



Chapter 13

Preparing for and Evaluating the Challenges of Growth

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Chapter Objectives

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1. Explain the term *sustained* growth.
2. Describe how firms can properly prepare for growth.
3. Discuss the six most common reasons firms pursue growth.
4. Explain the importance of knowing the stages of growth.
5. Describe the most important factors for firms to focus on during each stage of growth.

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Chapter Objectives

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6. Describe the managerial capacity problem and how it inhibits firm growth.
7. Discuss the challenges for firm growth imposed by adverse selection and moral hazard.
8. Discuss the day-to-day challenges of growing a firm.
9. Explain why “cash flow management” is a challenge for growing a firm.
10. Explain how “quality control” can become a challenge for growing a firm.

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Three Things a Business Can Do to Prepare for Growth

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Appreciate the Nature of Business Growth

Important Realities

- Not all businesses have the potential to be aggressive growth firms.
- A business can grow too fast.
- Business success doesn't always scale.

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Three Things a Business Can Do to Prepare for Growth

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Stay Committed to a Core Strategy

- It is important that a business not lose sight of its core strategy as it prepares to grow.
- If a business becomes distracted or starts pursuing every opportunity for growth that it's presented, it can easily stray into areas where it's at a disadvantage.

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Three Things a Business Can Do to Prepare for Growth

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Plan for Growth

- A firm should establish growth-related plans.
- Writing a business plan greatly assists in preparing growth plans.
- It's also important for a firm to determine, as soon as possible, what its growth strategies will be.

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10 Warning Signs That a Business is Growing Too Fast

TABLE 13.1 10 WARNING SIGNS THAT A BUSINESS IS GROWING TOO FAST

- Borrowing money to pay for routine operating expenses
- Extremely tight profit margins
- Over-stretched staff
- Declining product quality
- E-mail starts going unanswered
- Customer complaints are up
- Employees dread coming to work
- Productivity is falling
- Operating in a "crisis" mode becomes the norm rather than the exception
- Those working with the business's financial structure are starting to worry

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Reasons for Growth

1 of 3

| Reason for Growth | Explanation |
|--------------------|---|
| Economies of scale | Occur when increasing production lowers the average cost of each unit produced. |
| Economies of scope | Occur when the scope (or range) of a firm's operations creates efficiencies. |

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Reasons for Growth

2 of 3

| Reason for Growth | Explanation |
|-------------------------------------|---|
| Market Leadership | Occurs when a firm holds the number one or the number two position in an industry or niche market in terms of sales volume. |
| Influence, Power, and Survivability | Larger businesses usually have more influence and power than smaller firms. |

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Reasons for Growth

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| Reason for Growth | Explanation |
|---|---|
| Accommodate the Growth of Key Customers | Sometimes firms are compelled to grow to accommodate the growth of a key customer. |
| Attract and Retain Talented Employees | Growth is a firm's primary mechanism to generate promotional opportunities for employees. |

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Managing Growth

It's important for a business owner to know the stages of growth, along with the unique opportunities and challenges that each stage entails.



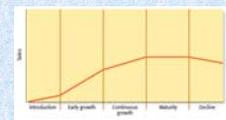
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Stages of Growth

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- Introduction
 - Start-up phase where a business determines what its core strengths and capabilities are.
 - The main challenge is to make sure the initial product or service is right.
 - It's important to document what works and what doesn't work during this stage.



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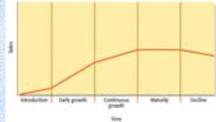
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Stages of Growth

2 of 5

- Early Growth

- Generally characterized by increasing sales and heightened complexity.
- Two important things must happen for a business to be successful in this stage.
 - The founder must start working “on the business” rather than “in the business.”
 - Increased formalization must take place, and the business has to start developing policies and procedures.



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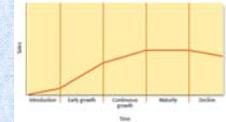
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Stages of Growth

3 of 5

- Continuous Growth

- The need for structure and formalization increases.
- Often the business will start developing related products and services.
- The toughest decisions take place in this stage.
- One tough decision is whether the owner of the business and the current management team have the experience and the ability to take the business further.



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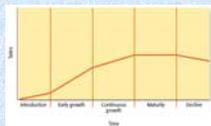
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Stages of Growth

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- Maturity

- A business enters the maturity stage when its growth stalls.
- At this point, a firm is typically more intently focused on managing efficiently than developing new products.
- Well-managed firms often look for partnering opportunities or opportunities for acquisitions or licensing deals to breathe new life into the firm.
- If new growth cannot be achieved through a firm’s existing product mix, the “next generation” of products should be developed.



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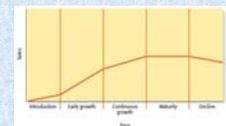
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Stages of Growth

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- Decline

- It is not inevitable that a business enter the decline stage.
- Many American businesses have long histories and have adapted and survived over time.
- A business’s ability to avoid decline hinges on the strength of its leadership and its ability to adapt over time.



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Challenges of Growth

Two categories of challenges for firm growth

- Managerial Capacity Problem
- Day-to-Day Challenges of Growing a Firm

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Managerial Capacity Problem

1 of 6

- Managerial Capacity

- Firms are collections of productive resources that are organized in an administrative framework.
- As a firm goes about its routine activities, it recognizes opportunities to grow.
- The problem with this scenario is that firms are not always prepared or able to grow, because of limited “managerial capacity.”

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Managerial Capacity Problem

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- A Firm's Administrative Framework
 - A firm's administrative framework consists of two kinds of services that are important to firm growth.
 - Entrepreneurial services generate new market, product, and service ideas, while managerial services administer the routine functions of the firm and facilitate the profitable execution of new opportunities.
 - New product and service ideas require substantial managerial services (or managerial capacity) to be successfully implemented.
 - This is a complex problem because if a firm has insufficient managerial services to properly implement its new product and service ideas, it can't grow.

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Managerial Capacity Problem

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- A Firm's Administrative Framework (continued)
 - Continuation From Previous Slide
 - The reason a firm can't quickly increase its managerial services (to take advantage of new product or service ideas) is that it is expensive to hire new employees, it takes time for new hires to be socialized into the culture of a firm, and it takes time for new employees to acquire firm-specific skills and establish trusting relationships with other members of the firm.
 - When a firm's managerial resources are insufficient to take advantage of its new product and service opportunities, the subsequent bottleneck is referred to as the managerial capacity problem.

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Managerial Capacity Problem

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- Additional Challenges
 - As a firm grows, it is faced with the dual challenges of adverse selection and moral hazard.
 - **Adverse selection** means that as the number of employees a firm needs increases, it becomes increasingly difficult for the firm to find the right employees, place them in appropriate positions, and provide adequate supervision.
 - **Moral hazard** means that as a firm grows and adds personnel, the new hires typically do not have the same ownership incentives as the original founders, so the new hires may not be as motivated as the founders to put in long hours and may even try to avoid hard work.

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Managerial Capacity Problem

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Basic Model of Firm Growth



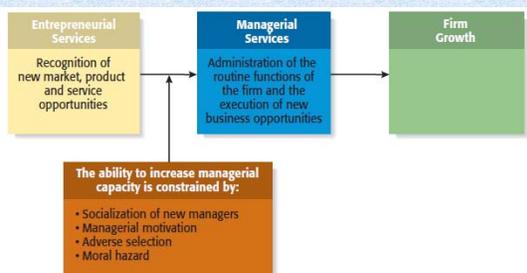
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Managerial Capacity Problem

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Impact of the Managerial Capacity Problem



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Day-to-Day Challenges of Growing a Firm

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| Challenge | Explanation |
|----------------------|---|
| Cash Flow Management | A firm requires an increasing amount of cash as it grows. |
| Price Stability | If growth comes at the expense of a competitor's market share, a price war could ensue. |

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Day-to-Day Challenges of Growing a Firm

2 of 3

| Challenge | Explanation |
|---------------------|--|
| Quality Control | An increase in firm activity can result in quality control issues if a firm is not able to increase its resources to handle the extra work |
| Capital Constraints | Capital constraints are an ever-present problem for growing firms |

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Day-to-Day Challenges of Growing a Firm

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- These two female entrepreneurs just launched a casual dining restaurant.
- Their ability to grow the business successfully will hinge largely on how they manage the day-to-day challenges of growing a firm.



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