

Is Growth Good? *(Revisited)*

By Mike West

Editor's Note: NAID has more than doubled its membership since this article originally appeared in the spring of 2003. With all our coverage of the prospective market size of secure shredding in this edition of NAIDnews, we thought it fitting to revisit the author's comments.

Growth (groth) n. 1.) gradual development towards maturity. 2.) degree of increase in size, weight, power, etc.

Webster's definition is simple enough, but there's more to the notion of growth than what Webster's offers us. Growth is core to who we are as individuals. Think about it, from our early childhood we are taught that growing is an expectation, a part of life, even a reason to celebrate. Birthdays are a major occasion. Marking the growth chart an inch higher brings cheers. The progression from kindergarten to elementary school has mom in tears. A child's first-time involvement in organized youth sports swells dad's pride. We salute these growth benchmarks and are reminded almost daily that growth is good. Growth is our own personal reassurance that life is moving in the right direction.

Until we reach adulthood, our growth is generally measured in physical terms. By the time our body stops growing (independent of the inevitable extra pounds), we turn our attention to other areas for growth. Society teaches us that we should now focus on mental, spiritual, emotional and, yes, financial or material growth. For most, this is a challenge we gladly accept. And thankfully, there is no shortage of opportunities for personal growth. Without much effort, we can choose to participate in anything from a fishing class to pottery 101. The choices are endless. And we participate in record numbers each year.

But we also do something else with our growth: We keep score. The more expert you are at some task, the more

respect you engender. Within minutes of meeting someone, you can certainly expect to be asked where you went to school and what you do for a living. Sure, these questions are asked to help people find common ground, but they also silently assess how far someone has advanced along the growth continuum.

If keeping score is the endgame, you have to look no further than one's business success to see how we are most often measured. In general, the perception is if you are "successful" in business, then you must be smart, aggressive, hardworking, gifted. Further, if you own your business and it is "successful," then you are even more impressive. Truthfully, on the surface, it is hard to argue with that perception. However, we may be asking the wrong question or measuring the wrong criteria. Seemingly "successful" businesses may not in fact be financially strong. I know perception is often the reality. That is probably true in most cases, but perception will never pay the bills.

You might have noticed I placed quotation marks around "successful" in the preceding paragraph and you may be wondering why. It's because defining whether or not something is successful is completely arbitrary and individual. Let me explain. Nine times out of ten if you ask someone about their business's success, they will answer by telling you how much revenue they generate and how much revenue is growing. Push them on this, and they will generally stick to the party line, using those two measurements as success indicators. But peel away the layers and get inside their head, and often you find completely different responses.

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Over the years I have heard, “I love this job, it’s just fun to do what I do,” “this situation gives me time to do what I love on the side and pay my bills—I could never ask for more,” or even, “I feel like I am pushing myself personally to do things I never thought I could.” It’s funny, once I get the individuals to open up, the answers come naturally and are sincere. But why didn’t these people respond that way the first several times I asked them? Because it’s not the way we talk or measure success in the business world.

In the business world, we are all expected to grow our revenue and our business annually. Anything short of that is often viewed as failing. Ask a room of ten people if they expect to grow their business in the next year and uniformly you will see ten hands spring up. If you don’t believe me, try it. I have and it happens almost every time. Why? Because that’s what people expect from a successful business, and we all want to be perceived as being successful.

Ironically, in that room of ten, maybe three people really don’t care if they grow or not, another two couldn’t grow the top line if customers were handed to them, and probably four will grow their revenue, but will be no better or worse off this time next year. So that leaves one person who is probably ready to grow their revenue and enhance profitability during the next year.

If everyone responds that they want revenue growth, we need to explore the question, “Is revenue growth always good?”

The short answer is, “It depends.” It depends on your goals for the next year and for years beyond. I know that sounds like a Dr. Phil kind of answer, but it is true. Without understanding your goals how can you possibly know if increasing revenue will help you get there? You can’t. But business owners work to increase revenue all the time. They chase revenue under every rock, thinking that is just what “successful” businesses do. It’s the herd mentality—everybody else is focused on growth so I better grow too. It reminds me of what cows do in a storm: they all gather under the same tree—a great plan, unless of course that tree gets struck by lightning.

So as boring as it sounds, I suggest you identify your goals first, and then explore what incremental revenue growth will do to help you achieve them. Take some time with this. There is no need to hurry off underneath the tree everyone else is plodding towards.

But that isn’t all I have to say about revenue growth. I haven’t really answered the question posed in the title.

I come from a fairly cynical view of business growth, learned through my own private school of hard knocks. I have the scars. They have all healed nicely, but I can still remember the pain and the extended recovery time. I also have observed countless companies charge into a sales growth strategy only to watch the messy retreat. Simply put,

the pursuit of revenue growth has led to more implosions of companies than any other identifiable factor. Sure, you could argue being undercapitalized is the leading cause of failure, and in some cases that’s true. But even when a shortage of cash is to blame, often you just have to look for an overly aggressive growth strategy to find the culprit.

Let’s look back at recent history. The Internet boom stemmed from the belief that companies could grow their brand and market share in months as opposed to the decades it used to take. Hundreds of millions of dollars were invested in these companies, and they were asked to spend it quickly for the sake of the land grab. Unfortunately, someone forgot to point out that the businesses weren’t ready to handle the growth, their management teams were inadequate, operations were nonexistent, and oh by the way, eventually a profit would be required. Along the way, a lot of money was lost.

Similar implosions occur every day at small, privately held companies. Revenue growth can place a heavy demand on your business. Among other things, it may require you to work harder, make unwise capital investments, and ask your team to shoulder additional new-business responsibilities that they’re incapable of handling. Operationally, you might not have a solution for the new burden. Cash may also become tighter. I have seen more than once, a really viable company crash and burn because they funded an unnecessary growth plan, unable to manage or finance the immediate cash-flow requirements.

Therefore, I contend that revenue growth is a double-edged sword. The whole business world is telling you to grow to be “successful,” and yet so many bad things can happen if you try to grow your top line too fast. Recognizing the decision to grow is very individual, I offer the following items as a context for how to analyze and make your own decision.

PROFITABILITY

If your product or service can profitably be delivered on a consistent basis, then revenue growth may lead to enhanced profitability and increased bottom-line cash. Intrinsically scaleable businesses often can benefit from revenue growth. This is only true, however, if the margins can be maintained while the customer base grows. Margins are a product of two distinct categories: 1) pricing on the revenue side and 2) costs (including the costs of capital) on the expense side. If you must cut pricing below your margin target to obtain new customers, then growing for the sake of more revenue will not help profitability and may even damage the value of your business. In fact, under those circumstances, you are likely to be less profitable.

You may wonder how scaleable businesses like in the shredding industry can cost more to operate when you add new customers: simple, agree to do something for the new

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client(s) that you wouldn't do during your normal course of business. For example, I saw a company recently that had grown revenue significantly over the prior twelve months primarily by adding two accounts. However, they made significant pricing and operational concessions to get the clients to agree to work with them. The company was all smiles about its newfound revenue, rejoicing in its good fortune and waiting for the benefits to accrue. The value never came. In fact, the clients became an albatross draped around the company's neck. The pricing was so poor they lost money every time they serviced them. And the operational hoops they were jumping through caused service to the established, better-paying clients to suffer. In the end, revenue did increase but with a major negative impact on the company. Strangely, the owner didn't see it that way. He felt increasing revenue was the only goal that mattered. When I pressed him on this issue, he explained that he wanted to sell the company and a buyer would pay as a multiple of revenue—so revenue was all that mattered. Unfortunately, he was badly mistaken.

In fact, although people often assume that value can be measured as a multiple of revenue, the real value is found in the amount of cash generated by a company. Many reporters in the past have said that if you want to find the answer, follow the money. Buyers do that. They want to know what cash can be generated after all costs are incurred. It's not a top-line game; it's a bottom-line game. In fact, if you talk to veterans of the buyout game, many will tell you the first thing they do when they buy a new entity is fire some of the existing clients. The point is that not all revenue is good. It is reminiscent of the business models that only care about revenue growth and miss the point that you have to make money. Remember, you can't lose money on every sale and make it up on volume.

RETURN ON INVESTMENT

A sound revenue growth strategy can also enhance your potential return on investment. Specifically, if you can effectively leverage yourself or your business and create a return for that investment, you can proceed with a sound growth plan. Moving forward with that strategic plan means you will undoubtedly have to invest in the business beyond your current level. The ultimate challenge is determining whether the incremental investment yields the proper return, or if managing your current business without growth provides the right return.

Look at it this way, if you know for every truck you buy you could generate x dollars in profit and you know roughly when your market reaches saturation, then the decision to buy incremental assets is easy. Building a model for this is simple. But most people don't go that far: they just go on

instinct. They assume because their four trucks are busy that if they had five trucks, they would all be busy too. That assumption may not be true. If you buy the fifth truck and later learn you have to discount your pricing to bring it to capacity, you have damaged ROI, your immediate profitability, and the value of your company.

An even greater downside to guessing wrong is you are fully leveraged to fund your growth. What happens if the market slows, or if competitive pressures drive pricing down to the point you can't maintain profitability? Think it won't happen in your area? Think again. In an industry with several aggressive, large companies and fledgling start-ups entering every day, the competitive pressures will become stronger. So be careful how quickly you buy that next asset. The return may be slow in coming.

CASH

Revenue growth doesn't usually generate cash in the short term; it usually eats it. Before you venture into an aggressive growth strategy, make sure you are protected against market downturns. Plan ahead so you know you can cash-flow your operations in the short term, regardless of the surprise expenses that will surface during growth. Be wary of the negative impact caused by receivables. Regardless of whether or not you get paid, you have to pay a new driver a salary.

Is growth good? Yes, I am willing to say it is. The harder question is, "Which type of growth is good?" What about revenue growth? I don't know if the answer is always the same. It could be exactly what the doctor ordered, or it could be the tonic that brings on a bad case of organizational flu. In the end, it needs to be your informed decision rather than that of a herd mentality. All pressures in the business world will be there to tell you that you have to grow revenue. The arguments are compelling, but they're not foolproof.

Is growth good? Grow your profit! Be the cash cow, not the cow running for the tree.

AUTHOR'S COMMENT 2006: *When I wrote this article three years ago, it was difficult for some in the document destruction space to appreciate the importance of being bottom-lined focused; pricing was good, competition was manageable and buyers were opening their bank accounts and paying for revenue. Those days are gone.*

Today, competitive forces have created a much riskier environment for the independent owner. In fact, many companies we evaluated recently have diminished profit margins and, in many instances, what little profit they have is generated by the sale of paper. Said differently, they have become a commodity-based business and not a service

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business. Doubt that's true? Study your numbers. Continued pricing pressures, costs pressures, and the need to compete with the "big boys" have led to the erosion of profit margins. Now more than ever, you must pay attention to your bottom line. It is no longer about chasing revenue to garner some inflated revenue multiple in a business sale. It is now about long-term viability. The document destruction space remains a great business, and we are not pessimistic about its future. We still believe, however, that the best companies don't look like race horses: they look like cash cows.

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