



Middle Market Methods™
Value Creating Solutions in Private Equity

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Designing an Organization for Scale

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Growth is a non-negotiable expectation of lower middle market portfolio companies. However, scalability may entail challenges yet unseen by the portfolio company's leaders. Marshall Goldsmith shared his angle on this phenomenon for individuals in his book, *What Got You Here Won't Get You There*. In the middle market, where do you start and what do you do regarding the holistic business model? This installment will offer some ideas.

Getting Started

Along the path of scalable organizational design, the first milestone is a clear understanding of what the business model does. As odd as this may sound, the answer may not be as systemically clear as should be the case. Following Frederick R. Barnard's advice that "a picture paints a thousand words," one practical suggestion is

Turn "present state" workflow into a picture.

turning the business model into a picture. The best tool is a cross-functional process map whose scope is concept to cash. (See Figure 1.) What will this accomplish? Primarily, the cross-functional process map will (i) document the order of process steps within functions, (ii) reveal decision trees when multiple options prevail, and (iii) identify what functional area owns pertinent tasks. The outcome of the first milestone is a "present-state" depiction of the business model.

What are the leverageable benefits of a "present state" cross-functional process map? The possibilities include: (i) identifying extraneous steps that may be eliminated, (ii) revealing dysfunctional step *order* than should be rearranged, (iii) detecting improper step *ownership* that may be altered, (iv) spotting deficient tools within steps that may be improved—including manual activity that could/should be automated, (v) highlighting *task owner skillsets* required for effective step execution, (vi) providing context for what inputs *from whom* are required by preceding steps, (vii) providing context for what is

supplied *to whom* and requirements by succeeding steps, (viii) illuminating bottlenecks, (ix) rationalizing managerial metrics and/or management information insights, (x) edifying *supervisory skillset* requirements, and (xi) suggesting relative load balance for supervisors.

Let's revisit "bottlenecks" from the litany of possibilities above. This is one of the key challenges in scalable organizational design. The bottleneck phenomenon is one of the issues addressed in Lean manufacturing, although Lean is equally applicable to services. If the cross-functional map picture does not make bottlenecks obvious, ask the employees a simple question to identify the bottlenecks: "If we were three times as big tomorrow morning, what would be our biggest process challenges?" Fair warning: Their answer may not be what the boss is expecting. However, employee perspective is likely more reliable because they own granular execution.

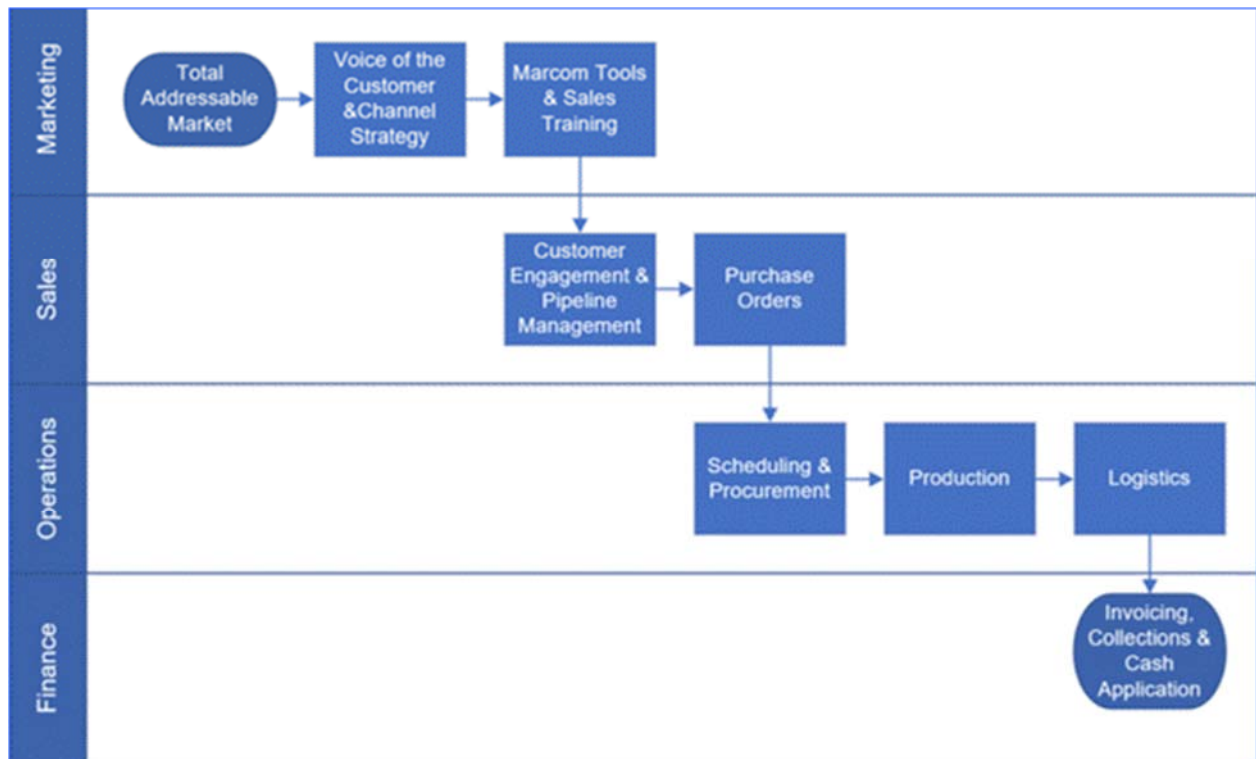


Figure 1: Simple cross-functional process map example

Should the "present-state" deficiencies be immediately remedied? Not necessarily. Of course, there may be some blatantly obvious things deserving immediate attention. However, "present state" mapping more practically gives us a point of reference for attacking one of the BIG "future state" questions: "What should the workflow of the business model look like (in light of strategic aspirations)?" This comprehensive approach may entail a more sustainable resolution to the "known" bottlenecks. As Lean veterans know, however, growth will illuminate new bottlenecks in the continuously robust scalability endeavor.

Designing Toward a Target and Succession

Private equity portfolio company leaders inherit an investment thesis with the advent of an equity sponsor recapitalization. Post-close planning is a best practice for transitioning ownership of the investment thesis to the portfolio company leadership team. Identifying the “vital few” initiatives is a byproduct of the exercise. Add to this the high probability that growth may require new leadership positions in the company that may not be present or may need upgrading. Here are a few positions that are commonly on the short list: finance, marketing, sales, information technology, and human resources.

Before completing the leadership list, think ahead to succession planning. Does the existing CEO intend to stay through the next liquidity event? Let’s start with a “yes” scenario. Is the leader more operational or business development oriented? Both are rarely in the same package, but do not fret. The point is playing to strengths. If the answer is business development, then hiring an operational leader may be appropriate for scaling. Simply put, this scenario could be described as the business development-oriented CEO feeds and the COO new hire digests. If the answer is operations, then a marketing and sales leader new hire may be appropriate to scale. Again, the pithy version of this scenario is the new hire feeds the business model which the operationally-oriented CEO digests. Let’s revisit the question with a “no” scenario. The right response may be starting with the “yes” scenario options, but with the intention of a succession hire after the bifurcation of the CEO role stabilizes.

*Design with
scenarios in mind.*

The Process of Redesign

Process check. The “present state” map is captured, the leadership team knows where it wants to take the company, the vital few strategic initiatives are identified, and new leadership skillsets are verified—which may require new positions. Do you start reengineering the processes before or after the new hires? The right answer is usually a hybrid. For functions with clear spans of control, go for it. For functions requiring new leadership, create a job description reflective of managerial requirements in the role to assist with recruitment. Candidate screening and interviewing should include open-ended questions for “been there, did that” examples under something Geoff Smart, founder of the ghSmart organization, called TORQ (threat of reference check).

Whether now or later, within each function, itemize all the tasks that are—or should be—performed in the function. Then, subject the list to the RACIX model promoted by Jay R. Galbraith in his book, *Designing Organizations: Strategy, Structure, and Process at the Business Unit and Enterprise Levels*. RACIX facilitates design navigation for determining responsibility, accountability, SME consultation, affected parties who should

be informed (but who are not party to decision making), and parties who should cease involvement with tasks. (See Figure 2.) Responsible parties delegate to accountable parties who do the work. Not only is RACIX a good managerial control tool, but it is also a skillset inventory for job descriptions that lead to training needs for resource development. Moreover, the tools help anchor effective communications messaging for those parties affected by, but uninvolved in, the task decision.

Task	Responsible	Accountable	Consulted	Informed	X (N/A)
Forecasting	Sales Leader	Analyst	Operations, Finance		
Safety Stock	COO	Raw Materials Manager			
Procurement	COO	Purchasing Manager	Warehouse Supervisor		
Scheduling	COO	Scheduler		Sales Leader	
Manufacturing	COO	VP- Manufacturing			
Shipment	COO	Logistics Supervisor	Warehouse Supervisor	Sales Leader	
QA/QC	Quality Leader	Six Sigma Blackbelts		Procurement	

Figure 2: High-level RACIX example

Communications Prerequisites

Small companies benefit more by informal communications than they may know how to appreciate, absent experience in a larger organization. Informal communications are more powerful than formal communications. The coffee pot in the break room is a good gathering spot for effectively communicating important information on an impromptu basis. However, as the company grows, informal communication remains effective, but is less efficient. People who need to know may unintentionally miss a message (because it was not delivered)—and with unintended consequences.

Think bigger. In times of stress, which is commonly correlated with growth, the vacuum of insufficient communication presents a tempting opportunity for misinformation. Some of the misinformation may be benign; some may be malicious. The reactive leadership energy requirement to combat misinformation is greater than that required for proactive

communications. Moreover, goodwill damage has a protracted recovery time. The point: make time to communicate.

The obvious solution is a communication plan. (See Figure 3.) Communication entails more than newsletters, emails, or memos. Communication is not a one and done phenomenon. The workplace is typically overwhelmed by communication signals. All humans cope with a cognitive dissonance mechanism to help them filter “relevant”

Treat communications as a legitimate priority.

information. In this case, “relevant” means confirmation of their *existing* worldview. Thus, contradictory information tends to be sieved absent proactive change-management efforts. The only practical way that leaders may combat this

is by repeating information over time and using multiple delivery mechanisms. Moreover, the messages should be clear and concise. Think in terms of sentences in an Ernest Hemmingway novel. Do not worry about “over-communicating.” John Kotter of the Harvard Business School asserts that over-communication is impossible.

Target Audience	Objective	Message	Owner	Medium	Frequency
Customers					
Vendors					
Employees					
Creditors					
Investors					
Communities					

Figure 3: Communications plan framework

The scope of communication should be tailored to the business model, but communication scope typically includes metrics, reports, staff meetings, and performance management. However, entrepreneurial founders chronically wrestle with this one. The short explanation is that the founding entrepreneurs may regard formal communications as bureaucratic. Indeed, a healthy disdain for bureaucracy is what compelled them to leave their big employer and challenge the status quo with the business they mortgaged their home to start.

Another communications challenge regards sharing pertinent data with employees. Founding entrepreneurs commonly resist disclosure even though employees need to know how they are doing and what impact their performance has on the company. Information control may actually be the CEO’s governance mechanism. However, this

must change in order to scale. Yes, it is bureaucratic, but maybe a different angle on bureaucracy is in order. The definition that may resonate is “just enough structure to avoid chaos.” Not only is this scalable, but it is more appealing to the future workforce: millennials.

Closing the Loop

In summary, whereas that which got us here may not get us there, wise leaders grasp that the path must be thoughtful and deliberate. Clearly, the answer entails more than an organizational chart. Actually, the organizational chart should be deferential to the process that enables scalability. Different positions and spans of control should be expected—even in a flatter organizational structure. Change must be proactively managed. The best change-management tool is proactive communication to help employees make their personal peace with the propriety of something different. The best practices above invite employee engagement for crafting solutions that work for the culture. The rewards include a smoother ride to and through the future.

Middle Market Methods[™] offers a value-creation toolbox of cultural, growth, and productivity solutions to portfolio companies of private equity firms. The premise is that best practice adoption correlates with a smoother investment hold period, resulting in higher exit multiples. Additionally, deal team time is liberated from operational surprises to invest in new transactions.