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CHANGING YOUR ROLE IN YOUR BUSINESS TO HELP IT GROW

WHITE PAPER

If business owners want to grow their businesses, it's practically a given that they must change their roles within the business at some point. Peter Drucker, who is widely considered to be the founder of modern management and wrote nearly 40 books on the topic during his lifetime, believed as such when he wrote, "As a new venture develops and grows, the roles and relationships of the original entrepreneurs inevitably change. If the founders refuse to accept this, they will stunt the business and may even destroy it. But even among the founders who can accept that they themselves need to do something, few know how to tackle changing their own roles and relationships." [1]

Our experience as advisors to business owners echoes Peter Drucker's decades of research and observation: business growth will be stunted if owners fail to change.

This is true not only in business, but in life as well. Charles Darwin, a careful observer of change, distills the same observation in a quotation often attributed to him, "It is not the strongest of the species that survives, nor the most intelligent, but the one most responsive to change." If our experience, Drucker's research and Darwin's observation of the natural world do not convince you of the need to change your role, let's look at three (fictional) owners.

3 Different Owners, 3 Different Paths

In the following story, each of three owners start their businesses at about the same time, in the same industry, yet end up in three very different places. The specific industry does not matter, but the inflection points do.

An inflection point is a "moment of dramatic change, especially in the development of a company, industry, or market." [2]

Inflection points occur, not always dramatically, as a company grows and develops. As inflection points occur, you as an owner have a choice: change course and your role within your company, or continue to do business (and everything yourself) as usual.

The ending of each fictional owner's story is the direct result of how these owners dealt with their roles in their businesses and the effect their decisions had at two critical inflection points on the ability of their businesses to thrive.

As you read about how these owners adapted (or did not), think about how you will respond when you reach each inflection point.

1989: The Starting Line

In 1989, three freight expediter companies open their doors. Each founder possesses far more intellectual than monetary capital, and each has worked for years in the industry.

Inflection Point One

The first inflection point does not occur in a prescribed amount of time. Instead it occurs when continued growth requires owners to decide whether or not to delegate management responsibility.

In this case study, we've used ten years as the time it took for each business to reach its first inflection point. Your businesses may reach that point more quickly or slowly.

In ten years, each company has grown to \$5 million in revenue. Compensation and other distributions to each owner total \$250,000 (the median compensation of CEOs in 2016 [3]). Each owner has been handling almost every aspect of the business, but at this point, each takes a different ownership- and management-style path.

Meet the Owners

Arnie DeHoek

Arnie is quite happy with his eight-person company. He enjoys making every decision and doesn't mind working 50 to 60 hours each week. The company and his income are stable so he sees no reason to change his "hands-on-head-down" approach to ownership.

Brent Bridges

Brent begins to delegate many responsibilities to others within the company. This eventually allows him to reduce his workweek to between 30 and 40 hours. He is still the company's "deal closer" and maintains many of the most important customer relationships. But he has delegated many less critical and less enjoyable tasks to others. His day-to-day style is primarily "hands-off-head-down"—but he is still deeply involved in financial and key business decisions. Brent begins to travel and volunteer in his community. He has become a "star with helpers." [4]

Charlotte O'Hara

Charlotte's management style is similar to Brent's, but Charlotte envisions that her company will one day be a market leader. She

delegates responsibility more to expand its capabilities and grow the company quickly than she does to work fewer hours. She's a "hands-off" owner, but is also emerging as "heads-up" leader as she pursues her vision with the help of a team of outside advisors with whom she meets periodically. She is evolving from a "star with helpers" to a "leader of a team."

Ten Years Later—Inflection Point Two

Arnie

Revenues are stable but earnings are slowly declining. Arnie still controls all aspects of his business, but just cannot pedal any harder. He has heard that businesses like his are selling for seven times earnings before interest, taxes, depreciation and amortization (EBITDA) so he decides to sell before his health fails.

Brent

Revenue has reached \$20 million and EBITDA almost \$1 million. Brent's compensation and cash distributions total \$750,000. The company employs 25 full-time workers. Growth is slowing as the industry has matured. His management team is functioning smoothly and Brent finds that he enjoys his volunteer activities more than work so decides to test the waters to see if there is a buyer for his business. Brent is being pulled toward an exit, not pushed out because of boredom or burnout.

Charlotte

Charlotte's company's profitability and revenues have surpassed Brent's, but her compensation remains \$250,000 as she uses all available cash flow to strengthen the company. Given her hands-off-head-up style, Charlotte foresees that the days of rapid growth are over unless she injects significant capital into the business (to be used to acquire other businesses, state-of-the-art systems, and software).

Charlotte knows that her company needs more than capital to move to the next level: her management team is limited by its lack of experience at a higher level and, possibly, ambition. She appreciates that if she doesn't take steps to grow her company, bigger, well-funded competitors with better economies and efficiencies of scale will crowd her out. Consolidation within the industry means that the big boys are getting even bigger.

As Charlotte sees it, her choices are:

- 1. Stay in the business knowing full well that revenue and profits may stagnate or decline.*
- 2. Sell to one of the bigger industry players—three of whom have approached her in the past nine months.*
- 3. Use bank financing and all excess cash flow to fund the purchase of smaller competitors, acquire the same software used by the industry leaders, add employees, space, etc., and to hire next-level professional management who can use their knowledge and experience to compete successfully with the "big boys."*

Charlotte has reached the second inflection point.

This second inflection point arises when successful owners realize that they, and their management teams, have reached their limits. Taking the business to the next level and competing with well-funded companies requires significantly more capital and possibly next-level management. At this point, owners determine the future of their business and their future with the business.

Brent chose to sell; Charlotte doubled down. Arnie never reached the second inflection point. Recall that he decided not to delegate responsibility to others so his business growth was limited to what he could manage. He didn't want to assume the risk associated with delegating important tasks to others.

So, speaking of risk, who were the big winners and losers?

Brent (like most owners) chooses to sell and transition to the next phase of his life. Charlotte decides to keep her business, and moves to a less entrepreneurial, more ownership role. Unlike Brent and Charlotte, Arnie has no options.

Most owners reaching this inflection point choose to exit. They do so for reasons that include their age, the ability to exit successfully, or a desire to do something else.

Reaching this inflection point allows owners to leave for a variety of reasons. Owners tell us:

I had the right team to 'Go big', but bigger wasn't attractive to me. Neither was taking on debt. Still, my decision to sell was not about either risk or a fear of failure. Having lots of

employees and lots of clients were never goals for me. I valued having relationships with each of my clients and I liked the flat (rather than hierarchical) organizational structure I'd created. Going bigger would require changing all of that. After a lot of soul searching, I knew I had grown the business to the level I wanted and decided to sell.

The Finish Line

Arnie

Arnie hired a business broker to sell his business. After twelve months of tepid interest, there were no offers. He closed the doors just shy of the company's twenty-fifth anniversary. Had Charlotte known Arnie's company was available she might have acquired it "on the cheap." In the end, once he decided to exit, there was no decision to make about the future of the business. It had no future without him.

Brent

Having enjoyed life outside the business—a benefit afforded him by his success at delegating most responsibilities to his management and staff—Brent didn't have the capital or desire to continue. Like Charlotte, he realized that the industry would continue to consolidate and squeeze smaller players. To compete, he'd have to grow or sell. The choice was easy: he sold—but only after a two-year undertaking to transfer important customer relationships to his management team and pay down company debt.

Charlotte

Charlotte made her vision of a larger, more competitive company a reality. She sought bank financing, brought in top-shelf management and acquired three smaller companies. Company revenues quadrupled, EBITDA grew to just over \$4 million and the business was worth at least \$25 million. She was now ready to exit, but only for the right price.

Each business and owner started at the same line. Each, however, ended at a very different place.

The Owners Role in the Company Growth

Essentially, if businesses are to provide launch pads for their owners' successful exits, owners need to change their perspective, their roles, and their activities in those businesses. For that reason, we've listed below, in the organic order in which three changes that most owners must make occur. We encourage you to think about how each applies to you and your business.

Keep in mind that each change is not a one-and-done event, but part of an ongoing process. As you accomplish the first, the second comes into play and requires your complete attention. As you accomplish the second change, you begin to make the third and final change.

You must move through each change if you wish to: 1) set the stage for your business to move to its next level and 2) move to the next chapter of your life; which, after all, is really the point of having a business exit plan.

Change 1. You must change your focus from growing your business based on your talent and effort to growing it beyond your capabilities.

Change 2. You must change your role in your company from hub to spoke. Owners who are spokes retain an important role in their companies, but their companies can function and grow well without them.

We turn to Drucker one more time: "Long before the time has come at which management by one person no longer works and becomes mismanagement, that one person also has to start learning how to work with colleagues, has to learn to trust people, yet also how to hold them accountable. The founder has to learn to become the leader of a team rather than a 'star' with 'helpers'."

Change 3. As you make the first two changes, you gain the freedom (and time) that comes with fewer duties and responsibilities. With more time, you have the opportunity (and we'd argue, the task) to explore and develop non-business pursuits.

Lessons for Owners

Arnie, Charlotte, and Brent illustrate three key lessons for owners who want their business exits to achieve their goals.

Lesson 1. You, as an owner, choose your role within your business.

Lesson 2. Unless your role continually evolves and becomes increasingly less critical to the ongoing success of your company, growth will be slow or stunted.

Initially, Charlotte and Brent changed their roles in their companies by carefully delegating responsibility to capable employees and management. This strategy allowed their businesses to grow beyond each owner's time, skills, and experience, but it also provided two other important benefits: transferable value and free time.

Transferable value means that a business can be transferred to another for cash with minimal disruption to the cash flow of the business. By definition then, companies with transferable value do not rely on their owners for success.

The second benefit of becoming less critical to your company's success is the free time you gain. Brent finally took advantage of his free time to volunteer, while Charlotte used hers to develop and implement a business strategy to move through the second inflection point and become a leading player in her industry.

Lesson 3. If a business has no transferable value, a successful exit is most unlikely. Arnie was comfortable with his hands-on-head-down role and, not surprisingly his business stopped growing when he reached his physical capacity to run it. He chose to go-it-alone and did not call upon the expertise of an advisor skilled in exit planning—or any advisors for that matter—to help him. He never attempted to develop a true management team. He was comfortable running and controlling almost every aspect of the business.

Most owners follow Arnie's path. Like Arnie, they remain mom and pop enterprises without the ability to transfer ownership and achieve financial security.

Lesson 4. Successful business exits require the involvement of advisors. Brent and Charlotte, to differing degrees, involved advisors. Charlotte looked for and found the best advisors available to help her and her company move to the next level.

Lesson 5. It is your decision to transform your relationship to your company as it approaches critical inflection points. The choices you make separate businesses that cannot be sold from those that attract the attention of well-heeled buyers and those that become industry players.

Who Can Help?

Who can help you make the choices and changes you must make at each inflection point? Peter Drucker suggests that those who help owners be capable of performing certain functions.

". . . the founder does need people with whom he can discuss basic decisions and to whom he listens. Such people are rarely to be found within the enterprise. Somebody has to challenge the founders' appraisal of the needs of the venture, and of his own personal strengths. Someone who is not a part of the problem has to ask questions, to review decisions, and above all, to push constantly to have the long-term survival needs of the new venture satisfied by building in the market focus, supplying financial foresight and creating a functioning top management team."

[5]

How Much Do You Need to Change?

It's likely that you've already been evolving as an owner and changing your role within your business. The question now is: How much more must you change?

Change is often uncomfortable and you may feel no need to make any more than is necessary. If that's the case, or your asset gap is small or, like Brent and Charlotte, you've already moved to a more "hands-off-head-up" role, change only enough to create a business with sufficient transferable value to carry you to your goals.

Often a management transition plan can describe most of what you (and your management team) must do. In other situations, owners have already transferred much responsibility to management and their companies now only require their special expertise. We suggest that you look at your company and determine, with the help of experienced advisors and consultants, what you can do best to further its success.

Business value becomes transferable by: 1) delegating to management and others, 2) creating systems to manage workflow and all other processes within the company, and 3) focusing on growing value in other ways that build transferable value. Please contact us to request additional information on the subject of transferable value.

Conclusion

To exit in a way that meets all of your goals (including the foundational goal of financial independence) requires that you transfer responsibility for value creation and sustainability to others. Arnie refused. Brent and Charlotte were willing to change their roles. In delegating many of his duties and functions, Brent allowed his company to grow without his direct involvement and paved the way to a comfortable exit. Charlotte went one step further and replaced herself with next-level managers in order to make her company an industry leader. She remained the CEO, but removed herself from the operations and management of the company.

Had Brent and Charlotte refused to give up their original roles, the growth of their companies would have slowed or stopped making successful exits nearly impossible.

Like Brent and Charlotte, you must make difficult decisions within your company—perhaps changing personnel, advisors, strategic partners and more. Most importantly, you also must change from hub to spoke.

Every day we help the Arnies of the business world become Brents and Charlottes. We also help the Arnies, who are happy where they are, to create tax-efficient strategies to accumulate wealth outside of their businesses. Likewise, we help the Brents transition ownership to achieve their goals and aspirations and the Charlottes prepare to take their businesses to the next level.

BONUS: Ownership Evolution Assessment

Is your business at an inflection point that requires you to make a choice between changing your role and continuing to do business as usual? The following questions are designed to help you determine where you are in your transforming your role from the hub of your business to a spoke.

1. Have you established your exit goals?
2. Do you know the size of the gap between where you are (financially) today and where you want to be when you exit?
3. Do you have a written business exit plan that maps out how you will reach your exit goals?
4. If you are still an army of one, are you willing to become one in an army of many?
5. Overall, is your business capable of succeeding without you running it?
6. Is your current management team capable of assuming greater levels of responsibility and growing your company?
7. Are your current advisors capable of supporting you and your management team in changing your roles?

Answers are not right or wrong, but they do provide you insight about whether:

- You are on the road to creating a business that can run successfully without you. Businesses that do not depend on their owners to succeed have transferable value.
- Your current involvement in the company needs to change to allow faster growth. If so, consider what role you should take in the company.

- Your current advisors have the experience and skills necessary to help you create a business with transferable value.

[5] Drucker, Peter F., *The Essential Drucker*, HarperCollins, 2001, pages 159-160

Changing your role and thus creating a business with transferable value involves installing and using financial controls, operational systems, and hiring, motivating and retaining next-level managers.

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[1] Drucker, Peter F., *The Essential Drucker*, HarperCollins, 2001, pages 159-160

[2] American Heritage Dictionary of the English Language, 5th ed., s.v. “inflection point.”

[3] <https://chiefexecutive.net/how-much-does-the-average-ceo-really-earn/>

[4] *Ibid.*

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