to have accountability.

There Was a Lack of Understanding About Where the Firm Was Going. Many Medco employees complained that not only did they not know what was expected of them; they could not understand where the company was headed in the long term. This resulted from the inability of Medco's management to communicate its vision for the future to the company's personnel. Employees were aware that changes were being made, but were not always sure how these changes would affect them or their departments. Consequently, employees experienced high levels of anxiety. When this anxiety became too great, many left the firm.

Most People Felt Meetings Were a Waste of Time. Employees complained that too many meetings were held among top managers and not enough among the lower levels of the organization. In addition, those meetings that were held were often inefficient and did not result in resolutions to problems. It was because few meetings had written agendas or minutes—many of those attending described them as "free-for-alls." They were at best discussions, and at worst fights between departments or individuals. Worst of all, they went on interminably.

Moreover, people complained that most meetings were called on an ad hoc basis. Since these meetings were unscheduled, people typically came to them without any sense of their purpose and certainly with no preparation. Thus, they tended to have the atmosphere of bull sessions in which people shot from the hip. In addition, people felt that they could not plan their work because they were constantly interrupted for "crisis" meetings.

Some People Began to Feel Insecure About Their Places at the Firm. This problem grew out of the many changes taking place and the large number of problems the firm was encountering as it grew. Some original founding members were terminated and replaced. This caused people to wonder who was next. Although many recognized that some employees had not grown as the company grew, they worried about their jobs and their places within the firm. This, in turn, led people to spend an increasing amount of their time covering their vested interests.

The Company Grew in Sales but Not in Profits. Medco, like many entrepreneurial firms, traditionally had been most concerned with increasing sales. It adopted the philosophy of many growing firms: "If we're selling more, we must be making more profits." Unfortunately, this is not often the case. The other side of the profit equation, costs, often increases along with sales, and if costs are not contained, the firm soon may find itself in a position of losing, rather than making, money. Thus, although Medco sales were increasing at a rapid rate, profits were remaining relatively constant.

Medco's problems certainly are not unique. Indeed, these are the classic symptoms of what we have termed "growing pains," as will be described in detail in Chapter 5. It should be noted that while these "symptoms" represent problems in and of themselves, they also suggest a deeper, more systemic organizational problem. Specifically, they signal that the organization is coming precariously close to choking on its own growth. This, in turn, indicates that the organization must change its very nature; it must make a transition to a different kind of organization, a more professionally managed firm with processes and systems to facilitate growth.

The Need for Transitions

Bob Mason recognized that his business was experiencing problems. He realized that the organization had outgrown the current way it was being managed, and that both he and the organization needed to make some serious changes in the way things were being done.

His first step was to get deeper insight into the kinds of problems he was facing at Medco. He did a search for books that would help, and obtained a copy of an earlier edition of *Growing Pains*. After reading the book, he initiated action to help his company overcome the problems associated with growth. Specifically, he began a program of organizational development for Medco. The four specific steps in the program were as follows:

STEP I: Conduct an organizational assessment.

STEP II: Formulate an organizational development plan.

STEP III: Implement the organizational development plan.

STEP IV: Monitor progress.

Step I: Conduct an Organizational Assessment

An organizational assessment was performed to evaluate Medco's current state of development and future needs. The assessment involved collecting information from employees about their perceptions of Medco and its operations. One tool used in this process was the Growing Pains Survey©, which will be presented and described in Chapter 5. This survey measures the extent to which an organization is experiencing the 10 classic symptoms of growing pains.

At Medco, the scores on this survey ranged from 30 to 34, with an average score of 32. As explained further in Chapter 5, this indicated that the company was experiencing some "very significant problems," which required immediate attention. Specifically, the assessment revealed that the company needed to:

- Better define organizational roles and responsibilities and linkages between roles.
- Help employees plan and budget their time.
- Develop a long-range business plan and a system for monitoring it.
- Increase the number of qualified present and potential managers.
- Identify the direction the company should take in the future.
- Reduce employee and departmental feelings that they always "needed to do it themselves" if a job was to get done correctly.
- Make meetings more efficient by developing written agendas and taking and distributing meeting minutes.
- Become profit oriented rather than strictly sales oriented.

Steps II–IV: Formulate and Implement an Organizational Development Plan and Monitor Progress

Having identified its organizational problems and developmental needs, Medco proceeded to the next step: designing and implementing a program that would resolve problems and help the company develop the infrastructure necessary to accommodate its rapid growth. Management met at a retreat to design a plan for the firm. The plan included specific action steps to overcome its problems.

Some of these steps were (1) acquisition of human resources and development of operational systems needed to support current operations and continued growth; (2) implementation of a strategic plan that clearly defined where the company was going, and how it was going to get there; (3) implementation of performance management systems to motivate people to achieve the company's goals; (4) design of a management and leadership development program to help people become better managers and overcome the "doer syndrome"; (5) development of a system to explicitly manage the corporate culture. In addition, Bob began to focus on making some important changes in his own role, behavior, and attitudes.

Acquisition of Resources and Development of Operational Systems. As the company grew, so did its need for greater skills and sophistication in certain functional areas. A controller was recruited to replace the firm's bookkeeper. A national sales manager was appointed. Medco also hired a personnel director and a marketing manager. Moreover, Medco engaged a consultant to serve as its adjunct management and organizational development adviser. In brief, the firm made a significant investment in its human resources. These people, in turn, were responsible for developing the day-to-day operational systems required to manage growth in various areas.

Implementing Strategic Planning. One of the first steps Medco took to manage its growth was to develop a strategic plan and begin implementing a formal strategic planning process. The major goal of this process was to motivate the company's managers to begin to take a longer-range view than "what's happening after lunch." A related goal was to affect the corporate culture at Medco and make planning a way of life.

The process began with a two-day strategic planning retreat that focused on some fundamental issues necessary to guide the future development of the company, including:

1. What business is Medco in?
2. What are our competitive strengths and limitations?
3. Do we have a market niche?
4. What do we want to become in the long term?
5. What are the key factors responsible for our past success, and to what extent will they contribute to our future success?
6. What should our objectives and goals be for developing Medco as an organization?
7. What should our action plans be, and who is responsible for each action plan?

In addition to these generic strategic planning issues, which are relevant to all organizations, the company also examined certain company-specific strategic issues.

After the strategic planning retreat, a draft of a corporate strategic plan was prepared. This plan clearly identified the business that the company was in, its long-term goals, and its competitive strategy. The plan also included specific, measurable, time-dated, short-term goals—with each goal being assigned to a specific member of the senior leadership team. The plan was circulated among the firm's senior managers for their comments and input. It was revised and approved by Bob, and then distributed to all senior managers. The plan provided a "blueprint" for future development, including specific goals focused upon eliminating the problems leading to the company's growing pains.

Medco then held quarterly meetings to review the company's results, compare them with the plan, and make required adjustments. This signaled that the plan was more than merely a "paper plan"—it was a real management tool.

A key decision made by management during this retreat was to be more selective in accepting new business until the firm had digested its present growth by building the required infrastructure.

Performance Management Systems. Medco developed and implemented a more formal performance management system. A first step in this process was to develop a measurement system for tracking progress against each goal in the firm's strategic plan. These measurements were developed as part of an organizational development team meeting in which all of Medco's senior management participated. Once the measurements had been decided upon, the next step was for Medco to revise its information system so that the data required could be obtained. Some of the data came directly from the firm's accounting information system. For example, information about sales, gross margins, and net profitability came from this source. Other information had to be obtained separately. The firm's management team felt that one of the vital aspects of the business concerned the percentage of merchandise that was being shipped to dealers as opposed to end users. This information began to be monitored on a regular basis.

Management and Leadership Development. Bob and Medco's other senior managers realized that people were Medco's true asset. The firm's technology, products, and equipment were really not proprietary; the true differentiating factor was the motivation and skills of its people.

Recognizing this, Medco believed the company had to make an investment in building its management and leadership capabilities for two reasons. First, there simply was not a sufficient number of effective managers. Although many people had managerial titles and could recite the right buzzwords, relatively few were really behaving as managers. They were spending too much time as doers rather than managers. There was little true delegation, and insufficient effort was given to planning, organizing people, performance appraisal, and team training. Another need for management development was more symbolic. Bob recognized that some of the people who had helped build Medco to its current size were in jeopardy of becoming victims of the Peter Principle: They had been promoted to their level of incompetence. Bob felt that the company owed its people a chance to grow with it and he saw management development as a chance to provide them that opportunity. Quite frankly, he felt that if people had this opportunity and failed to grow, the organization could feel it had met its responsibilities to them.

To deal with these issues, Medco asked a consultant to design a management development program for its personnel. Two programs were developed: one for top managers and one for middle managers.

Corporate Culture. Although Bob Mason had been aware that his firm had a culture, he had never taken any serious steps to manage it. He had always wanted the firm to be sales oriented, aggressive, and profit oriented. He hadn't realized that there were also a great many other facets to the firm's culture, which had been embedded since the earliest days of its operation.

As the firm began to change, Bob became increasingly aware that he needed to manage the firm's corporate culture in order to reinforce the change. One of the unintended aspects of the firm's culture that had developed was that people felt that if they worked hard they should be rewarded regardless of the results. Bob felt that people needed to learn that hard work was simply not enough and that they had to be oriented toward bottom line results.

A second aspect of the firm's culture had been that decisions would be pushed up to Bob. Since Bob was acknowledged to be an entrepreneurial genius and since his personality had tended to lead to nuclear explosions whenever someone made a mistake, people naturally pushed decisions to his desk. Bob now wanted to reverse the culture, and push the decisions down to the lowest level of responsibility in the firm where they could be meaningfully made. The firm also tried to emphasize that under the new culture, mistakes would be examined, and corrected, but that people would not feel the brunt of a nuclear explosion if a mistake was made.

A third aspect of the Medco culture had been that "we're good crisis managers." This meant that Medco managers had to learn to turn on a dime and solve whatever crises came up. Mason now wanted Medco to revise its culture to emphasize the importance of long-range planning. He wanted the culture to become one of "planning is a way of life at Medco." A fourth aspect of the Medco culture had been "we're hands-on managers." This needed to be revised so that managers stayed in touch with operations, but delegated responsibility to the lowest level capable of performing the required tasks.

One of the most important aspects of this change was that Bob, together with the senior managers, now realized that the management of the corporate culture was an important part of the strategic leadership function that they had to perform.

Changes in the CEO. Bob Mason realized that just as Medco had to change, so did he. His basic skills were as a salesman and as an entrepreneur. He had worked hard, and he had built a successful company. He had the title of president, but he realized he was not acting like a president.

In spite of the fact that he was the CEO of the company, Bob continued to spend too much time dealing with the technical and marketing aspects of the business. This is what he knew how to do, and this is what he enjoyed. He knew he was not devoting a sufficient amount of time to the broader aspects of organizational development.

Bob also understood that there were certain other problems with his management style and capabilities. In spite of the fact that his organization had grown substantially, he still wanted to control too many details of the business. He knew he still poked his nose into too many areas of the business. He began to understand that this was not only a problem that he was facing, but his behavior was seen as a role model by other managers in the organization who, in turn, were doing the same things at their level of responsibility.

The first change that Bob made was to decide to change. He then proceeded to redefine his concept of his role. He decided to spend more time on the planning and organizational development aspects of the business and less time in many of the technical areas. He made a decision to give up control over the marketing area by delegating more responsibility than he had in the past. He decided to change his leadership style from "making all decisions" to "involving the senior leadership team" in many of the decisions that needed to be made. There were always going to be decisions where he would, in effect, have to decide what was best for the company and then announce it to the organization. However, he decided to significantly increase the extent to which his senior managers were involved in planning overall organizational changes and in making day-to-day operational decisions.

Another aspect of Bob's behavior that needed to be changed was the way he was dealing with stress. Bob, like most entrepreneurs, was constantly under a great deal of pressure. Periodically he would "explode" or as one of his managers put it, "go nuclear." When Bob went nuclear, everybody headed for the hills. If something went wrong, Bob might "nuke 'em" in a meeting. This had led, over time, to people avoiding bringing Bob bad news. In turn, this had created serious problems for the business because Bob was, at times, simply not in touch with information he and other senior managers needed to have to make effective decisions. As people began to see Bob dealing with conflict but not exploding, they became more open in discussing problems, and even disagreeing with the direction that Bob was proposing. His management team began to be a team in the true sense of the word.

Bob sent another signal to the organization about his willingness to change by participating in the organization's new management development program. As he stated: "If I want people to change, I've got to lead by example as well as by word."

Program Results

For 18 months, Medco implemented its new program of organizational development. After this period, the organizational growing pains score decreased from an average score of 32, which put the company in a red-flag danger zone, to a score of 21, which indicated some problems but nothing of major concern. This improvement occurred despite the fact that the firm continued to grow. Moreover, the firm's profitability increased significantly during this period, as a wide variety of operational inefficiencies were eliminated.

In brief, Medco had made a fundamental transformation. It had gone from a firm about to choke on its own growth to one that was able to absorb growth and operate profitably and effectively. In addition, Bob Mason had made the transition from an entrepreneur to a true CEO.

Summary

This chapter has examined the issues of success and failure typically facing organizations and their leaders after promising entrepreneurial starts. We have identified the need for continued success, and described the personal and organizational transitions to promote that continued success. We have identified and discussed the changes that the CEO needs to make as his or her organization grows, and we have examined the alternatives available to CEOs who face such transitions.

The chapter presents a comprehensive case example of the transitions required by Medco, which faced classic growing pains and developed strategies for addressing them. The steps that Medco took to identify its challenges and work to address them illustrate how an organization can build the infrastructure needed to promote sustainably successful growth. The personal challenges faced by Bob Mason, Medco's CEO, and how he addressed them provide a good example of how to make the personal transitions required to support an organization's continued successful development.

There is no one way to make a successful transition from an early-stage entrepreneurship to a future stage of growth. However, the key to making this change is for the entrepreneur to recognize that the company's former mode of operation will no longer be effective.

All change is accompanied by risk, and many of us feel uncomfortable during the process of change. Unfortunately, the need for organizational transitions and their accompanying personal changes is inevitable. Those who do not believe this are likely to increase the risk that their organizations will experience significant difficulties. However, if knowledge is truly power, then entrepreneurs and others who understand the need for the kind of transitions described in this book will be set up for the possibility of continuing success.

The remainder of this book deals with how to make these required personal and organizational transitions—beginning with the next chapter, which presents a framework (based upon research and experience) that identifies the key factors that must be focused upon in building a sustainably successful organization.

Notes

1. Dean Starkman and Russ Mitchell, "Nasdaq: Déjà vu 15 Years Later," *Los Angeles Times*, March 3, 2015, B4.
2. We have published many articles presenting our models, testing them empirically. We have also published case application articles showing how our frameworks and tools have actually been used.
3. Starbucks was originally founded by a three-man group in Seattle as a "local roaster," not a café. Howard Schultz who had worked at Starbucks left to found Il Giornale Coffee in 1986, and then purchased Starbucks and rebranded his company as Starbucks in 1987.
4. Diedrich Coffee was founded in 1983 by Martin Diedrich. It was an outgrowth of an earlier family business begun as a coffee plantation and then a local roasting store that opened in 1972. Diedrich Coffee went public in 1996. In September 2006, Diedrich Coffee announced its plans to close its company-owned retail stores, 40 of which were sold to Starbucks and reopened under that brand. Diedrich's franchisee-owned stores remained unchanged. The company continued as a roaster and wholesaler of coffee beans, with a few independently owned and operated Diedrich stores that remained open in California and Texas. On November 3, 2009, Peet's announced that it was buying Diedrich, but its offer was exceeded by Green Mountain Roasters, Inc., which currently owns the company.
5. *Cat on a Hot Tin Roof* is a play by Tennessee Williams. It was winner of the Pulitzer Prize for Drama in 1955. The use of this phrase here is not intended literally, but to suggest the motivation "to movement" by the entrepreneur.
6. Timothy "Tim" Cook spent 12 years at IBM in its personal computer business. He ultimately became the director of North American Fulfillment. Later, he served as COO of the computer reseller division of Intelligent Electronics. Finally, before joining Apple, in 1998 he was Vice President for Corporate Materials at Compaq for six months.
7. Ryan Knutson and Sam Schectner, "Zuckerberg Seeks Calm with Telecom Carriers," *Wall Street Journal*, March 4, 2015, B4.
8. This case is based upon an actual situation, but details have been changed and the company has been disguised.
9. Eric Flamholtz and Yvonne Randle, *The Inner Game of Management* (New York: AMACOM, 1987).