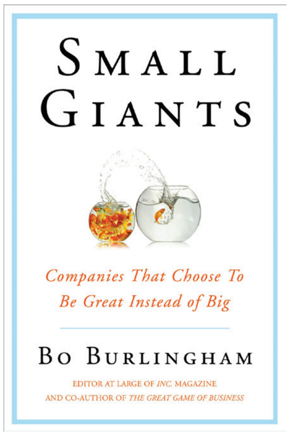
STILL small GIANTS



A conversation with Bo Burlingham, author of *Small Giants*

Growth. That's the goal in many businesses. It's a word that characterizes the wildest dreams of budding entrepreneurs. Get started, get big, get rich, change the world, and live happily ever after. For already large companies, it becomes a means of survival as new start-ups and foreign competition press margins downward.

We measure businesses by revenue and stock price. We recognize them by their Super Bowl ads. News outlets profile fast-growing organizations and flash-in-the-pan ideas. Popular business books study the histories and strategies of the names we all recognize.

Bo Burlingham took a different approach when he wrote Small Giants. He wanted to learn more about companies that chose to be great instead of big. Why did they do it, and what specific actions did they take to ensure that it happened? What contributes to the "mojo" that allows them to be so successful? It's a topic worthy of consideration for small and midsize organizations. There really are a lot of good reasons to limit growth on purpose.

Burlingham is no stranger to entrepreneurs. Since 1983, he has been an editor of *Inc.* magazine, including seven years as executive editor. Prior to *Small Giants*, he wrote two books with Jack Stack, cofounder and CEO of SRC holdings: *The Great Game of Business* and *A Stake in the Outcome*. In 1983, Stack led a group of employees to save a failing division of International Harvester. The books detail how they broke convention and created a true ownership culture where everybody – from the executive team to the shop floor – knew the real-time financial state of the company and managed their roles accordingly.

The CEO Advantage Journal interviewed Bo Burlingham to glean further insights from his years of observing entrepreneurs – and small giants, in particular. In this edited transcript, Burlingham talks about what has happened since Small Giants was published and elaborates on the role of entrepreneurs in today's economy.

I'm sure you stay in touch with some of the companies profiled in *Small Giants.* How are they faring in the current economy? Do you have any follow-up lessons to share as you watch them through this tough time?

Most of them have done pretty well, though there have been a lot of changes. Norm Brodsky has sold the majority stake in CitiStorage. Fritz Maytag recently sold Anchor Brewing. Danny Meyer's company (Union Square Hospitality Group) is still on the growth path it was on when I wrote the book.

Reell Precision Manufacturing got into a lot of trouble right after the book came out. I was very interested to find out what happened, so I wrote an article about it for *Inc*. That situation made me realize that I should have included a chapter in *Small Giants* about the financial profile of a small giant.

The company I've watched most closely and has taught me the most during the economic crisis is Jack Stack's company, now called SRC Holdings. They have probably done the best job managing the crisis of any company I know. Jack would say they spent the last 30 years getting ready for the financial crisis because they started during the deep recession of the early 1980s. That experience taught them to get ready for the next big crisis that would inevitably come. Their preparation has enabled them to pretty much sail through this recession. They are doing great – growing like crazy.

So across the board, the Small Giant companies have done pretty well with the one exception of Reell Precision Manufacturing. There are a lot of important lessons in what happened to them.

You say you should have included a chapter on the financial profile of a small giant. Elaborate on that.

Well, let me summarize what happened to Reell. They had two CEOs, and I first noticed something was wrong when I tried to reach one of them shortly after the book was published. I received a reply saying he had a different email address, and it was obviously a personal one. I called the other one to find out what was going on and learned that Steve had been fired and was very unhappy about it. In fact, he was suing the company. When I asked about the company, he said, "Oh, it's in terrible shape. People are very demoralized." This is a company that had had a tremendous amount of mojo when I researched the book, but they had completely lost it.

In the mid 1990s, they faced a critical decision. Their business had two parts, but the largest and most dynamic part was that which made the constant torque hinges for laptop computers. They were the pioneer in that business and set the standard of excellence. But that whole business moved offshore in the 1990s; American customers like Apple, Compaq, Hewlett-Packard, and IBM were replaced by companies in Asia, Korea, Taiwan, and China. Going up against local suppliers in a very competitive market put them at a disadvantage, but they felt that they had to do it in order to avoid laying people off. They had never done that and did not ever want to do that. So for the best of reasons, they chose to go after this new market.

At first, they did extremely well thanks to a patented innovation. At one point, they owned 25% of the global market for laptop hinges. The next year, however, their fears were realized. Asian companies duplicated the product and undercut them on price, decreasing their business by 40%. The problem was that when the sales had gone through the roof, they had expanded their factory in Minnesota and hired a bunch of people to deal with the demand. Suddenly, instead of struggling to keep up with demand, they needed more orders to fill their capacity. Consequently, they kept getting beat down on price. When I did my follow-up story on them, they were having record sales of laptop hinges but were losing money on each one. It's very hard to maintain mojo when you are losing that kind of money.

One way they had avoided layoffs in the past was by having everybody take a pay cut until they got things squared away. But while it's one thing to take a pay cut for three or four months, it's another thing to take a pay cut for more than a year. Combine that with a poorly handled leadership change, and morale was terrible. In a very short period of time, this culture of trust which had taken 20 years to build was gone. It's a very sad story. I wrote about it in an article called "Paradise Lost." (You can find this article by Googling "Paradise Lost Bo Burlingham.")

This situation opened my eyes to the importance of the financial structure of small giant companies. Each small giant in my book had a very solid business model and protected its gross margins. Reell got into trouble when it failed to protect its gross margins. So if I ever do an updated edition of *Small Giants*, I will include a chapter on the financial structure of a small giant.

How does a company like SRC Holdings avoid situations like Reell's?

Jack Stack uses what I call "creative paranoia." He and his colleagues built the company on a whole set of questions like "what if this went wrong?" and "what do we do if that happened?" They built these questions into their annual planning process, creating a structure of contingency plans. They meet twice a year for a sales meeting. The first one is in June when they assess how the year is going. The second one is in October when they start the planning process for the following year. Each company under the SRC umbrella (I think there are 15 or 16 of them now) presents their plan to the others. The plan must include an amount equal to 15% of projected sales set aside for development of new products. These new products must be specifically identified and graded based on their readiness for production. If something goes wrong with one product, they want to be able to immediately bring something in to take its place. That's how they avoid laying people off.

Take their automotive division, for example. General Motors was their biggest customer, so you can imagine what happened to them in 2008. They lost something like 50% of their business overnight, and half of their workforce had nothing to do. However, they were prepared. They could move some to other SRC companies and put others on shorter schedules. Meanwhile, they immediately began looking for other business. They discovered that one of their existing engines could be converted to a natural gas pumping engine for which there was a market in Canada, so they got that business up and running. The post office still needed automotive engines, so they worked out a deal there. In short, two months after losing half their business, they found themselves shorthanded. They hired new people, and when GM eventually came back, they were positioned to take full advantage of the situation. Similar scenarios played out in other divisions of the company.

A LOT OF PEOPLE LIKED TO TALK ABOUT HOW TO LOOK AT SOCIETY AND ECONOMIC DEVELOPMENT, BUT IT WAS THE ENTREPRENEURS WHO WERE REALLY CREATING NEW WAYS OF DOING THINGS THAT HAD A TREMENDOUS POTENTIAL FOR IMPROVING THE LIVES OF PEOPLE.

It sounds like SRC Holdings is a prime example of how to build a company for any situation. They didn't have to suddenly come up with ideas in a crisis situation. The ideas had already been fleshed out and were ready to go.

Right. There's also something to say about the mentality you create in the work force. Most of the companies in *Small Giants* practice some form of open book management. Zingerman's, for example, took the ideas of *The Great Game of Business* and adapted them to their own culture which was very different from SRC's. It has created strength in the organization that allows them to get through tough times without laying anybody off and thus keeping the spirit of the organization strong. Another such company is ECCO in Boise, Idaho, the world leader in backup alarms and emergency lighting. Their disciplines of weekly meetings to review financial numbers with the entire company enabled them to come through tough times very strongly, although they did have to do a layoff. Reell Precision Manufacturing also practiced a form of open book management, but they obviously weren't sufficiently paranoid.

You've been around entrepreneurs for decades. How did your interest in entrepreneurship develop? As you talk to entrepreneurs, what do you find makes them unique?

I wound up studying entrepreneurs by accident. As a child of the '60s, I thought capitalism was evil and business was the agent of evil. Then I got married, had a couple of kids, and found myself in a situation where I had to get a real job. I was living in Boston and was approached by a headhunter from Fidelity Investments. They needed someone who could write, so I wound up going to work there in 1982. It was a tremendously exciting time, and it challenged a lot of my ideas of what business was all about.

Then I wound up at *Inc.*, a magazine that covered a part of the economy that I found absolutely fascinating. That was when the entrepreneurial revolution was going on, and I was in a spot where I could watch it, write about it, and get to know a lot of great companies and their leaders when they were still young. It totally changed everything; I couldn't believe how misguided I had been. These were some of the most interesting, idealistic people. This was where the real innovation was going on. A lot of people liked to talk about how to look at society and economic development, but it was the entrepreneurs who were really creating new ways of doing things that had a tremendous potential for improving the lives of people. That really excited me.

What role do you see entrepreneurs playing in the current economic situation?

Unfortunately, there is still widespread ignorance of entrepreneurship in society, particularly among the political elites. They just don't understand how business works and what it takes to create a job. Creating a job is one of the most important social benefits of business, but the people in power (most of whom are lawyers) have no idea what goes into that. We are facing some big questions right now about exactly what kind of an economy we're going to have. Are we going to have an entrepreneurial economy which I believe will be more prosperous, more free, and generally better for everybody? Or are we going to have more of a top-down, command and control economy?

My wife and I have a house in France where we spend two or three months each year. I'm very fond of France; I love the French people and the French culture. But they are dealing with huge problems resulting from a corporatist economy. It is very hard to be an entrepreneur in France due to the extensive legal obstacles. The great irony of Europe is that they put these things together to supposedly protect working people, but instead, they have perennially high unemployment. In contrast, India and China are discovering entrepreneurship and are frankly beating the pants off the European countries as a result.

***Small Giants* focuses on organizations that choose greatness over growth. If entrepreneurs are the ones who create jobs by growing businesses, are small giants being selfish in choosing to limit growth?**

That's a very good question. It was actually a question that was posed to me right after the book came out by Bill Taylor, one of the founders of *Fast Company* magazine. Nowhere in *Small Giants* do I suggest that there is anything wrong with deciding to grow your company as large as possible. People who can do that also provide tremendous benefits to our society. There are very few who can do it, but if you have the stomach for it, the smarts, the access to capital, and the ability to put together the right kind of management team, more power to you.

The point of *Small Giants* is that there is nothing wrong with choosing not to do that. Is it selfish? I don't think so. Did Bill Gates, Steve Jobs, or Larry Ellison build their companies with selflessness as a motivating factor? I don't think so. The questions are what can you do, what do you want to do, what kind of a life do you want to have, and what kind of company do you want to build?

One thing that small giants can do that bigger companies cannot is to be intimately involved in their communities. Travel around the United States and you'll find that the backbones of these communities are small giants. By employing people, participating in the chamber of commerce, and providing the tax base, they really create the social fabric of American society.

Consider a company like Whole Foods, which I greatly admire. But it's a huge company now and no longer rooted in its community. It can't afford to because it is striving to create a customer experience that is the same whether it's in Austin, Boston, San Francisco, or Chicago. I think Whole Foods is a great company, but they have traded some things away in exchange for growing large. Business leaders need to make those decisions with eyes wide open, understanding who they are, what they want out of business, and why.

The people at Zingerman's or SRC are some of the hardest working and most giving people I know. They're certainly not selfish. Zingerman's could have franchised Zingerman's Deli and spread across the United States, but would the world be better if they had done that? I doubt it.

Many times when companies make that choice, they lose their uniqueness, and in many cases, they aren't particularly good. That's what Starbucks is struggling with. I have tremendous respect for Starbucks. They employ a lot of people. But they would be the first to admit they have lost something.

So the question of "to grow or not to grow" includes a choice between the ability to create more jobs and the relationship with a home community.

Yes, although companies like SRC Holdings and Zingerman's still have a widespread impact by teaching other people a different model for doing business. I would argue that their impact has been many times greater than a lot of companies 10 or 15 times their size. Zingerman's has transformed the whole specialty foods business by creating a new model for it. Great companies, regardless of size, have an influence that goes well beyond the four walls of their business.

That's a good point. Both SRC and Zingerman's have broadened their impact through intellectual capital. They have developed processes, tools, and training to help other companies learn their business models.

That's exactly right. The real management innovations of the last 30 years have not come from academia or from very large companies; they come from entrepreneurial companies. Running a very large company is a very complicated exercise, and I think it gets in the way of innovation. That's why so many large companies scale back their own research and development and instead buy small companies that have done the work already.

Let's talk about leadership transition in

privately-held companies.

I'm so glad! That's my next book!

Well, it's clearly a kill point for many privately held businesses. What insights do you have for small and midsize companies who are preparing for a leadership transition?

You're asking a question that I'm currently trying to work out in my own mind. Whenever I talk about *Small Giants*, someone raises his hands and asks, "These companies are all run by very charismatic people, so what happens when they leave?" Indeed, many of the companies in the book have had to deal with that since it was published. The fact is that every entrepreneur eventually leaves his business and every business gets sold or liquidated. The real question is whether the entrepreneur guides the process or it is handled by his estate.

This is going to be a bigger and bigger question because we have a generation of baby boomer entrepreneurs who are now trying to figure out what will happen to their companies when they're gone. Others are saying, "I've done this for 30 years, and I'm ready to do something else."

Interestingly, with all the resources on entrepreneurship and running a business, there is very little on how to exit. So I've decided to build my book around a simple question: what is the difference between a good exit and a bad exit? I've met people who have gone through the exit process and look back on their business with a sense of satisfaction and accomplishment. I've also met such people who look back with despair. What accounts for the difference? After a lot of interviews, I've come up with nine things that will be presented in the book.

The one thing I will say for now is that I looked for private companies that managed to preserve their culture for more than two generations of leaders. It's very hard to find outside of family businesses. After much searching, I noticed that the companies that were able to do it were all employee owned. Not every employee owned company is successful and able to preserve its culture long-term, but the ones that are able to preserve their cultures long-term are employee owned. That was really a revelation for me.

Interesting. When do you expect that book to be released?

Probably the end of 2011.

We will look forward to that. It's a big topic for CEOs and executive teams. Much of the material that is available on the topic tends to be more technical – the mechanics of evaluation and deal structuring. You are right that there is not much on preserving the organization's culture through a transition.

I've also noticed that virtually all the literature on this topic is geared toward getting the most money out of the business. Obviously, money is an important component as far as allowing the seller to be financially independent, but getting the absolute top dollar for your business is not that important. What is important is being able to feel good about the process, about what you have done, and about what you are doing afterward. One of the struggles with exiting is that it is very hard to get excited about leaving something. It's much easier to get excited about going somewhere. Many business owners have trouble imagining what their lives will be like after they sell the business.

We have found that to be the case for a number of CEO Advantage advisors. They have already run their own businesses, and they see advising as an opportunity to stay engaged with business while transitioning to a new stage of life.

I know other people who have made a similar transition, and I think it's wonderful. Experienced entrepreneurs can be a tremendous resource for other entrepreneurs.

Exactly. Many entrepreneurs who leave their companies have years of productive life ahead of them. They want to continue to be productive.

I find that for entrepreneurs who go off and play golf, golf becomes a job for them! The very things about their nature that made them entrepreneurs leaves them highly dissatisfied with purely leisure activities. Some don't fit that profile, but I find them to be a distinct minority.

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