



MANAGING FOR GROWTH

Enabling Sustainable Success
in Canadian SMEs

2003

EXECUTIVE SUMMARY

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Canadian
Manufacturers &
Exporters
Manufacturiers et
Exportateurs du
Canada



Background

In 2002, RBC Financial Group, Canadian Manufacturers & Exporters and the Canadian Federation of Independent Business joined forces to explore a major social and economic question: During the past two decades, why have Canadian living standards risen at a slower pace than American living standards, leading to a widening prosperity gap with the United States? The result was the 2002 report, *The Path to Prosperity: Canada's small- and medium-sized enterprises*, which examined external barriers to growth and their effect on Canada's small- to medium-sized enterprises (SMEs). Topics studied included taxation, government regulation, trade policy and access to funding. The report concluded with significant recommendations for change for public policymakers, the financial community and business leaders.

Researchers also noted the need for a second report, one that would focus on internal barriers to growth. This report would examine the role of management more specifically to determine why some Canadian SMEs manage to grow from small to medium, and even to large, enterprises while others do not. We wanted to learn why some firms fail, despite good products, services and human resources and to understand better which

management strategies help SMEs overcome external barriers and which ones are themselves barriers to growth.

This report, *Managing for Growth: Enabling sustainable success in Canadian SMEs*, brings together the research to date on SME management and growth and suggests strategies for dealing with internal barriers to growth. It also makes recommendations for additional steps that can be taken by business, government, colleges and universities, and the financial community to improve the chances for success of our entrepreneurial SME community.

This report is the first comprehensive examination of internal growth barriers facing Canadian SMEs. It underlines the vital importance of management skills in moving entrepreneurial start-ups to profitable businesses with the scale and scope for ongoing success. It draws from decades of management research, distilled into the language of SME business leaders. Case study methodology and interviews are used to augment findings from management literature, and the experience and expertise of successful Canadian business leaders and advisors is shared through this report.

Methodology

Researchers first developed definitions and tools for understanding and discussing the management needs of SMEs, particularly the needs specific to each growth stage. They amassed statistical and illustrative evidence through the following:

- ▲ reviews of Canadian and international research on the subject of management;
- ▲ data analysis;
- ▲ interviews with professionals, CEOs, and analysts by Queen's School of Business (QSB) and Queen's Centre for Enterprise Development (QCED) research teams;
- ▲ facilitated roundtable discussions with SME consultants and advisors;

- ▲ insight from new and existing case studies;
- ▲ Ipsos/Reid survey data.

Researchers at QCED developed their findings into a tool for assessing the management needs of growth-oriented SMEs — the SME growth framework (Figure 1) which illustrates the trajectory of management issues as a firm grows and matures. Managers can identify their company's current growth stage on the framework and track present and future challenges.

This report focuses on the middle segments of the framework — companies moving out of the start-up stage and working toward the sustainable and global enterprise stages. These companies face internal challenges in business development, management and infrastructure. The external challenges listed

Figure 1 **SME growth framework**

Challenge Areas	Specific Challenges	Start-up Stage		Fast-growth Stage		Sustainability Stage		Global Enterprise
Business Development (Strategy)	<i>Strategy for Growth</i>	Validation	Transition	Growth for Survival	Transition	Growth for Profitability	Transition	Sustainable Growth
	<i>Managing the Financing Gap</i>	Seed Funding		Financing Growth		Retained Earnings and/or Exits		Financing Evolution & Change
	<i>Creating Networks & Market Connectivity</i>	Sales		Connections		Alliances and Awareness		Mergers & Alliances
Management Development (Leadership)	<i>Upgrading Management Skills & Capabilities</i>	Entrepreneurship		Management		Leadership		Executive Vision
	<i>Challenging the Leader's Assumptions</i>	Perseverance		Results		Stakeholders		Critical Feedback
	<i>Managing Successions and Exits</i>	Directing		Delegating Leadership		Nurturing Leadership		Stepping Aside
Organizational Development (Infrastructure)	<i>Growth & Organizational Change</i>	Managed Chaos		Alignment		Operational Improvement		Re-Engineering
	<i>Professionalizing the Business Infrastructure</i>	Observation & Intuition		Reporting		Controlling		Professional Benchmarking
	<i>Maintaining Organizational Culture & Values</i>	Explicit Definition of Desired Culture		Aligning Culture with Strategy		Monitoring Culture		Aligning Culture with Strategy
Influencing Factors (Context) * Explored in Framework Agenda Papers (See Appendix X)	<i>Innovation Climate</i>	Product		Customers		Process		Diversification
	<i>Government & Public Policy</i>	Incentives		Taxation		Regulation		Macroeconomic Policy
	<i>Financing Availability</i>	Owner Equity /Love Money		Debt Financing		Private Equity		Public Equity
	<i>Internationalization</i>	Domestic	Opportunistic	Exporting	Multinationality			
	<i>Knowledge Strategy</i>	Know-How	Information Flows	Decentralizing Knowledge	Knowledge Management			
	<i>Alliances</i>	Customers	Distribution	Operations	Diversification			

in the bottom section of the framework were addressed in the earlier report. Following the topic areas defined by the framework, each section of this report examines one specific internal challenge facing SMEs. It synthesizes the accumulated

research on the subject and illustrates ways of managing these challenges based on studies, best practices, examples and case studies.

Key findings

Managers of Canadian SMEs with the capacity for profitable growth but fail to achieve commercial success often lack the necessary organizational and leadership skills to respond to business challenges. Although external challenges can be considerable, good managers work around them. They don't blame government or investors for their difficulties. Nor do they look to government to solve all their problems. Instead, they improve the way they manage problems.

Weak management contributes to low productivity and profitability. For this reason, SME managers in the middle growth stages need to consider the strengths and weaknesses in their own management style. This report identifies nine internal challenges:

Strategy for growth

▲ Weak SME strategic planning practices occur when insufficient attention is paid to an action plan. Action plans need adequate resources to ensure effective follow-through and concrete results.

▲ Although some SMEs have strategic plans, they often fail to update them. Changes in key organizational variables, such as a company expansion, a new product line or a new marketing project, signal the need for a new plan.

▲ Well-developed strategic plans are useful for SMEs pursuing financing. But plans are not the same as action. Management teams that become preoccupied formulating and revising plans ignore the most important part of the plan — the action that results from it.

▲ Strategic plans need to be flexible enough to leave room for innovation and new ideas. Managers who avoid innovation because of inherent planning challenges forego significant growth and profit opportunities.

Managing the financing gap

▲ SME managers promote their companies to lending and investing institutions from their own perspective rather than from the financier's perspective. Consequently, they often fail to communicate the investment potential of their company.

▲ Managers can improve their chances of obtaining financing by learning the language of finance, using advisors to help plan their presentations and writing business plans that target the financier's interests.

▲ SMEs need to consider a wider spectrum of financing options, from venture capital to angel and family investors.

▲ When approaching investors, SMEs should consider compatibility of objectives, especially in arrangements in which the entrepreneur trades control of a company for capital to finance survival or growth.

▲ SME managers need to show through action that their company is a high-quality, growth-oriented and professional investment opportunity.

Creating external networks and market connectivity

▲ Entrepreneurs need to be connected to suppliers, markets, financiers, competitors, advisors and colleagues to gain the momentum needed to propel a young company through the growth stages.

▲ Clusters appear to be important factors for growth since they encourage innovation and collaboration, draw customers and create confidence.

▲ By collaborating with colleagues and competitors, small companies can overcome power asymmetries to compete with large, well-established companies for the same market.

Upgrading management skills and capabilities

- ▲ The turnover of some key personnel during a company's transition from one growth stage to another can be a sign of good management. In fact, it may be an indicator that real growth is occurring. Key personnel for one growth stage may not be suited to the working environment of the next stage.
- ▲ Key personnel retained from one growth stage to another — including the entrepreneur-owner — need to retrain to learn the management skills required for the next growth stage.
- ▲ Managers need to think ahead in order to draw the company forward. This means finding and hiring personnel with experience in the next growth stage and developing human resource practices and compensation packages to match. It also means upgrading their own aspirations to pursue new product development and global opportunities.

Challenging the leader's assumptions

- ▲ Entrepreneurs can become too focused on the needs of their present growth stage and be unable to step back to see where they are headed. The perspective of outside advisors, especially those with relevant experience, is critical for successful transitions from one growth stage to the next.
- ▲ Sources of advice include family, lawyers, accountants, boards, employees and professional consultants.
- ▲ SME managers need to consider the expertise and objectivity of advisors when choosing an advisory team.

Managing succession and exits

- ▲ Successful succession means passing the company to the next generation, selling it or delegating and letting go of responsibility and authority. Well-managed exits ensure that investors get their original money out and that the entrepreneur is adequately compensated for the years of time and effort spent building the company.
- ▲ Both succession and exits require considerable planning. Entrepreneurs who enjoy being the manager and cornerstone of the company during the excitement of the start-up stage need to envision what they expect their role to be once the company becomes sustainable. Moreover, leaders who don't think ahead may not be adequately prepared to avoid unpleasant takeovers.

- ▲ Managers need to examine their satisfaction with their own leadership role, as well as the needs of the company, when deciding how and when to let go of authority.

Growth and organizational change

- ▲ Managers need to deal with organizational inertia in the face of a rapidly changing environment; yet many companies are unable to cope with change.
- ▲ Clear plans and expectations, ongoing consultation and communication across the organization, step-by-step implementation of the change process, and allocation of adequate time and resources to change plans are all needed in order to ensure efficient change without reducing productivity.

Professionalizing the business infrastructure

- ▲ SMEs tend to operate with informal structures, an arrangement that places additional stress on managers who must control multiple aspects of the company. While suitable for a start-up, this informality becomes a drain on resources as the company moves into the fast growth and sustainability stages.
- ▲ Once in the fast-growth stage, a company needs to formalize its operations, including human resource practices, accounting systems, inventory procedures, performance measures and formal boards of directors and/or advisors. This formalization is a structured and accountable way for the manager to delegate responsibility.

Maintaining organizational culture and values

- ▲ In the start-up stage, the values of a company are those of the leader. As the firm grows, the values become those of the entire staff, with each new recruit adding to the culture.
- ▲ Companies with a positive organizational culture tend to have more loyal and dedicated employees, which contributes to productivity.
- ▲ Successful managers create desirable organizational culture by hiring based on company values, compensating and rewarding employees for behaviours consistent with these values and constantly re-evaluating the appropriateness of the culture and values for the current stage of growth.
- ▲ A company's values need to be communicated consistently to all levels of staff.

Despite considerable research on the subject of internal barriers to SME growth, there is a need for further study. This report raises questions beyond its scope that need to be addressed. These include major questions about innovation, alliances, financing, knowledge strategy, government and public policy, and internationalization.

Based on literature and data reviewed, six research agenda papers outline the specific questions that need to be studied and describe a suitable study method. The research agenda papers are presented as a separate document entitled *Managing for Growth: Research Agenda for the Future*. It is available from QCED at www.qced.com.

Conclusions

This report concludes with a call to action to SME leaders, public policymakers, and public and private institutions connected to SMEs. These recommendations focus on actions that encourage and support SME managers dealing with internal and external challenges and lay the foundations for improving SME management in Canada.

For SME leaders

- ▲ Set time aside every year for an annual planning review to assess the current growth stage of the company and plan for the next growth stage.
- ▲ Anticipate and be prepared for the growth challenges that all companies experience rather than allowing crises to dictate events.
- ▲ Change the company's course and direction if that is what is required to meet these challenges.
- ▲ Groom leadership at all levels of the company. Ensure that professional development and upgrading occurs for all managers at least once a year.
- ▲ Encourage managers to step back from day-to-day operations to assess the company from a broader perspective.
- ▲ Set aside resources for professional advice at critical transitions between growth stages.
- ▲ Learn about best practices in organizational development through case studies and advisory groups.
- ▲ Promote, communicate and manage change throughout the organization.
- ▲ Open communication lines with all levels of staff to promote discussion about the evolution and growth of the company.

For government

- ▲ Reinforce programs that clearly benefit SMEs, such as the Industrial Research and Assistance Program and the initiatives of the Export Development Corporation that assist SMEs. Make it easier for them to use Technology Partnerships Canada. Provinces should consider reinforcing these programs.
- ▲ Review securities legislation to ensure that private SMEs have access to high net worth financing through regulatory measures for exempt corporations raising capital from small groups of investors.
- ▲ Strengthen access to capital by allowing publicly traded high-tech companies to sell flow-through shares as a mechanism to capture cash from unused tax benefits from research and development.
- ▲ Ensure that governments focus on tax and other measures that are specifically aimed at growth companies rather than lifestyle SMEs.
- ▲ Implement regulatory and other measures to provide access to high-speed broadband and e-commerce in all parts of Canada.
- ▲ Make management training and education a higher priority in funding programs for universities and colleges.
- ▲ Dedicate resources to establish centres of expertise within government on growth-oriented SMEs, monitor their progress and review public policies affecting them. This can accelerate the progress of Canada's gazelles (smaller companies on a fast-growth path with proprietary technology). Canada's innovation strategy should be particularly attentive to the potential of growth companies.
- ▲ Make the encouragement and support of fast-growing companies a top priority. At the federal level, give a junior

minister within Industry Canada special responsibility for growth-oriented companies.

For local government and economic development agencies

- ▲ Focus on the needs of growing companies rather than on the needs of start-ups alone.
- ▲ Actively seek opportunities to promote cluster development and other forms of collaboration and provide local information sessions on growth strategies.
- ▲ Ensure that local infrastructure meets the needs of growth companies.
- ▲ Work with local colleges and universities so that they can serve as resources for growth companies, including management and skills training and research, engineering and problem-solving support.
- ▲ Encourage growth companies to participate in co-op programs for college and university students.

For educational institutions

- ▲ Expand university and college business programs to teach not only entrepreneurship but also SME management skills and best practices. Ensure that graduates have the skills they need to navigate a small company through its growth stages.
- ▲ Train business students on how to be active investors in early-stage companies.
- ▲ Encourage the study of SMEs, including topics useful to SMEs. For research projects, ensure that adequate space and resources are allotted for topics specifically related to SMEs. Create research distinctions between topics related to large businesses and those related to small and growing businesses.
- ▲ Develop upgrading and training programs targeted at SME managers. Ensure that each season of continuing education courses includes some programs of interest to SMEs.
- ▲ Teach business students about the pivotal role SMEs play in the Canadian economy. Promote SME management as a desirable career option.

- ▲ Disseminate SME research widely. Make survey results, data and best practices information accessible to SME managers, their financial stakeholders and their networks.

For support and service professionals

- ▲ Create market-segmented services for SMEs, recognizing their unique needs and financial realities.
- ▲ Designate staff to specialize in SME growth issues. Hire new staff with experience and training in SME management.
- ▲ Train all staff about the internal and external barriers SMEs face. Ensure that all programs directed toward SMEs are based on the realities of their situation and not just on those pertaining to large businesses.
- ▲ Actively seek the trust of the SME community. Cultivate relationships among SMEs.

For financial institutions

- ▲ Partner more with SME leaders to identify opportunities to enhance product and service options for SMEs.
- ▲ Review opportunities to leverage SME leaders, to increase understanding of the requirements of SMEs, to access sales force capability and participate in educating/training those who specialize in handling SME accounts.
- ▲ Continue to develop specialized financial service options for growth companies, recognizing their unique needs and financial realities.
- ▲ Increase the number of suppliers of venture capital/private equity. This applies especially to insurance companies, pension funds and other institutional investors.
- ▲ Expand the capability to provide practical advice through education programs, resources, tools and workshops to educate SMEs on financing issues, options and alternative sources so that SME owners have a better understanding of what the financial community expects in a financing relationship.
- ▲ Encourage the development of the angel investor network and the sub-prime debt market to fill the void in the risk spectrum. Partner with public policymakers to ensure growth of alternative financing options.