EDWARD LOWE FOUNDATION

Second Stage

The challenges of second stage

A successful business passes through a variety of stages, from its idea conception to eventual maturity. Along this continuum, a critical juncture for any growth company is entering "second stage," a category of development defined by the Edward Lowe Foundation as having about 10 to 99 employees and $1 million to $50 million in annual revenue. Although these metrics are loose boundaries that fluctuate depending on industry, they confirm the company has a proven business model and is able to concentrate on growth as opposed to survival.

Second-stage companies are significant for a variety of reasons. For starters, they are powerhouses when it comes to job creation, generating more than twice the number of jobs compared to their market share. For example, second-stage companies only comprised 16% of all U.S. businesses during 2022, but they were responsible for more than 38% of all jobs, according to YourEconomy.org.

Other hallmarks of second-stage companies include:

- *National or international markets,* which brings outside dollars into local and regional economies.

- *Greater confidence and success at risk-taking.* With more experience and financial bandwidth, second-stagers are able to expand into new markets and introduce innovations that impact their industries.

- *More stable employers.* Companies that have moved beyond startup generally have deeper pockets, which enables them to offer more diverse, high-quality jobs and provide better benefits for employees.

- *Devoted corporate citizens.* Second-stagers typically invest in their communities, whether it's revitalizing a neglected neighborhood with new facilities or supporting local charities and nonprofits.

Interior phases

Entering second stage is a major shift for growth entrepreneurs, and it happens at different times for different companies. Some may enter second

stage two or three years after business startup. For others, it may take a decade or longer, and the transition may come as a surprise.

Within second stage, business owners encounter new challenges — ones that require changes both in their organizations and their role as leaders. To help understand these pivotal points, the Edward Lowe Foundation has identified four interior phases within second stage:

1. Overwhelmed — Founders realize that the needs of their business have outgrown their capabilities. This can be a painful period. Even though their companies are growing, they may feel out of control. At some point they typically hit a plateau or encounter some type of turbulence and admit that they can't go it alone. Recognizing they need external help is an important milestone, but with an already exhaustive to-do list, second-stage leaders lack time and often don't know where to turn. Depending on what's keeping them awake at night, assistance could take the form of a peer or trusted adviser, service provider, entrepreneur support organization, consultant or combination of sources.

2. Building the team — At this juncture, second-stagers need to bring on additional employees and senior managers, which enables them to delegate and fill in blind spots. Instead of being a technician immersed in their business, they now start working on their business. They move from being a manager of few to being a leader of many; their role evolves into one of visionary and coach. Building the team means adding people with specific, professional skill sets, along with policies and procedures on everything from HR and communications to culture. This talent infusion and infrastructure helps entrepreneurs manage their growing business and increase employees' accountability and performance. It creates an organization that can run efficiently even when they're not around — which means they may actually be able to take a vacation.

3. Growing to last — This phase is about developing strategic plans and organizational structure to achieve sustainable, profitable expansion. Second-stage entrepreneurs refine their company's core competencies. They set big, long-term goals, such as going public or scaling the business to sell to investors, along with specific tactics for reaching those goals. It's important to not only consider the company's internal strengths and weaknesses, but also the external environment and how changes in politics, the economy, technology and society can affect their firm's growth. Bottom line, second-stagers are learning how to scale.

4. Focused opportunities — As the second-stage leader becomes more strategic, he or she begins to get better at recognizing very specific opportunities in which to invest time and resources. This could include moving to a new geographic market, expanding their client base in a new industry, adding a new product line or service division, investing in new technology or acquiring another company. At this point, they need to recruit outsiders for technical knowledge that is beyond their organization's wheelhouse, such as expertise with regulatory and international policy, supply chain, marketing or financing.

The first two phases tend to involve challenges within the walls of the company while the last two focus more on the external environment. It's important to note that these phases are not necessarily linear — and can be repeated.

Embracing structure and shifting roles

What made a company successful during startup will not guarantee success in second stage. CEOs need to introduce stability into their companies. They need to stop wearing so many hats and start delegating — easier said than done.

"In startup phase, the entrepreneur is the CWO (chief whatever officer). Whatever happens, you have to take care of it," says Jayson Meyer, founder of Synergy Billing LLC in Holly Hill, Florida. "Yet as the business grows, you must identify which things you should delegate, hire managers to take care of those things — and then trust them. Realizing that it's not just about you anymore is a tough thing, because founders derive great satisfaction and self-esteem from the business they gave birth to. Letting go requires you to make a real mental shift."

Meyer launched Synergy Billing in 2006 to provide revenue cycle management services to community health centers, and by 2016 the company was generating more than $8 million in annual revenue with 100 employees. Growth has been particularly strong since 2013, which Meyer credits largely to creating structure — developing policies and procedures, quality assurance programs, employee training programs and building a management team — that has enabled him to focus on strategy. "You may think things like strategic planning and performance management sound nice, but that you have to be practical and get things done," Meyer says. "Then you realize you have to make time for those disciplines because they're what enable you to grow consistently. Profits and revenue growth should be a specific goal, not an accident."

Another advocate of structure is Larry Kooiker, founder of Agritek Inc., a manufacturer of engineered metal components in Holland, Michigan. Kooiker admits that he avoided structure for a long time because he associated it with bureaucracy, waste and moving slowly. "Entrepreneurs don't need a committee meeting to get something done," he says. "We just do it."

Delegating was also a difficult concept to embrace. "In early days, you're the guy who turned the lights on and off, dumped the trash and swept the floor. You try to do everything because you believe you can do it better than anyone else," Kooiker says. "But you reach a point where you realize this won't work anymore. You've got to delegate and put other people in charge, to create a team of specialists so all your divisions can be more successful." This epiphany came when Agritek's staff had grown to

Photos from top down: Larry Kooiker of Agritek Inc. in Holland, Michigan, and Jayson Meyer of Synergy Billing LLC in Holly Hill, Florida.

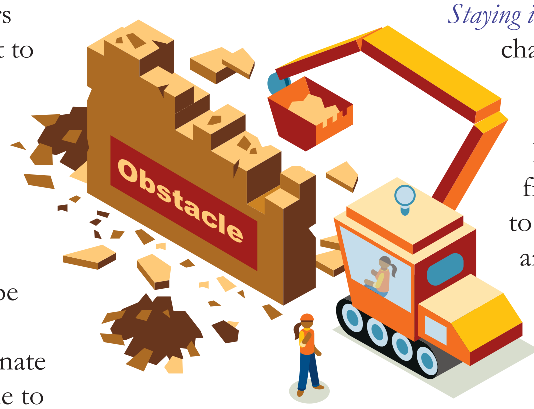
about two dozen employees, and Kooiker noticed a change in attitude. Instead of focusing on increased production and quality, employees were more concerned about punching out at the end of the day.

Expanding his staff had caused a lapse in communications, Kooiker explains: "When you only have a few employees, it's easy for everyone to be excited and motivated. They know what needs to be done because you're working with them on a daily basis — it's like they're an extension of your right arm. Yet once you go over 20 employees, you lose that direct contact, and it's easier for people to become disengaged."

In response, Kooiker created employee manuals, production goals and documentation for operating equipment correctly. He began holding quarterly companywide meetings to discuss how employees' jobs aligned with the company's mission and goals. He hired senior managers and gave them equity in the company so they would think like owners. Although Kooiker misses the spontaneity of his startup days, developing infrastructure and relinquishing control has enabled him to grow Agritek to more than 120 employees and $20 million in revenue — while simultaneously increasing profit margins.

Other major challenges

Personnel issues loom large in second stage. "As you expand your staff, you suddenly have a new system on your hands to manage — a social system," points out Dino Signore, manager of entrepreneurial education at the Edward Lowe Foundation. "This is one of the most confounding aspects of running a company. Employees bring their problems to work, and those problems become your problems. Not many entrepreneurs launch their business because they want to manage people."



On one hand, it becomes easier to attract employees as second-stagers have more credibility and financial wherewithal. Yet finding people who possess specific expertise and fit in your company's culture can be difficult.

Second-stagers may also procrastinate about bringing executives on board due to sticker shock. For example, hiring a CFO or vice president of marketing is a lot more expensive than adding a line worker. But it's worth it. A skilled senior manager can leverage the second-stage CEO, allowing him or her to focus on top-line growth — which can be a real game-changer.

Personnel challenges include more than senior managers. Second stage also requires constant assessment and development of staff. Sometimes the people who started with you are no longer a good fit as your company evolves. Not promoting a staff member or even letting them go can be extremely difficult for founders to do when as these staff members have been in the trenches with them, fighting for market share for years.

Building the team is much easier if entrepreneurs create job descriptions and org charts — documents that not only address what the company looks like today but also what they want it to look like in five years. This helps leaders know what seats need to be filled and what kind of expertise to recruit. It's also important to define and communicate the company's purpose, vision and values in order to recruit and retain employees who are a good fit.

As they scale, second-stagers face fiercer competition and shifting market dynamics, which can require them to tweak business models and restructure their organizations. It's essential to be aware of what's going on in the external environment — from demographic and sociological shifts to economic and political ones. This can impact business leaders in a variety of ways, such as:

Understanding how you compete — When it comes to profit models, businesses fall into two primary camps: A commodity-driven approach that revolves around low margins, high volume and a focus on process innovation; or a specialized niche that revolves around high margins, lower volume, and a focus on product or service innovation.

It's important to be clear on your business-level strategy and for everyone in the organization to understand it because it affects how they interact with buyers and suppliers. It's also important to know what lane you're in and to stick with it. If you do change strategies, you'll need to change your approach to buyers and suppliers.

Staying in touch with customers — Marketing channels that generated initial growth for your company may not be adequate to take it to the next level. Early success may have come from an ability to respond quickly to customers' current needs — and anticipate future ones. Yet as the company grows, founders become more distanced from customers. If you don't have systems for staying in tune with customers, it can hurt your competitive edge. Another consideration: Entrepreneurs, who tend to be restless and want to chase the next shiny object, may want to innovate for innovation's sake rather than develop products and services that truly reflect customers' needs.

Being vigilant of new market entrants — If your company launched with an innovative product or service, you might have faced little or no competition in early days. But as you succeed, competitors are going to show up on your turf. Case in point: When Edward Lowe introduced Kitty Litter in 1947, he created an entirely new industry. Yet within a few years, copycats were taking a bite out of his market share. In response, one of Lowe's key strategies was to continually improve existing products and introduce new ones. He invested heavily in R&D and even established an R&D division where 120 cats were "on staff" to assist scientists with product development.

Bottom line, second stage brings on a new variety of new challenges, something Lowe referred to as "brick walls." The goal during the second stage is to tear down these brick walls and transition the company into a healthy sustainable business for the long term. This is true whether your intent is to run it for many years or prepare it for sale in the future.