SCALING THROUGH THE 'VALLEY OF DEATH'

Chair: Steve Kaplan, Neubauer Family Distinguished Service Professor of Entrepreneurship and Finance and Kessenich E.P. Faculty Director, Polsky Center for Entrepreneurship and Innovation, University of Chicago Booth School of Business

Panelists:

- *Ryan Decker, Senior Economist, Federal Reserve Board of Governors*
- *Kristin Nimsger, CEO, Social Solutions*
- *Mark Tebbe, Entrepreneur-in-Residence, University of Chicago Polsky Center for Entrepreneurship and Innovation; Adjunct Professor of Entrepreneurship, University of Chicago Booth School of Business*
- *Chris Wheat, Director of Business Research, JP Morgan Chase Institute*

The session objective was to understand how startups should balance growth and survival. New companies face a perilous path as they shift from demonstrating product viability to building a sustainable business model. The transition typically requires additional funding, new management expertise, additional organizational structure and often a shift in culture. Many companies stall or fail at this stage of growth. This session examined what we know, and would like to know, about the scaling of successful startups.

Ryan Decker started off the discussion with a presentation of research from the Federal Reserve. He talked about how young, high-growth (>25% growth) companies are critical to the U.S. economy. They drive almost 60% of job and output creation, even though they only make up 15% of organizations. Decker also pointed out that firms that are a bit more productive than average grow significantly more than average firms. Combined, this means that high growth firms reallocate resources that enhance the aggregate output.

Next, Chris Wheat gave a brief overview of his research at JP Morgan Chase, which includes transaction data from 138,000 small businesses. Wheat's findings show that firms with irregular cash buffers and cash flows are the least likely to survive. Furthermore, he finds that organic growth businesses in aggregate generate the majority of small business revenue and payroll, but are also the most likely to exit.

Decker and Wheat were able to give a macro-level view of growth in startups. After they finished their presentations, the panel switched gears to Kristin Nimsger and Mark Tebbe to discuss the intricacies of scaling an individual company.

Nimsger talked about her experience living through hypergrowth. She said it is just as painful as a failing business, although it is more fun. Assuming you have the right market and customers who are willing to pay, she said, growing ultimately comes down to luck and execution. Specifically, at this stage of the company there are three focus areas: talent, product and business model. For the product, the big question is whether you take big or small steps in its growth. For the business model, it is critical to think about the long-term value of your business, particularly in terms of repeatability and sustainability.

Mark Tebbe discussed how, in today's environment, entrepreneurs have become overly focused on the need to get VC funding. He also said that the ability to grow is based on the ecosystem entrepreneurs are a part of. "If you have a good garden," he said, "things will grow there."

The audience then asked some thought-provoking questions with respect to startup growth. The first that garnered some serious discussion was, "How do you know that it's time to scale?" Nimsger and Tebbe both looked to their past experience for answers. Nimsger compared scaling to a minefield that one has to navigate. She said, "Knowing when to scale is a combination of data and intuition. When we were trying to go from five to 50 (employees), we had so much client demand we couldn't keep up. We added two sales people, then five sales people, and we continued to overperform. Eventually we just decided to scale quickly."

Tebbe said that experience is the best way to determine when growth is needed. He said, "Entrepreneurs are overly optimistic. New entrepreneurs will overextend their cash flow. It's important to have a plan. Businesses that have the discipline to have a board of directors or advisors will not get caught up in the hype and pull back a bit. The management needs to have a clear plan and measure themselves against that plan. It's far more valuable to be cautious and not overextend yourself."

Another question centered around how much of the decision to grow should be based on the desire to outrun the competition. Nimsger talked about how CEOs should have a very clear understanding of their competition. If you see your competitors growing rapidly, then you should know it is a good market. This should motivate you to work harder on your own business and give you confidence that you are in the right market. Along with this, it should reveal more about what customers actually want, allowing you to further refine your product.