



- Growth metrics
- Knowing when to pivot
- Stages of growth
- Challenges and crises of growth
- Scaling
- Team and organizational growth
- Manager vs. Founder focus

Launching New Ventures

Welcome back to Module Five This is segment 5.4 *Growing and Scaling Your Business*. What are we going to talk about today? We're going to discuss different aspects of growth, including how to keep track of your growth. Knowing when to pivot. What does pivoting mean? What are the different stages of growth and the challenges of growth? What does it mean to scale up your business? And to think about your team and your organizational growth, and then finally your managerial focus versus your founder focus, once you get to be of a certain size.

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0m 05s

5.4 Growing & Scaling

Launching New Ventures: Entrepreneurship & Strategy for Technology-Driven Startups

Prof. Chris Tucci and Prof. Marc Gruber

So, as we just mentioned, we're going to talk about different ways of measuring growth. Now, there are lots of different aspects to think about when you're measuring growth, and I've sketched out a few things here that you can think about. Not every single business is going to use every single one of these things. But try and adapt this list to your own circumstances. So, obviously the quickest and easiest way to think about growth is how many total users are you serving? How many people have signed up to use your service? How many people are your customers overall, your overall customer base? And then we have total active users because in some cases people might sign up for service, but then they may not actually go and use the service once they've signed up. So we want to keep track of both total users, which is everyone who is signed up, somehow; and total active users, and those are the people who are coming back every once in a while to use your service. Now, we have total paying customers. Here we have to think about the business model a little bit. Who are your customers? Who are the users? They may not be the same people. Who is paying for the service that you're offering or the product?

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5.4 Growing & Scaling

Launching New Ventures: Entrepreneurship & Strategy for Technology-Driven Startups

Prof. Chris Tucci and Prof. Marc Gruber

In which case you want to track how many paying customers do you have. Total revenues, that's pretty obvious. We talked a lot about that in the last module. Then we have the couple of things that are new here, which are a little bit interesting: conversion rate of free to paying users. So in other words, in some businesses, you might offer something for free, just to get it off the ground. To build a user base or to get some initial customers so that you can then tell everyone you have more customers, etc. So you may offer some things for free at first, or you may have a sort of free-mium model. Free-mium model's where you have different types of services. You have the free service, which is the basic service. Then people who want more can pay for more. The so called premium people. So the question is what percentage of those people that start out free, switch to paying? And you might want to track that overtime. Churn rate is when you have customers who come and go, and they're your customer for a while, then they leave. And so you want to track how many customers, what percentage of your customers actually leave and quit the system somehow. And then finally, the last item here is customer acquisition payback period.

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Summary



0m 02s



- Total users
- Total active users
- Total paying customers
- Total revenues
- Conversion rate of free-to-paying users
- Churn rate
- **Customer acquisition payback period**

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So it might cost you something, it will cost you something to acquire customers. And so the question that you have to ask yourself is, "Well, how much does it cost for me to get a customer versus how much do I gain from the customer?" Assuming you have some kind of, for example, a subscription model or something like that. Or someone pays for unlimited usage of some product or service. Then the question is you know if it cost you 100 dollars to acquire the customer and the person pays \$10 a month, that means it's going to take you 10 months just to pay back to recoup the initial cost of acquiring that customer. So basically, what I'm asking you to do here is, with the growth metrics, is to kind of track this things for your business, adapt this for the kind of business that you have, and then track this overtime to see how things are working out.

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3m 20s



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Tracking those growth metrics will help you decide whether you need to pivot. Pivoting is a term that people use when you change one or more aspects of your business model. So you're going to make some changes here, and you need to understand those growth metrics to decide whether you need to make some changes. Now, certain schools of thought say that you should use the following method for pivoting. And here what you have is rapid prototyping. So you want to come up with something relatively quickly that you can show and demonstrate to other people. And that might lead to a so-called minimum viable product. Minimum viable product basically means it's the smallest unit that you need to have no extra bells and whistles that you can show. So it's like your first prototype --or it could be your second or third prototype as well-- but you got to pull up together a kind of a product that's good for demonstration purposes. And then you want an immediately illicit feedback from potential customers, potential users, other eco-system participants; the whole supply chain. You should demonstrate and show this to people, and you should get feedback. And then you need to revisit your assumptions.

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0m 06s



Pivoting refers to changing one or more aspects of your business model.

Method:

- Rapid prototyping
- “Minimum viable product”
- Immediately elicit feedback from potential customers and other ecosystem participants
- Revisit assumptions
- If something is not working, make adjustments
- Repeat the above until successful

Source: Steve Blank (2013): Why the Lean Start-Up Changes Everything.
Harvard Business Review

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And if something is not working, then you need to make adjustments. Now some people make a distinction. They draw a distinction between a small adjustment, which could be called an iteration or something like that, and a large adjustment which could be called the pivot. But in any case, if something isn't working, and also your growth metrics that I've just showed you will also inform that, then you need to make some kind of adjustment, and that adjustment is usually called some kind of pivot. And then what you want to do is an iterative process, you want to repeat those steps until you come up with something that works for you and that works for the people that you've demonstrated to; so in other words, it's a successful idea. A successful product or service.

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5m 35s



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Given what we just discussed, you may ask yourself: when should I pivot? And the answer to that question is a little bit complex because there's no one answer saying, "Oh, you must pivot now." But what I've done here is I've drawn up a little laundry list of items that you should consider before pivoting. So if you've made some big assumptions about your market, about what customers like or need when your primary assumptions are wrong. So you've been confronted in the prior slide with something, with feedback that says "Gee, I thought people would pay for this," or other aspects of it, then you have to say, "OK, my primary assumption was wrong. I might need to think about something different here," "I might need to modify what I'm doing." And there are different variations of this in my list here. Customers have different needs than what you thought. That's one assumption that you make. You can have other assumptions about demographics, etc. But customers is a big one, and if you find out that they have different needs than what you've thought, then that's a very clear signal that you may want to pivot. If your environment is changing.

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What does that mean "environment's changing?" Well, what that means is example, you have new competition. Some well-funded competitor enters the same space that you're in. When new regulations are introduced, or other sort of government interventions. If macro-economics changes are taking place. So in other words, if there's a recession that's starting after you started your company, or a giant boom so people have more money to spend, that's also something that cause you to rethink what you're doing. The key one here: when no one wants to pay for your product. I think this is a very common one, actually. Either directly or indirectly. In other words, you trying to sell your product and people don't want to buy it. You try and make money from advertising, and getting some kind of indirect payment for your product, and no one wants to pay for advertising. So that's a very clear signal. Something about the customers and something about your product offering that you might want to rethink. Or another very common one, when your sale cycles are too long. So in other words, you thought you would be able to get out there and sell these things right away.

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0m 11s



When your primary assumptions are wrong

- When customers have different needs than what you thought
- When your environment is changing
 - When new competition arises
 - When new regulations are introduced
 - When macroeconomic changes take place (recession, boom, etc.)
- When no-one wants to pay for your product, either directly or indirectly
- **When your sales cycles are too long**

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The people would jump on, and it turns out that you need to really, really talk and educate your customers for a very long time before they're willing to actually pay. Some aspects here, and you could have other aspects too, but these are things that cause you to rethink what you're doing and make you wonder whether or not there is certain aspects of your product, your service value proposition, your partnership, etc., that you may want to rethink.

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So once you've arrived at something that works for you, you've pivoted to the point where you think you've got a good idea, and it seems to be working well, you may want to think about scale. So, what does scaling mean? Scaling is achieving a higher sales volume using the same infrastructure. In other words, if you have one salesperson, and that person goes out and gets customers for you, and that person can get one customer, it may take a year to get that first customer. And then to get a second customer, that person might spend another year to get a second, so that's not a very "scalable business" in some sense, right? If you have to hire a new person to get another customer, then that's not achieving high scale. So scale is really thinking about bringing your sales volume up using the same infrastructure that you have, so that one salesperson may be able to get 10 customers or a hundred, a thousand, or a million customers. So what does it take to achieve scale? Well, the first thing it takes is a back-end that works efficiently. So back-end is something that the customer doesn't see. So it could be order fulfillment, delivery, etc. Those kinds of things need to be ready for high volume.

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0m 13s



Scaling refers to achieving a much higher sales volume using the same infrastructure.

Some methods to scale effectively:

- Create a back-end that works efficiently
- Understand the size of the market
- Understand the marginal cost of gaining more sales as you grow (it should be low)
- Know the whole sales cycle
- Design and market with large numbers in mind
- **Make sure the organization can handle growth**

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You need to understand the potential size of the market and think about how big it is. And then having the marginal cost of gaining more sales be relatively low. So in other words, using that example, the salespeople — if you need to hire a new person for every customer that you have, then that's obviously not a very scalable business because your marginal cost of getting additional customer is very, very, very high. So you might want to think about how low you can bring down that marginal cost. You need to be not very labor intensive for getting new customers. Which is related to the next point which is knowing the whole sales cycle. How long do people need to think before they're willing to actually pay for the product or service that you've got in mind here? Furthermore, you have to design the product or service, and market the product or service with large numbers in mind. So not a one-off type thing. Of course in the prototyping phase, no problem, but then, when you get to the scale phase, then you want to make sure that your product can handle multiple users, at the same time, multiple customers. Same thing with marketing to them. And then, we're going to talk about just a little bit more, is making sure the organization itself can handle growth. In other words, what kind of organization do you need to be able to gain large sales volume?

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10m 28s



Warning!

“Startups need 2-3 times longer to validate their market than most founders expect. This underestimation creates the pressure to scale prematurely.”

Source: Startup Genome
by Bjoern Lasse Hermann

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OK, here's a little warning for you here. This is a very interesting quote. Start-ups need 2 to 3 times longer to validate their market than most founders expect. This underestimation creates the pressure to scale prematurely. I think this is very good words of wisdom here. Because I've seen it myself in different ventures. Validating your market takes a while. Trying to understand where you're going to end up and pivoting to the right place takes some time. And then when you have the pressure to scale prematurely, that means you're not ready for the scale. And that means you either not going to achieve it or even if you somehow manage to get all these customers you're going to disappoint them because you're not going to be ready to handle them. So either way, be warned that there is a time lag here to validate the market and then you want to go ahead and go for the scale.

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Alright let's look at this model, Greiner's Model of startup growth. This is a very interesting and insightful work. Basically, if you look at the left axis, what we have is the size of the organization, starting at small and going up to large; and then if you look at this x-axis here, then what you have is the ages of the organization starting off at young and going up to mature. And as you might imagine, there is a correlation between the size of the organization and the age of the organization since organizations tend to get bigger overtime. At least the ones that survive. Now, what we're going to talk about here are the different stages of growth. So the very, very, very early stages here is what we call *creativity*. And then there's going to be different crises, and the different crises is a transition period between one stage and the next stage. So this first stage is all about creativity, and then there's a crises of leadership which leads to slightly bigger organization. And then we have this second stage which is called the *direction*; and we grow further, and then we finally have in a crisis of autonomy. And then we have a case where we have *delegation*. It's where the founders have to step back a little bit.

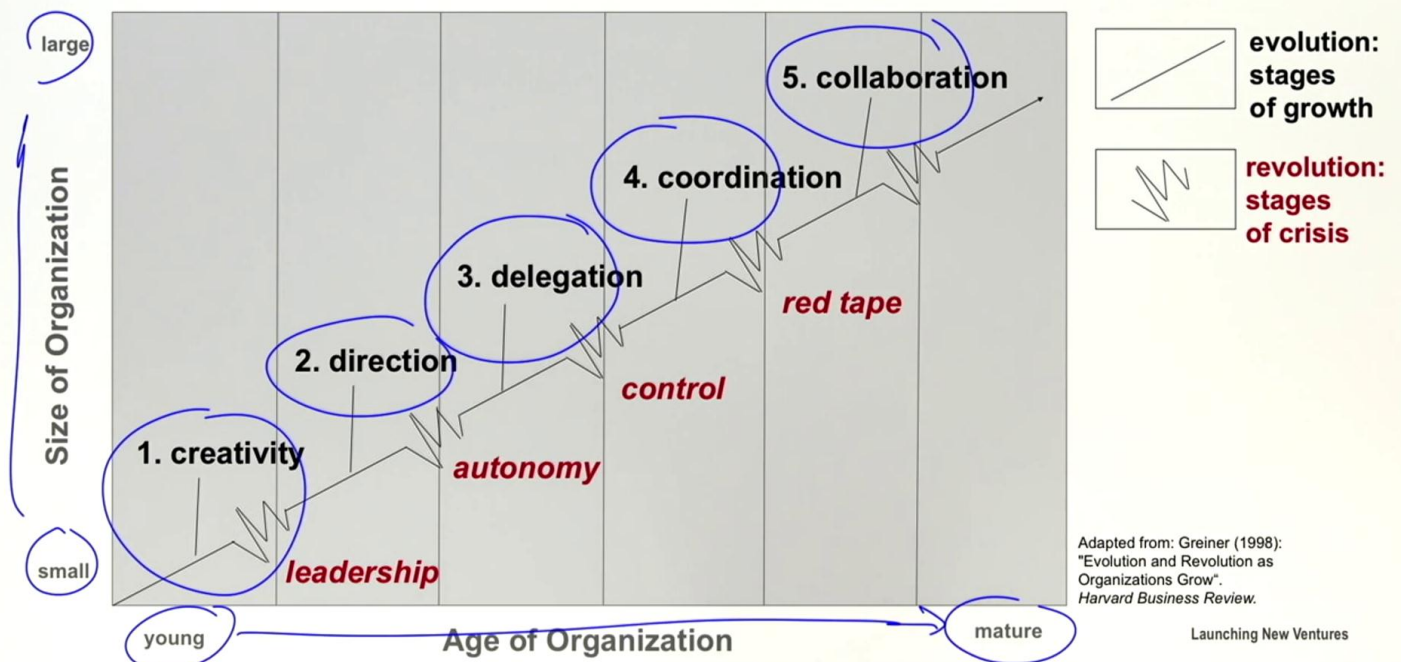
Notes

Summary



0m 19s

Stages of growth: Greiner's Model



So the first phase is really about pure creativity, and what you might want to call almost chaos. The second stage is about finding your footing and growing and then finally, in this third, not finally, but this third stage, you have *delegation*. In other words, you have to impose some kind of management structure on your organization as it grows. Big literature in sociology on this. Very, very difficult to have an organization grow in an uncoordinated fashion. And so you end up with a crisis of control, eventually, and then you move on to the next phase which is the *coordination* phase, getting much bigger, and then you turn into some kind of bureaucracy and that's where the red tape crises comes from. And then, you are in a stage of *collaboration* in a much more mature company. So what you see here is that the company starts off very small and very disorganized, I would say. And then overtime, as the company grows, there are certain kinds of organizational structures and controls that need to be imposed to be able to handle the growth.

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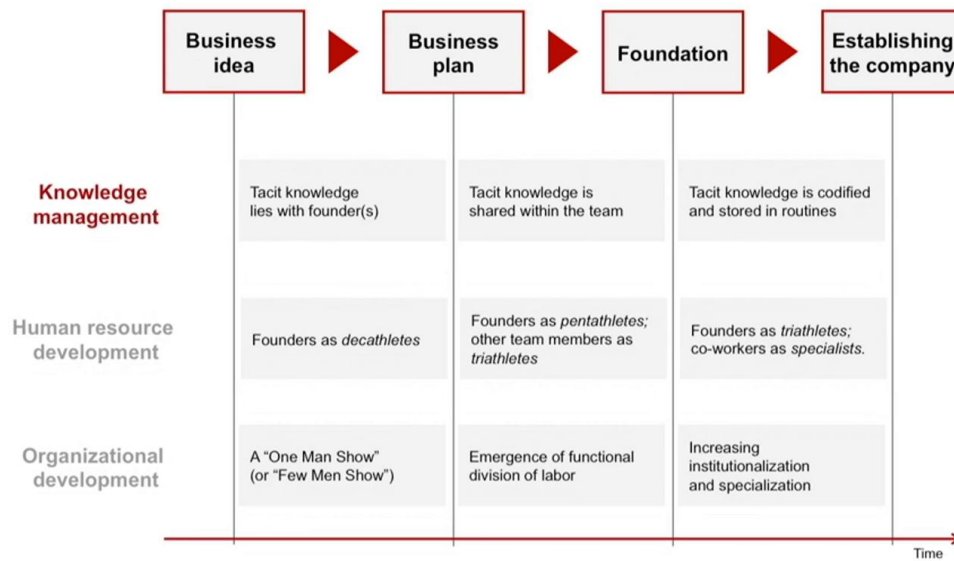
Here's another way of thinking about this. This slide is focusing on the early stages of the team of the company. Basically, what you can see on this slide is that we're starting with the business idea here on the left and then we're going to overtime progress. So there's going to be an idea at first that would turn into a business plan, and then the company will be founded, and then the company is more well-established. So this is a time progression. Now if you think about this in terms of the human resource development one of the ideas here is that you have to be sort of a jack-of-all-trades at first. We call it a decathlete. And then overtime, you specialize a little bit. And so the founders become instead of decathletes, they become pentathletes. And then the other team members are more like the triathletes. And then eventually, the founders are triathletes, and everyone else is a specialist. So overtime, again, consistent with the prior page, there is a specialization aspect once the company is growing. And that's down here too, under the organizational development. We start off with a so-called one-man show, one-woman show. And that might turn into a few people.

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0m 23s



Source: Harhoff and Gruber (2000)

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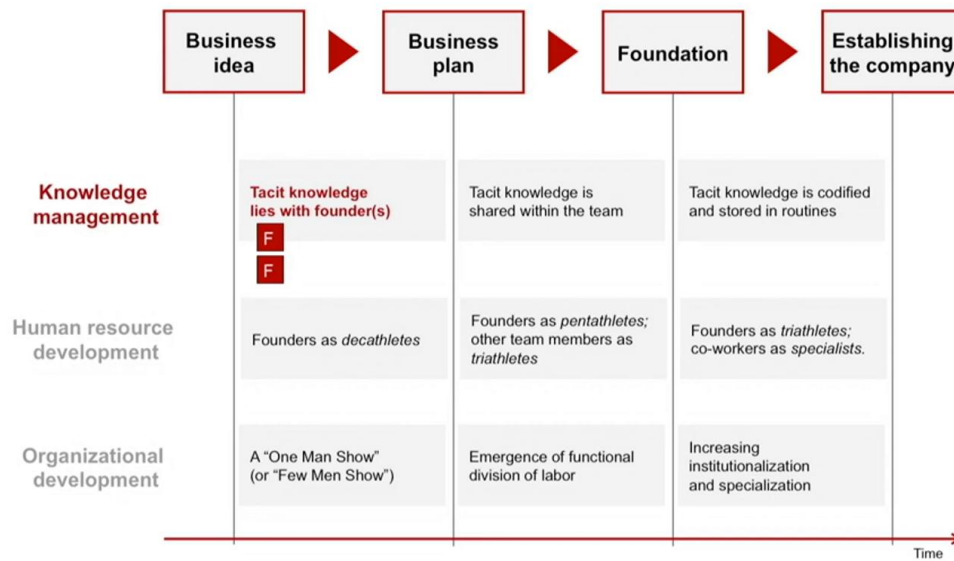
And then we have the functional division of labor. And then finally, we have increasing institutionalization and specialization. And if you think about tacit knowledge that's knowledge that's hard to describe and codify.

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17m 28s



Source: Harhoff and Gruber (2000)

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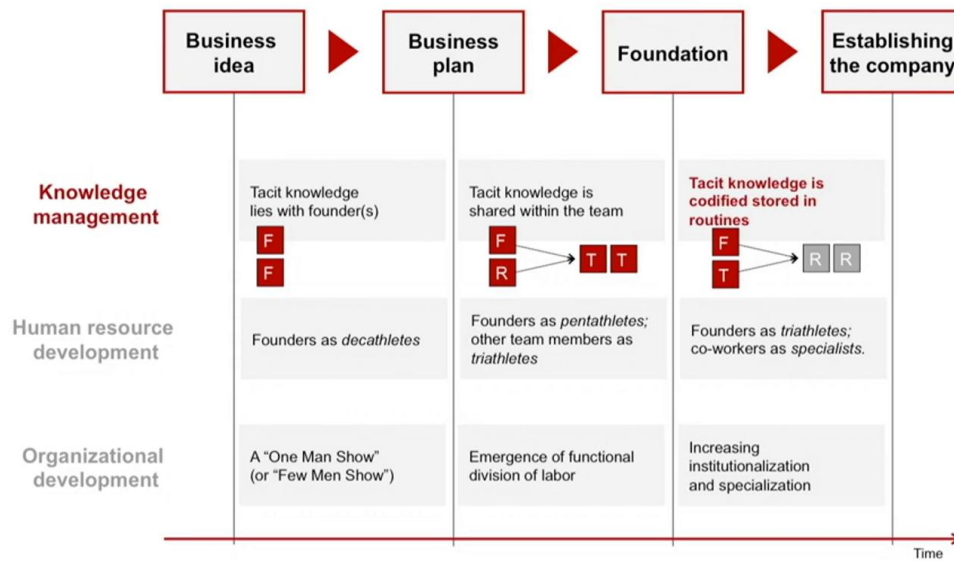
Tacit knowledge is only in the heads of the founders at the very early stage. So that's the little f's are for.

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17m 43s



Source: Harhoff and Gruber (2000)

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Eventually, the tacit knowledge is shared because you can learn by doing with the team. And then finally, what happens is after a while you get into some routines and those routines actually help you exploit your knowledge that's why they call it; it's *codified and stored in routines*. So basically, the idea here is that there's a progression overtime starting with the business idea and this very chaotic organization. And then, as the organization grows, things become more regimented and routine-based, and people become more specialized. That's normal.

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17m 52s



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Continuing on where we left off, we're talking about this sort of progression between the small startup company and the large scaled up business. We want to contrast here two different types of organization. The first one is what we call the *organic structure*, and the second one is more *hierarchical structure*. And so just to give you a little bit-- you're probably in the organic structure right now. That's at the very early stages. When the founders dominate the venture, there's a big, big focus on product development, market development. There's not a lot of managerial tasks, delegation, etc. Since people try to do multiple tasks -- just sort of the decathlete that we talked about last time-- and then we have a lot of informal communication which increases creativity and sort of network type control. It's not like sort of a boss telling you what to do but more of everyone's doing their own thing and we all talk to each other and that's the way and we are accountable to each other somehow as a group. And then, as the business matures, inevitably, it almost has to move toward a hierarchical structure.

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I'm not saying it's impossible to leave it this way, but it's kind of hard to manage a company that's growing rapidly once it gets to a certain size without delegation and some kind of hierarchical structure. So what does that mean? It means we have specialists focusing on product development, on production, on marketing, etc., and all the different functions of a company. We have more formal processes. We tend to write things down more and say, "What does the job description look like?", and "How does your salary work?", and your bonus system, etc. There's a lot of continuous monitoring and improvement of internal information flow. So instead of just having a chaotic information flow, we try and structure the information flow so that we can communicate in a more efficient manner. And then there's well-defined control. That basically means there's more of a supervisor-subordinate type relationship where, "I'm the employee and you're the boss", and you basically, negotiate with me about what task I should work on. Then I prove to you that I am actually doing the things that you're controlling, in some sense. So what you have here is the inevitable move toward a hierarchical structure.

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0m 29s



Which structure would you choose for fast growth and quick adaptation to new opportunities?

Organically grown structure:

- Founders dominate the venture
- Focus on product and market development
- Founders tend to avoid managerial tasks
- Informal communication increases creativity
- Network-type control

Hierarchical structure:

- Development, production and marketing tasks divided among specialists
- Formal processes
- Continuous monitoring and improvement of internal information flow
- Well-defined control

Source: Bergin (2001)
See also: Greiner (1998), Clark & Fujimoto (1991), MacCormack et al. (1999)

Launching New Ventures

Now, of course, having a hierarchical structure too early on in a venture is also not good. It's most people would consider to be kind of an impediment to creativity. And on the other hand, hanging on to an organic structure after the company's gotten very, very big, is also very problematic because then you start running into a lot of efficiency problems and it makes it hard to scale.

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Launching New Ventures

So what kind of problems can you expect when you are in your growth phase? Typically, what that means is you're hiring people, your market's expanding, you get a lot more customers coming in. So basically, you're scaling, as we've discussed, and that sounded great, at the time, a few slides ago. But now, when you think about the downsides of this, there's a lot of things to watch out for here. The first is that your tools, your controlling tools, --which is usually word of mouth and network controls, we've mentioned before-- they're insufficient to handle a larger number of employees and a large number of tasks and specialists. So the information flows become too complex because if everyone is communicating to everybody, and you have some specialists, but no one is really clearly making decisions because you're in kind of a startup mode, the information flows become too complex to actually use. Management becomes too overloaded. And we say there's running a business, focusing an operative business. The span of supervision is too large. In other words, a span of control is basically when one supervisor is in charge of multiple of employees.

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0m 32s



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That's the span, how many; and if that becomes too big --because there are too many things going on at once-- then it becomes very, very difficult to supervise. It can lead to a bottleneck when you're making decisions. For example, if every single decision has to go all the way up to the founder, and your company is growing rapidly, and there are lots of decisions coming in day to day, it can actually overwhelm the founder or the supervisor in some other cases. That leads you to push away all the strategic thinking that you need to do, and you're just focusing on the day to day, and that becomes very, very, very difficult to handle. So that leads to the overwork of the team. And whenever you have overwork, overwork is good in the short term. Feeling you're under a deadline pressure is nice, but continuous burn out can lead to frustration, loss of motivation. And finally, the tasks are originally defined by individuals and their personality, "I'm good at this. I should do this," and not by the job description. Eventually, you need to somehow decide on the different jobs for the specialists. And in case there's a fluctuation, the original plan of having everyone do everything and basing your task on your personality, becomes very, very difficult.

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0m 34s



Problems arising in organizational growth:

- Controlling tools often insufficient
- Information flows become too complex
- Overload of management (focus on operative business, span of supervision too large, strategic management is neglected)
- Overwork of team, leading to frustration and loss of motivation
- **Tasks defined by individuals and their personality, not by job description** → problems in case of fluctuation

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Because you might need to shift what people are working on, and it's better to, in the case of a growing company, to define the job description. So basically, what we're talking about here is moving toward a more managerial type company as opposed to a founder type company.

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Just getting back to the stages of growth model, I think what you can see here is that this is sort of the optimal way of dealing with scale. And as I mentioned before, keeping this model when your company is very, very large, is not a very, very efficient way to run a company. And you really need to move in the direction of the more-- this is the founder part. This is the founder-dominated part of the graph. Up here is the more managerial part, so you're going to switch for a founder orientation to a managerial orientation. Again, keeping a large company with a small company's organization structure is not very useful. Likewise, having a large structure for a small, small company is also not efficient at all, and it's too rigid. So basically, what we see here is there's inevitable bumps in the road. And so what you need to think about here is eventually, if you have this happy problem, you're going to grow. You're going to grow to a certain size overtime and that there are going to be bumps on the road on the way that have to do with different aspects of making a transition to a more structured organization. You can read the Greiner, we put a link to it on our site.

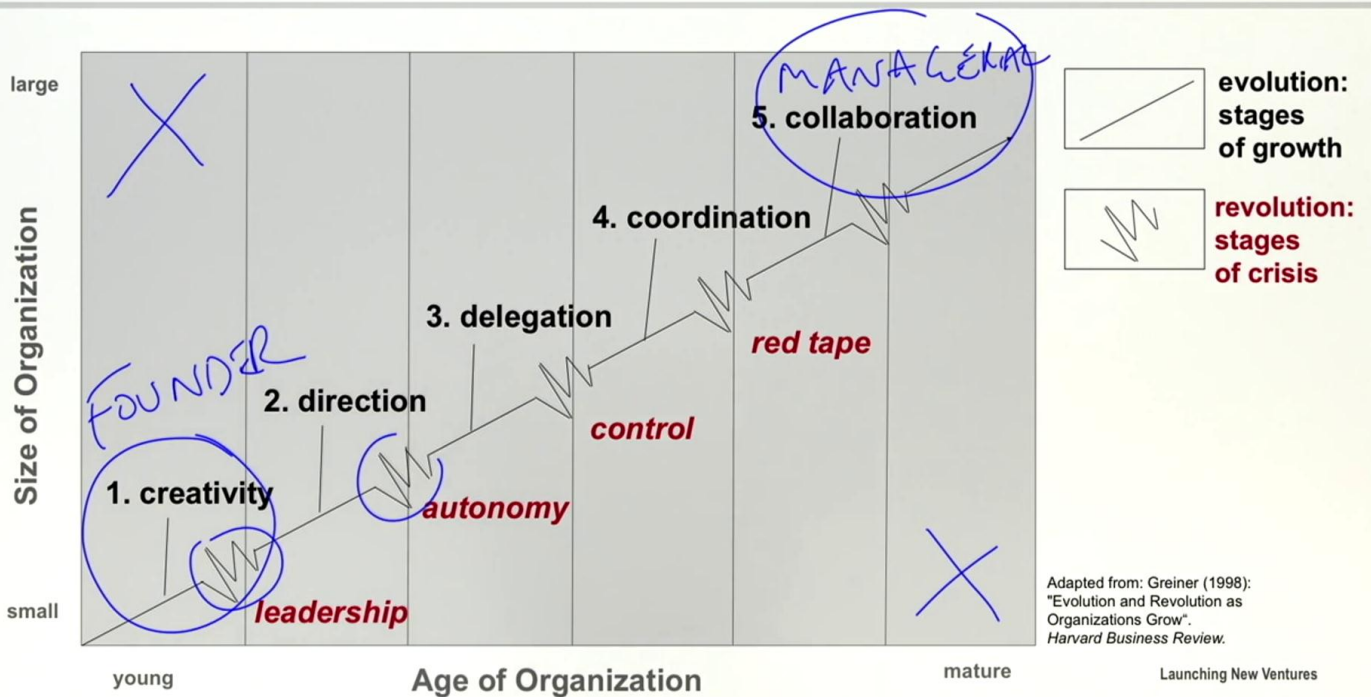
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0m 36s

Stages of growth: Greiner's Model



You can read the Greiner book for all the different details of the different crises. There are going to be certain crises overtime and they're going to be reorganizations overtime but in the end, this is a much more efficient way of organizing to handle a large company that has a large volume of sales.

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So that's it for 5.4. What we're going to do next is a little summary of this whole module, so stay with us.

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