STRATEGY

Breaking Through

BY MIKE HOFMAN @MIKEHOFMAN

How companies just like yours mushroomed into powerhouses in their industries. A conversation with Keith R. McFarland.

Ten years from now, who will fly in the private jet--you or the guy next to you at the trade show? Which company in your industry is most likely to grow by leaps and bounds and why? These are the questions Keith R. McFarland tackles in his new book, The Breakthrough Company*, published this month by Crown Business. McFarland is a management consultant and the former CEO of Collectech Systems, a collection agency for telecom companies. An acolyte of Peter Drucker, McFarland once asked the management guru how to tell which companies in an industry were likely to grow large. "I don't know," Drucker replied. "You need to write that book." And so he has. McFarland did in-depth studies of nine* Inc. 500 alumni that had reached more than $250 million but less than $2 billion in annual sales by 2004. The idea was to examine companies big enough to have overcome major obstacles but still small enough that McFarland could see the patterns that led each company to its breakthrough moment. Why do some companies grow so dramatically, while others just shuffle along? McFarland recently shared his findings with *Inc.* executive editor Mike Hofman.

How do you create a breakthrough company? Where do you start?

First, I'd say that it's not about being in a hot, sexy market. It's not about having the coolest, hippest product. We came up with an index of companies that grew to a certain level both in terms of their annual revenue and in terms of their financial performance, compared with the rest of their industry. And the breakthrough companies we identified came from all different worlds. Sure, some of them make software, but others provide professional services like leasing office space or staffing or processing payroll. Chico's sells women's clothes, and Fastenal distributes tools and nuts and bolts. This tells me that within every company in every kind of industry, there are the seeds of breakthrough.

What about the people who run these companies? What are they like?

The high-performing companies we looked at had one thing in common--they were almost all run for many, many years by their founders. But these entrepreneurs don't share a common personality type, and they do not create businesses where there is a focus on the personal characteristics of the entrepreneur. They don't see themselves as responsible for the vision of the company. Rather, they seek to create an environment where people understand the strategy and can spot strategic opportunities as they crop up. Breakthrough leaders are less concerned with people's personal loyalty to them and more concerned about building a place where everybody is loyal to the company first--even if that means disagreeing with the big cheese. The founders of breakthrough companies appear to be good at getting out of the way. In every case we looked at, the leader was proud of the organization but decidedly humble about his role within it.

Are you saying they are wallflowers?

No, this isn't to say that these guys are overly humble or timid. They are all different types. Tom Golisano, who runs the large payroll processing company Paychex, has a big, commanding personality. In contrast, Mark Smith, founder of Adtran, a telecommunications company, whom I interviewed shortly before he died, was an engineer and spoke with an engineer's pattern of speech. He was very careful in the language he used when he spoke. In general, these men are as different as you can imagine. But they share a perspective about business, an insight about how people work. They all see that it is very important that the company not be about them.

Let me give you an example: One breakthrough company is Staubach, the commercial brokerage business run by Roger Staubach, the same Roger Staubach who was the quarterback of the Dallas Cowboys for many years. I went to interview him for this book, and I walked into his office, and the first thing out of my mouth was, "Roger, where are your Super Bowl rings? Where's your Heisman trophy?" And he said, "No, we're building something much bigger here than Roger Staubach." I thought that was a throwaway line, but then I heard variations of it again and again. The CEOs who run these breakthrough companies take a different view of their role than other CEOs I know.

What does that mean in practice?

They are very tolerant of people within the company who insult the business and who insult the strategy they have come up with. By that, I mean that when employees say something in the business is screwed up, the entrepreneurs don't tell them to shut up. They also let people pursue ideas for new businesses even when they think they are wrong. The companies are made up of people who really, really want the best ideas to get out there.

What's an example of that?

For years, Tom Golisano resisted collecting payroll taxes. He believed the company should remain focused on processing payroll. He thought the tax collections business would be a distraction. One of his sales executives, Walter Turek, kept after him, and finally Golisano gave in and decided to test the idea. It worked so well that today, payroll tax collections account for an enormous percentage of Paychex's profits.

The same thing happened at Chico's. Marvin Gralnick, the founder of the company, really believed in Pazo, a new hip, low-cost apparel chain, even though it was losing money. But another executive, who succeeded Gralnick as CEO, closed that chain down and invested in upscale stores called White House Black Market. That turned out to be a huge moneymaker for the company--more than $360 million last year. And the company has the highest sales per square foot of any apparel retailer in the country and one of the highest profit margins in the industry.

And when an employee's idea doesn't work out?

The first person I interviewed for the book was Scott Cook, of Intuit. He once gave out a "failure of the year" award to the team within his company that produced a flop that the whole company learned something valuable from. None of these companies are afraid of taking risks. They periodically make big bets in new lines of business. They are curious enough to try new things.

Are these companies great at hiring people?

Yes, but more to the point, they are great at developing people. One statistic that blew me away came from Fastenal, the nuts and bolts distributor. The average tenure among the top 25 employees there is 23 years, which means that the people who ran the company in 1985, when it was small, are running it today, when it has $2 billion in sales. And Fastenal employs 1,500 in Winona, Minnesota, where the local population is roughly 2,700. What Fastenal and these other companies recognize is that to get really big, they have to create a culture that is so easy to learn and live by that ordinary workers can thrive. Fastenal, which is a pretty frugal company, spends very lavishly on rigorous employee training.

What are these founders like as managers?

They are good at settling internal disputes in creative ways. There's a legendary story at Staubach about two brokers getting into a fight over a commission. Roger called them in and heard both sides. There was serious money on the table. Roger said, basically, "Here's what we're going to do. We're going to give the whole thing to charity. And any time we're squabbling over money, let's do something good for the world, because this doesn't get the company anywhere." And you know, I bet he never had to mediate a conflict over a commission ever again.

You mention in the book that, in addition to listening to outspoken employees, these companies look outside the organization for good ideas. How?

The best company builders think like any smart builder--they use the business world version of scaffolding to build their companies. By *scaffolding*, I mean that they relied on outside support and structure while they were building their businesses. To a person, the entrepreneurs I profiled were either active in peer groups like Young Presidents' Organization, or they were tied in very closely with local research universities. SAS, the software company, works very closely with researchers at North Carolina State, and Fastenal has a relationship with the University of Minnesota. Paychex is really smart about using industry analysts at the big investment banks to learn more about trends in its industry.

Marvin Gralnick, of Chico's, went out of his way to recruit the best possible board for the retail industry. Chico's is big, but it isn't one of the top two or three retailers in the country. And yet Gralnick built a board that is a real who's who of retailing, with the former chairman of Macy's, the former chairwoman of the Limited, the vice chairman of Staples, the former CEO of Tommy Hilfiger, and so on. Gralnick says it really helped him to make the decisions he needed to reach a billion dollars.

So many entrepreneurs are afraid of having powerful boards because they don't want to lose control. Or, in the era of Sarbanes-Oxley, they look for board members who will be strong on compliance issues. That's missing an opportunity and focusing on the wrong stuff, I think. Gralnick reminds us of the value of having advisers on your board who can provide you with real strategic advice.

Why do so few companies break through?

Think about what makes small companies successful. They are small, so they can move fast without a lot of organizational friction. They can compete favorably on cost because they have low overhead. Their output per employee is high because there's a *Band of Brothers* environment at most of them. They are close to the customer. But growth by its nature negates these advantages. Breakthrough companies discover different leverage points--like outside advice or strong boards or maverick employees who lead them into new lines of business.

Correction: The original version of this story misstated the cities in Minnesota in which two companies have headquarters. Polaris has headquarters in Medina and has operations in Roseau, while Fastenal is based in Winona.

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