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BOOK REVIEW

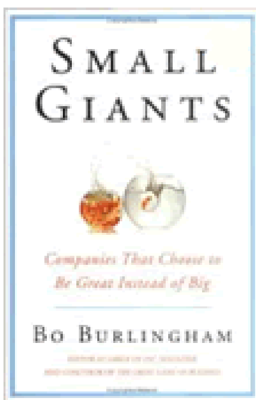
Prepared exclusively for REX Roundtable Members

Small Giants:

Companies That Choose to Be Great Instead of Big

by Bo Burlingham, Harvard University Press

Reviewed by Will Phillips



Almost every business has an interest in growing. Some businesses have lost their drive and plateau, but they still hold dear the concept of growth. Bigger is always better, right? According to the Fortune 500, as we look at the top 100 growers among large businesses in the United States, we see annual growth in the realm of 30 to 40 percent, both in terms of revenue and products. Upon looking a little more closely, we find out that most of this growth is due to acquisitions and price increases. Of the two studies that I have come across looking at true or organic growth, the rate is closer to 2 to 3 percent a year. In fact, in the 90s, Peter Drucker commented that no multi-national corporation that was in existence at the end of the Second World War had grown more than about 2 percent a year in the second half of the last century. All of this points out the difficulty of true, organic growth, as opposed to revenue growth via price increases and acquisitions. The demand and pressure for growth forces many companies to acquire just so they can report growth to their shareholders.

A Major Danger in Your Management Education

The danger for all managers, but especially privately-held businesses, is that the management bookshelf and the management consultant all base their latest insights on a few hundred publicly-held corporations. In fact, if you pick up more than a few business books, you will note that such companies as General Electric, Hewlett-Packard, and Disney are over-represented as the research sample; there is almost no research on small businesses. Most of the reported research that we show in the books that we love, such

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as ***First Break All the Rules*** or ***Good to Great***, is based on less than about 100 companies.

Why Grow?

Some of us just have a natural instinct that our businesses should grow, but what are the rational instincts? I believe that there are a number of reasons every business must grow if it is to remain healthy. For starters, by lacking growth, you lack opportunities for your employees. Promotion depends upon the death of someone currently filling the position above you. For the best of your managers, this is not a fast enough increase in their responsibility, challenge, or income. So they move on, leaving you with mediocre people who will guarantee slow or no growth.

A second important reason for business growth is to generate cash flow that will enable capital reinvestment dedicated to improving and even changing the business. Such capital reinvestment is crucial if the business is to remain strategically viable, particularly in light of new and growing competition. As the business grows larger, it generates more inertia and becomes increasingly difficult to change. Over time, the original capital investment and equipment are fully paid off, giving the owner a full sense of profitability because he or she is not re-investing into current equipment, facilities, etc. In many industries,5 to 8 percent of your revenue must be used for capital improvements and change efforts.

Two Kinds of Growth

We all know the first kind of growth, which is simply *bigger*. The second kind of growth is not bigger; it's *better*. I first learned of this from an architectural firm where the principals, who had worked in several other firms, decided that their firm should never be larger than 40 employees. Why? Working in larger firms, you end up being anonymous, and you also end up scrambling to have enough projects to cover the payroll. This firm wanted to stay small, keep it fun, and learn how to do what they did better and better. Over the years, this meant designing fewer prisons (not much fun or satisfaction there, apparently) and designing more civic centers and art museums, which they found interesting, challenging, and rewarding. At the same time, they learned how to do their estimates more accurately and became more efficient at interior coordination, thereby producing significantly growing profits, even though the revenue itself did not increase as fast.

In most cases, it is more difficult to get better than bigger. Of course, the very best firms figure out how to do both of these at once, thus achieving the status of Prime in the Adizes model of organizational evolution.

Small Giants

Small Giants is a book about companies that chose not to grow bigger, but to grow better. The author has carefully researched about a dozen businesses from a wide variety of industries scattered across the United States that have all made the choice for better. In fact, their betterness has led to a fairly significant amount of growth in revenue and profit. More importantly, they have grown strong competitive barriers.

The David & Goliath Strategy

For every small business owner who worries about competition from large regional or national chains, this book outlines a killer strategy for facing large competitors. In summary, the heart of the strategic choice made by all these small giants was to create an unusual and powerful presence in their community that simply could not be matched by out-of-town owners.

The criteria for selecting the companies in this business study were threefold: firstly, the owners had consciously made the choice to grow better, not bigger; secondly, these companies were admired and emulated in their own industries; thirdly, these companies that had been singled out by independent observers for recognition of extraordinary achievements.

Businesses that were not included were lifestyle businesses, franchisees, and boutique businesses, as well as Mom and Pop companies built around the goal of achieving employment for all the family members. These are people who chose to go it safe and place other goals ahead of growth. They received two things in return—control and time—which netted out at increased freedom to live the life they wanted and to do what was really important to them.

Mojo

One of the key descriptors introduced in this book is the concept of "mojo." This word comes from a Muddy Waters' blues song: "I got my mojo workin', but it just won't work for you." Mojo is mysterious; it might be sung about in blues songs, but it's not often written about in business books. It's an elusive quality that needs to be tended quite carefully. If a company loses its mojo, it becomes average. In research recounted by Gary Erickson in his book, *Raising the Bar*, Erickson felt that a business that had mojo could lose it—by becoming too commercial and focusing excessively on reducing costs, or by running like a business, i.e., ignoring their relationship with the employees, customers, and the community That's the thing about getting too big: it may jeopardize the emotional connections that exist between the business, its employees, and its customers.

The Seven Qualities of Small Giants

These seven qualities seem to be themes that ran through all eight small giants:

1. They consciously **questioned the usual definitions of success** and imagined different possibilities. This concept had

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been surfaced in the world of professional businesses, such as CPAs, physicians, and architects, where people talk about having a profession rather than a job. One of the key distinguishing factors that turned up in different architectural firms is whether a firm considered itself a practice or a business. When it was a business, financial criteria were prime. When it was a practice, a whole variety of other criteria took precedence. Of course they needed to make a living, but making money was not the overriding goal. The leaders had to overcome enormous pressures to take traditional paths to success. Often this meant **rejecting outside capital and growth opportunities** beyond their usual geography.

2. Each company has an extraordinarily **intimate relationship with its local community** in which it does business.

3. Each company cultivated exceptionally **intimate relationships with customers and suppliers** based on personal contact, one-on-one interaction, and mutual commitment to delivering on promises.

4. They had **unusually intimate work places** which were in effect functional little communities that strove to address a broad range of their employees' needs as human beings, creating an emotional, spiritual, and social bond, as well as the economic ones. For those of you who have read the Southwest Airlines story by Jody Gittell, you'll recall that the key to their success is called *relational coordination*, built on the principle of caring for people in the totality of their lives.

5. This sample represents a **broad variety of corporate structures and modes of governance** that they have come up with to help energize the force that drives their business success.

6. The **leaders brought passion to what the company did. T**hey loved the subject matter, whether it was music, safety, food, lighting, special effects, or constant torque hinges. They had deep emotional attachments to their business and these attachments extended, as mentioned earlier, to employees, vendors, customers, and their community.

Turn Downs

Anchor Steam Beer out of San Francisco was becoming very popular in the mid-1970s, and had a growing distribution. The general manager of the newly rebuilt MGM Grand Casino in Reno, Nevada, was a big fan of Anchor Steam Beer and wanted to serve it on tap in every bar in the house. Fritz Maytag, the CEO of Anchor Steam, felt that with a contract of that size, that far away from San Francisco, the company would be driven by meeting that demand and, ultimately turned them down.

Clif Bar had a similar challenge. Like many entrepreneurs, there was a sense that the company would eventually be sold and that would be a good way of guaranteeing its future. Quaker Oats was interested in purchasing Cliff Bar and would pay $120 million to the company. The owner of Clif Bar, Gary Erickson, and his partner were very excited about this sale. The company's annual revenue at the time was $39 million. The details were worked over during extended negotiations until finally a battery of Quaker Oats lawyers arrived in the Clif Bar Berkeley offices to sign the final papers. Half-way through that meeting, however, Erickson felt like he was having a panic attack and got up to take a walk around the block. He started crying because at the last minute Quaker Oats announced that they'd probably move the Clif Bar manufacturing facility to the Midwest, meaning that most of his employees would lose their jobs and the company's character would change completely. It would no longer be what he had created. He suddenly stopped crying, however, when he realized that he'd not yet signed the papers. With a big smile he walked back to the Clif Bar office where the Quaker Oats lawyers were waiting and shooed them out, announcing that he was not selling. His partner was quite upset and nervous, so Erickson offered to buy her out for $65 million. (At the time of that offer, he had $10,000 in the bank. Ultimately, he had to borrow up to $15 million at 23 percent to pay her off.)

Throughout these accounts we see that the more successful the small giants, the more difficult it was for them to stay on course, because with their success, enticing opportunities arose daily.

Danny Meyer of the Union Square Hospitality Group started the Union Square Café in New York City, which won acclaim from the start. Eventually, it became rated as one of the top values for restaurants in New York City and the Zagat Survey rated them as the most popular. With that success came offers for Danny to open similar restaurants in Los Angeles, Las Vegas, and Chicago. His soul-searching led him to come up with new criteria for growing his business: first of all, any new business he started would have to be within a five minute walk of his flat in New York City. Secondly, it would have to be capable of becoming as extraordinary as his first. Thirdly, it would have to enhance the value of his original restaurant. And fourthly, it would have to bring more balance to his life, not less. As a result, the company did not move out of town, but did in fact open additional restaurants which met all his criteria, including the five minute walk stipulation, These venues ranged from the upscale Eleven Madison Park, to the casual

Shake Shack, a classic burger stand in the center of Union Square.

To give an idea of how they live up to their criteria, the opening crew for The Blue Smoke Restaurant (another one of Meyer's subsequent ventures) consisted of a chef and general manager who each had eight years of experience at Union Square Café, a service director with five years at Gramercy Tavern, a pastry chef with three years at Kaplan's, … and the list goes on. They managed to create an integrity and strength that could never have occurred in a franchise or chain.

> *The single greatest challenge we have is to never, ever lose soul (mojo) in the restaurants.*
>
> Danny Meyer

Early on, Starwood Hotels decided to build a W Hotel in Union Square and asked Meyer to do their restaurant. After two or three meetings, though, he realized he could not meet his criteria in that situation and turned them down. Over the years, Union Square's original café achieved the highest NYC Zagat ratings for customer value. Finally, in 2004, they did stretch beyond the five minute radius when they were honored with the invitation to run the two new cafes in the newly redesigned Museum of Modern Art.

Ownerships

Basically, you can't have outside shareholders if you want to build a small giant because the outside shareholders are always committed to financial growth, and not the kind of spiritual growth that small giants are based on. These companies are searching for something indefinable and immeasurable, something that goes far beyond the standard definitions of success, something that can be easily lost unless it's protected against the homogenizing influences brought to bear upon every company, particularly as it grows in a chain or franchise.

Few of the small giant companies have grown in traditional ways. Many have grown by spinning off new ventures. Righteous Babe Records added a retail business, a music publisher, a real estate developer, a foundation, and a concert venue. Artists Frame Service morphed into a home and garden store, a wholesale frame business, and an art gallery. Once again, each of these collections of businesses fit into a family where all the members are a little bit different, but still hold a similar set of values.

Three Requirements for Small Giants

The first requirement for a small giant business is that you must go through that initial entrepreneurial, driven-for-growth stage—the one where you're going to conquer the world, you're putting in excessive hours, beginning to lose control of your home life and disconnect from your family. Once you have gone into that crisis and come out into recovery, you might have the opportunity to become a small giant.

Second, people who build giant companies from scratch are not the same as the leaders of small giants. They only have one desire in life or one neurosis, whereas the rest of us have a handful.

Third, you learn to be happy, lead a good life, have a great business, and make enough money without going crazy. When Donald Trump was asked whether he was a good father, he said, "I'm a good provider."

Another one of the small giants, Zingerman's Deli, has an extraordinary passion for food, its origins, and its history. Their newsletter is almost an academic journal on food. Zingerman's owners made a decision similar to Danny Meyer's in New York City. When their deli fabulously succeeded in Ann Arbor they decided, with some great struggle and pain, not to expand outside of Ann Arbor. They really didn't want to be flying to Kansas City to look at and manage what they felt could only be a second rate Zingerman's. They talked about the idea of Zingerman reflecting the distinct culture of Ann Arbor, a Midwestern college community with a lot of East Coast transplants—better described perhaps as Mideastern more than Midwestern. Zingerman's attracts and retains employees who are young and idealistic, which is key to their philosophy as a company.

What you begin to see in this description is that each community has its own culture, its own flavor; a community from rural Georgia is not the same as a community from rural Minnesota or upstate New York. They all have their distinct qualities, and in seeing that, each of these small giants placed those distinctions in a way that totally integrates them into the community and separates them from regional and national competitors who are simply unable to form this level of connection. The French have a word, "*terrorir*", which has to do with the way the soil and the climate in a given region contribute to the flavor of the food. It's because of the soil's mineral content, the amount of sun, the local vegetation, etc. that milk and cheese produced in one *terrorir* are entirely different from when the same species of cows produce milk and cheese in another. In a sense, every community has its own character or culture—a sort of spiritual *terrorir*. When you mass-produce food or services, you take the *terrorir* out. Such large regional or national organizations work hard to make sure people throughout their organizations are following the same rules, living up to the same standards, working toward the same goals, and reflecting the same values—none of which are in sync with the local community.

Similar books focusing on small businesses are Jason Jennings' *Think Big Act Small* and *The Small-Mart Revolution* by Michael Shuman. Other similar successes are reported in Inc. Magazine, *Big Brands, Small Companies,* Business Week, Small Biz August 13, 2001; Inc. Magazine's, *The Best Little Grocery Store In America,* June 2001, which outsells the big guys in sales per square and a staff that can recognize over 10,000 shoppers by name! They have annual customer retention of 80 percent.

Community Contributions

When Zingerman's celebrated its 20th anniversary, members of the Ann Arbor community tacked a sign on the front of the deli giving thanks for all they had done in support of their community. Underneath were listed the moguls of 13 local nonprofits which would not have existed or succeeded if it were not for Zingerman's. Interestingly, all of them seemed somehow related to Zingerman's spiritual values. The first non-profit they became involved with was Food Gatherers, started in 1988. Seventeen years later, Food Gatherers had collected between two and three tons of food that was still entirely edible but was about to be thrown out by restaurants, hotels, and dining rooms. The nonprofit redistributed this food to those in need. Over 20 years, Zingerman's has played a key role in over a dozen other nonprofits, all of which address problems in the community, such as education and homelessness. Zingerman's plows an enormous amount of money back into social, cultural, and educational vitality in their Ann Arbor community. Even on an in-house, smaller scale, they will match any employee's charitable contribution, two to one.

These practices required Ari Wienzweig, originally CEO, to transition into the new office of CSO, Chief Spiritual Officer. Zingerman's doesn't use these practices as a marketing tool; they do them because it's what they think is right.

Many small giants have found unique ways to support their communities. Anchor Steam Brewing has a fascinating facility in San Francisco which they will open to private charitable groups for a social evening. They tell them they can't sell tickets or require a donation, but they are welcome to make use of the brewery to thank their supporters. The brewery now becomes a civic center, continuing the historical role beer has played in bringing small communities together

From Bo's Blog after* Small Giants *was published:

LESSONS OF A BLUE-COLLAR MILLIONAIRE--ADDENDUM–The Eighth Characteristic of a Small Giant. Friday, January 29, 2010

There is always a lot of good material that does not make it into a magazine story, and that was true of my latest article in *Inc*., "Lessons from a Blue-Collar Millionaire." I think my editor was wise to have me structure the article as I did, but in the process I lost parts of the story that may be of interest to you and that have a direct bearing on the concept I refer to as *trust-and-track*. So I thought I would share the missing details in this blog. I will be repeating some of the points I made in the article, but I think it will help to understand the context.

When I interviewed Nick Sarillo, we talked at length about the problems he had had with the previous round of general managers he had hired to run his restaurants. He had eventually concluded that, nice as they were as human beings, they were so steeped in the practice and habits of command-and-control that they could not change, and they thus were inadvertently undermining the culture that Sarillo had been trying to develop. Coming to grips with those issues had been a difficult experience for him, but also an important one, not least because one of the general managers was somebody he had been very close to, both personally and professionally.

That person—we will call him Gerald—had come to Nick's Pizza and Pub in 2004 after working for Brinker International, which owns Chili's and other casual dining chains. By then, Sarillo and his partner, Chris Adams, were already committed to growing the business. (They eventually settled on a goal of having five restaurants by 2010.) Recognizing that they would need experienced managers to run the restaurants, they had hired Gerald to open the second Nicks, in Elgin, and he had done a spectacular job, as measured by the growth in sales in the first year. With that success under their belts, the partners turned their focus to the next target on their radar screen, Chicago, and began recruiting the additional people they would need as the company grew.

As I mention in the article, the Chicago restaurant ultimately fell victim to the financial crisis in the summer of 2008, when the company lost its bank financing. Meanwhile, the recession was taking its toll on the other two restaurants, where sales were down more than 13 percent and food-and-beverage costs were higher than they should have been. Sarillo and Adams realized they could lose everything if they did not fix those problems. So Sarillo dove back into operations at the Elgin restaurant, while Adams focused on Crystal Lake.

It did not take long for them to realize that the problems went deeper than they had imagined. Sarillo discovered, for example, that the manager at Elgin was not handling the beverage- and food-buying the way he had been trained. That was why the restaurant's costs were out of control. Sarillo questioned him to make sure he knew how the systems were supposed to work, and he appeared to understand, but week after week the purchases did not line up with the inventory counts. When Sarillo did it himself, the numbers worked out fine. So why could he do it and this guy could not?

At the same time, Sarillo was hearing from Adams about cultural problems at Crystal Lake, where Gerald had been serving as general manager. For months, Rudy Miick—the consultant I mention in the article—had been warning that Gerald was not practicing what the company preached, but Sarillo had not wanted to hear it. "I liked him. He was a great guy. And with all the stuff I had on my plate, I did not want to believe that one of our best leaders might be a problem."

But he could no longer ignore the evidence before him. "I was really shocked at how off-track we were with the training and the culture, and how little follow-through there was on the systems," he said. "I called my dad and said, 'I cannot believe what I am finding. There are so many things I thought we were doing, but we were not. What I assumed Gerald was following through on he was not doing at all!'"

Looking back, he realized that he had missed some clues. For example, it is very common for employees at Nick's to do a lot more than is in their job description. When I asked several of them why they did the extra stuff, they all told me that they thought it would help them become better leaders in the long run, or that they loved the company and wanted to do whatever was necessary to make it successful. In contrast, Sarillo said, when Gerald would ask people to do something extra, they would want to know how much more they were going to get paid to do it. In retrospect, Sarillo realized that this was a sign of an us-versus-them mentality creeping in. It should have tipped him off, he said, that something was amiss with the culture at Crystal Lake.

All that got me thinking about different approaches to management. I was familiar with command-and-control—we all are—but Sarillo's experience made me realize that it has more nuances than I'd previously been aware of. When I hear command-and-control, an image of a drill sergeant springs to my mind. I imagine a boss barking orders and the grunts doing what they are told. But the command-and-control mentality is often far more subtle. It can reside in the nicest of bosses, including some who talk the language of empowerment and employee involvement. You can find them practicing command-and-control even in ostensibly people-friendly environments. Under Gerald and the other general managers, the culture of Nick's was very people-friendly. Employees liked working there. Why not? Gerald, et. al. were nice guys and good bosses, as traditional bosses go. It is not hard for employees to adapt to a command-and-control boss who is not a jerk. Most of us do not mind taking orders if they are sensible, and many of us would just as soon have the boss take responsibility for the success or failure of the company (or the department, or the project, or whatever). It relieves everyone else of the burden of worrying.

But in trying to explain what Nick had discovered, I ran up against an obstacle. What exactly was the alternative way of running a business that he was trying to promote? I mean, what do you call it? It was obviously incompatible with command-and-control, but it did not have a name, which made it more difficult to explain and discuss. Sarillo was hardly the only person trying to come up with such an alternative to command-and-control. His management philosophy was very similar to those of a lot of other people and companies I had written about. Jack Stack and his colleagues at Springfield ReManufacturing Corp. (now SRC Holdings) were trying to do the same thing way back in 1984, when they began implementing the Great Game of Business, their system of open-book management. So were most of the companies in my book Small Giants. Zingerman's Community of Businesses in Ann Arbor is a prime example, not to mention Clif Bar in Berkeley, CA, and Union Square Hospitality Group, the restaurant company started by Danny Meyer. Then there is Joie de Vivre Hospitality, the California hotel chain founded by Chip Conley, author of *Peak*. And Joe Cirulli's Gainesville Health and Fitness in Gainesville, FL, which I wrote about in the August 2008 issue of Inc. As I looked at the list, I realized that it read like a who's who of iconic, privately owned, small-to-midsize companies.

So what should we call the type of management they practiced? I asked Jack Stack that question, and he suggested *trust-and-delegate*. That did not have quite the ring of command-and-control, but I figured it would do until I came up with something better. A couple of weeks later, I was in Munich attending a conference, and I discussed the matter with my friend Steven Wilkinson of Buchanan AG, a private equity firm based there. When I mentioned the phrase trust-and-delegate, Steven rolled his eyes and said, "Yes, I tried that, and it cost me a fortune." We talked it over and agreed that the phrase was missing something. You needed another element beyond trusting and delegating or you could get into a lot of trouble. We came up with trust-delegate-and-monitor. Otherwise, Steven noted, you were really practicing trust-and-hope.

But trust-delegate-and-monitor was a mouthful. I figured we could do better. I recalled the phrase that Reagan had used when negotiating nuclear weapons agreements with the Soviet Union: trust-but-verify. I thought maybe trust-and-verify would do the trick. Then, in early December, I had a meeting in New York with Paul Spiegelman, CEO of the Beryl Companies, and Ping Fu, CEO of Geomagic, as we prepared to launch the first of the Small Giants Safaris. (For more information about these, check out www.smallgiants.org.)

They didn't like the sound of trust-and-verify. We batted around some ideas before hitting on trust-and-track. Eureka! It struck me as the perfect name for an alternative to command-and-control.

I am sharing all this because, as Steven says, ideas only become personalities when they are christened and given a name. Trust-and-track now has a name, but its personality remains to be developed. I am hoping that all of you who are intrigued by the concept will join in that effort.