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Managing Growth, Part II: How to Support Good Growth

How to build the appropriate infrastructure to support growth initiatives.

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In the first part of this two-part series, we asked "what is good growth?" In the context of successful growth relative to business value, we sought to build a framework for identifying strategies for value-creating growth—as developing accretive growth is more complex than simply finding how to increase the top line.

But once the future direction of the business and its growth initiatives have been identified, what then can the business do to ensure the success of those initiatives? What does successful support look like, and what are some common pitfalls that can be avoided? In the second part of the Managing Growth series, we will outline our views on growth infrastructure and share from our experience with clients the challenge of putting ideas and plans into practice.

PART II: SUPPORTING VALUE-CREATING GROWTH

Identifying the opportunity and determining the appropriate strategy are only the beginning. Growth plans generally assume smooth curves and incremental improvements, but a company's infrastructure—its collective personnel, equipment, processes, and capital structure—rarely adapts or scales smoothly in accordance with plan.

Imagine this scenario: for years, a lower middle market business has tracked customer orders with a spreadsheet. As the business grew from

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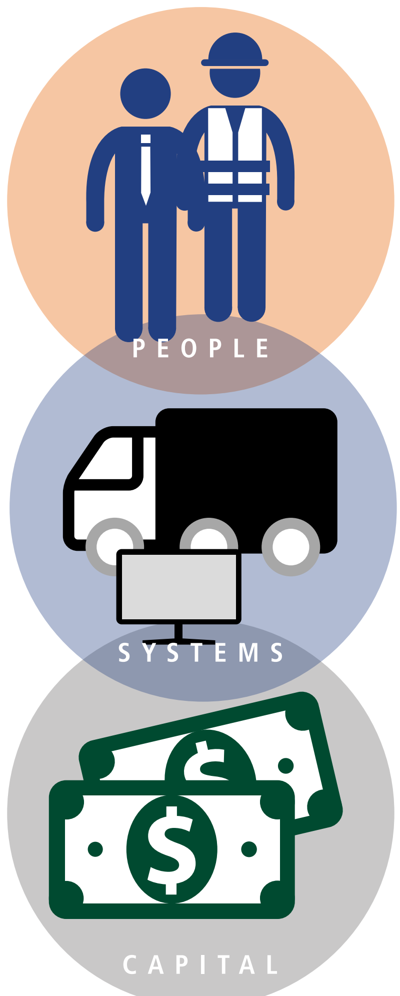
one to ten to twenty orders per day, the spreadsheet was cost-effective and passable infrastructure for supporting order tracking. But at some point in the future—maybe fifty orders per day, maybe one hundred—the spreadsheet and the person managing it will be overwhelmed, and the legacy system will no longer be effective.



3 ELEMENTS OF A COMPANY'S INFRASTRUCTURE

This tipping point marks the end of the scalability of the previous infrastructure and the beginning of a need for an updated system appropriately sized for the next phase of growth.

These tipping points and their resulting step changes in cost and functionality happen all across a growing organization, and rarely come in aligned batches. Successfully supporting growth means identifying and managing each of these tipping points across the organization, before they develop into issues that can slow or halt the growth plan.

We can break up the company's infrastructure into three elements: people, or the personnel that guide and carry out the plan; systems,

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or the processes and equipment involved in the company's sales and operational growth; and capital, the financing that supports people and systems.

PEOPLE

Growth can put a significant strain on a company's employees. For a sleepy business that has not experienced significant growth, employees may enjoy the status quo and find themselves unable or unwilling to adjust to new demands from customers, suppliers, and internal teams. As responsibilities shift, people will feel out of place—an account manager with double the relationships to cover or a sales manager with five direct reports instead of two can feel stretched or uncomfortable with a new role. Growth forecasts shouldn't simply involve spreadsheets, but honest assessments of current personnel in terms of their ability to handle new demands and thrive in what will likely be a different business.

This applies to all business personnel, from top to bottom. A strong board of directors can provide useful guidance and oversight to ensure rapid growth is proceeding as expected while not unduly burdening the company's existing resources. Board members are more valuable to the business when they are encouraged to speak their minds, and do not feel stifled by a strong-willed founder who reacts negatively when confronted with data that conflicts with and suggests changes to engrained past practices.

(continued p.2)

SYSTEMS

Operational tactics to support a new growth plan are very situational. First, a new growth initiative often requires a different sales and marketing approach. For example, if entering a new geographic market, third-party sales representatives can offer flexibility to dip a toe in the water without incurring fixed labor costs. Second, the existing supply chain needs to support the new strategy. Ensuring vendors, which may be new to the firm, are able to keep up is critical. Last, customer bases may change as a result of a successfully-executed growth initiative. Rapid growth driven by a major customer is not uncommon for aerospace manufacturers asked by Boeing or Tier I suppliers to rapidly ramp production for a new program. Assuming acceptable margins and capital investment, the resulting growth likely creates value, but with the offset risk of an even greater reliance on a primary customer. In instances such as this, seeking to lock customers into long-term agreements is one way to help mitigate the increased risk. In all of these scenarios, some foresight into the degree of change expected helps to drive the overall system design.

CAPITAL

Few great growth strategies can be executed without capital. Too often we see businesses design a capital structure by investigating what is available rather than what is required to support the business strategy. The first step should instead be to determine how much new capital is required, and the degree of flexibility required from the capital, to provide a stable foundation for the intended plan. Only then should the source, timing, and pricing of the capital be considered.

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Will the capital be used to expand headcount, further R&D efforts, or build a new facility? Adequately sizing the new capital budget to ensure sufficient capacity to execute the strategy without burdening the existing business with substantial underutilization and fixed costs is a critical exercise. Should the plan be funded with internal cash, an equity infusion from an owner's outside resources, or a third-party capital provider? How an owner chooses to finance a growth initiative is a decision that impacts returns, balance sheet flexibility, and ultimately the business itself.

The private capital markets are such that there is usually a source of capital to match every amount and risk parameter imagined. The crucial job to optimize a capital structure to fund growth is to understand the risks surrounding the future plan, and therefore what characteristics—amortization or return flexibility and schedules—best match the business. What business owners often don't appreciate is the wealth of knowledge that capital providers have that they can share, all the way from senior lenders benchmarking performance of different industry participants to equity investors with previous direct experience following the current company's path.

CONCLUSION

Growth is good. Usually. When contemplating a plan to achieve above-average growth, owners need to understand the margin profile and capital investment necessary to achieve that growth, and whether the longer-term outcome of such a plan will in fact grow the value of the enterprise. Even when convinced to move forward, building a well-vetted strategy and tactics that ensure the right people, processes, and capital to execute are all imperative. **ZS**

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ABOUT ZACHARY SCOTT

Since 1991, Zachary Scott has assisted owners of privately-held businesses in the greater Pacific Northwest to plan and execute major business or ownership transitions through three service lines: sell-side M&A, acquisition and investment advice, and direct investing. For more information on Zachary Scott, go to **ZacharyScott.com.**

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