When Companies Need A Brake On Growth

Experience shows that expanding businesses at the wrong time can cause unwanted side effects

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In 1995, Southern California beckoned as a promising market for Room & Board, the Minneapolis-based retailer of home furnishings. Room & Board was growing rapidly, having recently added a store on Chicago's elegant Michigan Avenue.

"We knew California would be a good market," recalled Room & Board President and Chief Operating Officer Bruce Champeau.

But Room & Board is a company that works closely with its suppliers, mainly U.S.-based furniture producers. "In most cases," said Champeau, "we are their largest customer." Could suppliers handle the ramped-up production required to meet new demand from California?

Room & Board concluded that the expansion would stress suppliers, perhaps wreaking havoc with production schedules and deliveries to other customers. Though the growing chain had already signed a letter of intent to purchase property in Santa Ana, it decided to back out.

"We walked away from it," said Champeau. "You don't want to just grow for the sake of growing."

That's an almost radical manifesto in a business world that holds idolatrous views of growth. More revenue, more profit, more investment dollars. For a public company, a higher share price. What's not to like?

Actually, lots, according to Edward D. Hess, a professor of business administration at the University of Virginia's Darden Graduate School of Business. Hess is a student of the risks of rapid growth.

Growth At What Price?

"Most entrepreneurs believe all growth is good," Hess said. "Growth is always better. Grow or die, they believe. "None of this is true," said Hess. "Growth can destroy value if your staffing and systems can't keep up with it," he added.

In his recently published "Growing An Entrepreneurial Business," Hess studied 54 fast-growing companies in 23 states. The companies had all survived the challenges of growth to reach an average $60 million in revenue. All these companies had faced similar challenges. But because they handled the risks and challenges of growth well, they were able to survive as many of their rivals crashed and burned.

"Many businesses fail because they grow too fast or expand too fast," said Hess. Room & Board exemplified one of the winning strategies. It was willing to walk away from a growth opportunity that might have overwhelmed its supplier base and wreaked havoc with its production schedules.

Growing companies require more formal processes, Hess says. For restaurants and food businesses, standardized processes must be developed for everything from receiving goods to making sandwiches. Stores must take inventory at the end of each day so they know precisely what they're using. There must be rules on refrigeration, on the proper temperatures for storing and serving food.

"If you don't have processes, mistakes will increase," said Hess.

A Matter Of Scale

Among the common business functions that will require standardized processes: billing, receiving and handling of complaints. Accounting will also have to adapt to growth. "The accounting system that works at $1 million, doesn't work at $20 million," he said. For entrepreneurs, the challenge is to impose needed processes at a pace that doesn't stifle the energy or creativity of a growing concern.

In 2007, Susan Feller founded Three Fellers bakery in Goochland, Va. to produce gluten-free baked goods. Feller, a retired high school guidance counselor, had been told she couldn't tolerate the gluten found in wheat and other grains. Gluten intolerance affects at least 5% of the U.S. population and Feller reasoned she had the makings of a niche business.

The business succeeded beyond her expectations, with Three Fellers winning a contract to supply Whole Foods markets in the mid-Atlantic area. Feller was overwhelmed with the chores of managing a growing kitchen, finding new business and keeping track of key business trends. "I was really good at selling and finding customers. I was not as good at keeping track of all the business details," she said. Three Fellers, for example, wasn't able to do a complete analysis of its business expenses or track its best-selling products or the impact of advertising.

"It's almost like we were growing too rapidly for a while and not doing the business analysis component. We had to step back, analyze where we were and move forward," she recalled.

Another challenge for many entrepreneurs is recognizing that the style of management that works in bootstrapping a venture is often counterproductive as the business develops. Entrepreneurs, says Hess, must make the transition to managers.

Growth requires the addition of mid-level managers. And entrepreneurs need to learn how to manage managers.

They must be willing to teach. "When mistakes are made, entrepreneurs have to teach, not punish. No one is going to do things like the entrepreneur does them," said Hess.

Entrepreneurs must also learn to delegate. "Entrepreneurs find it hard to learn how to delegate," said Hess. They're used to doing everything themselves. And doing it their way. But the managers he hires as his company expands will want to do things their way. The "my way or the highway" school of entrepreneurial management doesn't scale well, Hess suggests.

As Three Fellers grew its gluten-free business, founder Susan Feller brought in two new managers: her sons.

Each had a business background that complemented their mother's entrepreneurial and selling skills.

Susan Feller was asked whether she now delegates — or takes orders — from her sons. "Both," she replied cheerfully.