Pathways To Growth

Game-Changing Performance Strategies For Middle Market Companies

A REPORT FROM THE NATIONAL CENTER FOR THE MIDDLE MARKET

NATIONAL CENTER FOR
THE MIDDLE MARKET

In Collaboration With

THE OHIO STATE UNIVERSITY
FISHER COLLEGE OF BUSINESS

GE Capital

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About This Report

Pathways To Growth in The U.S. Middle Market

THE U.S. MIDDLE MARKET

The U.S. middle market is defined by companies with annual revenues between $10 million and $1 billion. In addition to their geographic and industry diversification, these companies are both publicly and privately held and include family-owned businesses and sole proprietorships. While the middle market represents approximately 3% of all U.S. companies, it accounts for a third of U.S. private sector GDP and jobs. The U.S. middle market is the segment that drives U.S. growth and competitiveness.

SUSTAINABLE GROWTH IN MIDDLE MARKET FIRMS

The purpose of Pathways To Growth is to learn what drives growth in the middle market by examining the real experiences of middle market firms. The recent recession offered a natural experiment for identifying those rare firms capable of growing through difficult times and beyond. This study focuses on firms with sustained growth and investigates whether they have practices worth emulating.

Pathways To Growth examines how some middle-market companies have bucked negative economic and market trends, either through steady, incremental expansion, or through a breakout event, which triggers growth. The study explores factors that drive sustained growth, specifically strength in executing eight well-established dimensions of management, including talent management, innovation, investment management and market expansion. A full list of factors is further explored in this paper.

HOW IS THE RESEARCH CONDUCTED?

The National Center for the Middle Market worked with our own experts and Dr. Gary Kunkle, an authority on middle market companies and economist-in-residence at Inc. magazine. The study began by leveraging available data from a database of 128,000 middle market firms. The data covers a recent seven-year period (2006-2012). Researchers divided the firms between those that grew and those that did not grow during the 2006 -2008 period. The researchers followed these firms to see which companies grew in the post-recession period (2009-2012). In addition, researchers conducted a comprehensive survey of 247 middle market CEOs and other C-suite executives from America's middle market companies to quantitatively understand the key drivers of sustainable growth.

THE NATIONAL CENTER FOR THE MIDDLE MARKET

Founded in 2011 in partnership with GE Capital and located at The Ohio State University Fisher College of Business, the National Center for the Middle Market is the leading source of knowledge, leadership and innovation research on the U.S. middle market economy. The Center provides critical data, analysis, insights and perspectives to help accelerate growth, increase competitiveness and create jobs for companies, policymakers and other key stakeholders in this sector. The Center's website, which offers a range of tools and resources for middle market companies, can be visited at **www.middlemarketcenter.org.**

Executive Summary

The financial crisis of 2008 offered a rare opportunity to study the growth of middle market companies during a period of unprecedented uncertainty. Within this period, research conducted by the National Center for the Middle Market revealed that only a very small proportion of firms—less than 1% of all firms—are Sustained Growers. These firms exhibited a pattern of growth during the recession and went on to double sales post-recession. These Sustained Growers are not merely in a 'lucky' industry or geography. They do not have distinguishing features, such as firm age. Rather, executives in these firms attribute their growth to executional excellence in terms of their corporate vision. Conversely, executives of firms that did not experience such growth point to external factors to explain their less desirable growth patterns.

Our research aimed to better understand how performance on different dimensions of management affects growth patterns. Researchers interviewed and surveyed some 247 executives about eight well-established dimensions of management: talent, innovation, vision, investment management, market expansion, product and markets, internal processes and partnerships. The executives were asked about the importance they placed on each of these dimensions of management. In some cases, the research revealed that growing and non-growing firms placed the same value on management practices. However, the growers were remarkably different in how they executed on these dimensions of management. The growers outperformed non-growers on every one of these dimensions, making executional excellence the notable difference between growing and non-growing firms.

Middle market firms looking to drive growth within their own organizations should consider emulating the top practices of the Sustained Growers, which include:

- **+ RETAIN TALENT**
- **+ DEVELOP A PROCESSES FOR EVALUATING INNOVATION IDEAS**
- **+ SPELL OUT MANAGEMENT FOCUS**
- **+ MAINTAIN CLOSE RELATIONSHIPS WITH CREDIT PROVIDERS**
- **+ EXPLORE DOMESTIC MARKETS FOR EXPANSION**
- **+ FOCUS ON CORE PRODUCTS**
- **+ WATCH THE FINANCIAL HEALTH OF THE FIRM**
- **+ INTEGRATE BETTER WITH KEY PARTNERS**

By implementing these best practices in their own organizations, middle market firms may be able to achieve and sustain growth, even in a slow economy.

[1] *Kunkle, Gary, 2013. Building scale and sustaining growth: The surprising drivers of job creation. Institute for Exceptional Growth Companies*

Key Findings:

FIRMOGRAPHICS DO NOT DETERMINE DIFFERENT PATTERNS OF GROWTH

Within the middle market, growing and non-growing companies are found across most regions and industries. Unlike companies buoyed chiefly by one-off external events—such as the dot-com boom—Breakout and Sustained Growth firms exist in almost every industry, with some variations in prevalence. Furthermore, growers and non-growers show no remarkable differences in geography, firm age or ownership structure.

MIDDLE MARKET FIRMS EXHIBITED FOUR SIGNIFICANT GROWTH PATTERNS PRE, DURING AND POST RECESSION

Research revealed four distinct growth patterns: two types of non-growers (Decliners and Stallers) and two types of special growers that grew post-recession (Breakout Growers and Sustained Growers). Decliners shrunk before, during and after the recession. Stallers initially showed some post-recession recovery, but ultimately did not grow. Breakout Growers suffered during the recession but doubled revenues in the post period. Sustained Growers grew before and during the recession and went on to double revenues in the post period. Sustained growth is clearly the most desired pattern.

FREQUENCY OF GROWTH IS THE BEST PREDICTOR OF FUTURE GROWTH

The best predictor of a middle-market company's financial future is not how fast it grows, but how often it grows. Sustained Growers—those that expand incrementally in most years—are the most likely to survive and thrive. By contrast, Breakout Growers experienced years of flat or negative growth followed by a period of rapid expansion ignited by a trigger event, such as the 2008 financial crisis. Breakout Growers not only recovered quickly from the ravages of the downturn, but also shot off on a trajectory of dramatic growth, easily outpacing the majority of their peers. Both Sustained and Breakout Growers are focused on creating infrastructures and cultures to keep them strong through the inevitable bumps on the road ahead.

NON-GROWERS FOCUS ON EXTERNAL CHALLENGES WHILE GROWERS FOCUS ON EXECUTION

Decliners attributed their fate to external challenges, such as the loss of a major customer, changes in what customers want or organizational challenges. Stallers also blamed external factors: raw material prices were up or technology and processes had changed. Interestingly, the Breakout Growers benefited from external factors, such as better raw material costs or increased demand for their product. To their credit, the Breakout Growers took advantage of the opportunities. In contrast, when asked about the triggers behind their impressive growth, Sustained Growers focused on delivery factors, including innovation, process improvements and restructuring. The Sustained Growers spoke of the fulfillment – or execution – of their vision as opposed to external factors that either hindered or buoyed performance.

PERFORMANCE EXCELLENCE DRIVES SUSTAINED GROWTH

Growers and non-growers alike place value on eight well-established dimensions of management. However, growers rated their performance more effective than non-growers on virtually all dimensions. Specifically, Sustained Growers excelled at retaining talented employees, having a process for transforming ideas into decisions, keeping management focused on growth, maintaining relationships with providers of capital, adding headcount, focusing on core products, making decisions and forming strategic alliances with key suppliers. Clearly, having the right attitude about a management practice is not enough to drive growth. Consistently executing on critical dimensions of management is the key to sustained growth for middle market firms.

Four Significant Growth Patterns
Among Middle Market Firms

For the purposes of this research—comparing middle markets firms that experienced growth with those that did not grow—our researchers identified and concentrated on four distinct patterns of growth. These four growth patterns do not represent all possible growth patterns, however they provide maximum contrast between the growers and the non-growers to facilitate research goals.

In examining the period 2006-2008, half of the middle market firms in the study exhibited growth, whereas the other half exhibited no growth. During the post-recession period of 2009-2011, the non-growers split into two groups:

DECLINERS shrunk in the recession and continued to shrink in the post-recession period of 2009-2011.

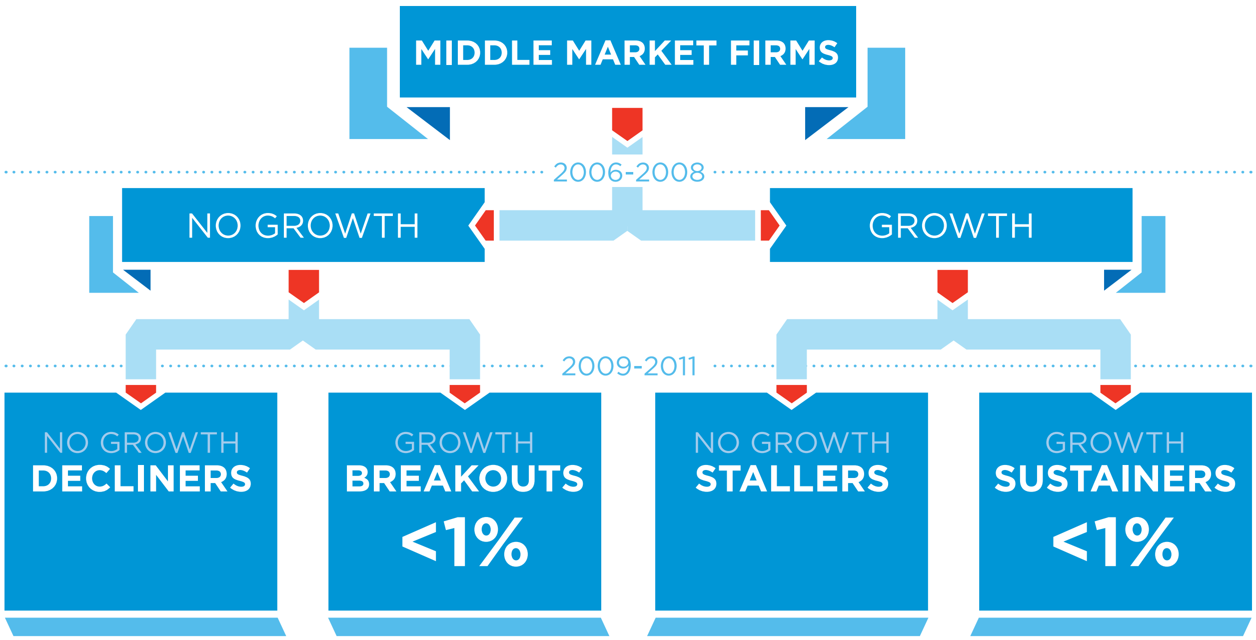
BREAKOUT GROWERS suffered during the recession, but experienced breakout growth and doubled their revenues in the post-recession period.

The firms that grew pre-recession also split into two groups following the recession:

STALLERS showed initial recovery in the post-recession period, but ultimately did not grow.

SUSTAINED GROWERS grew before and during the recession, and went on to double revenues in the post period.

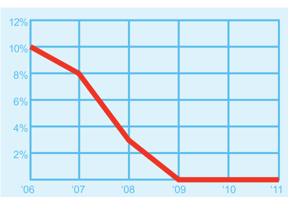
SUSTAINED GROWTH *IS CLEARLY THE MOST DESIRED GROWTH PATTERN.*



NON-GROWERS

DECLINERS

Decline in recession and beyond

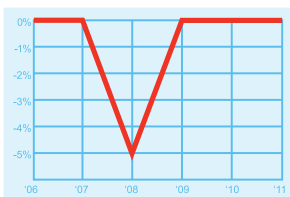


- Loss of major customer
- Change in customer preference
- New organizational structure

EXTERNAL AND INTERNAL FACTORS

STALLERS

Post-recession recovery stalls



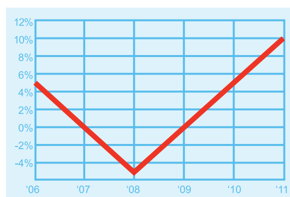
- Raw material price increase
- Change in process/product technology

EXTERNAL FACTORS

GROWERS

BREAKOUTS

Down in recession, but doubled revenue after

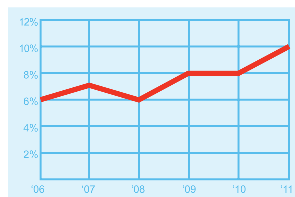


- Increased demand for current product
- Raw material price decrease

EXTERNAL FACTORS

SUSTAINERS

Grew in recession and continued growth



- Disruptive innovation
- Change in process/ product technology
- Acquisition merger

VISION FOCUSED MANAGEMENT

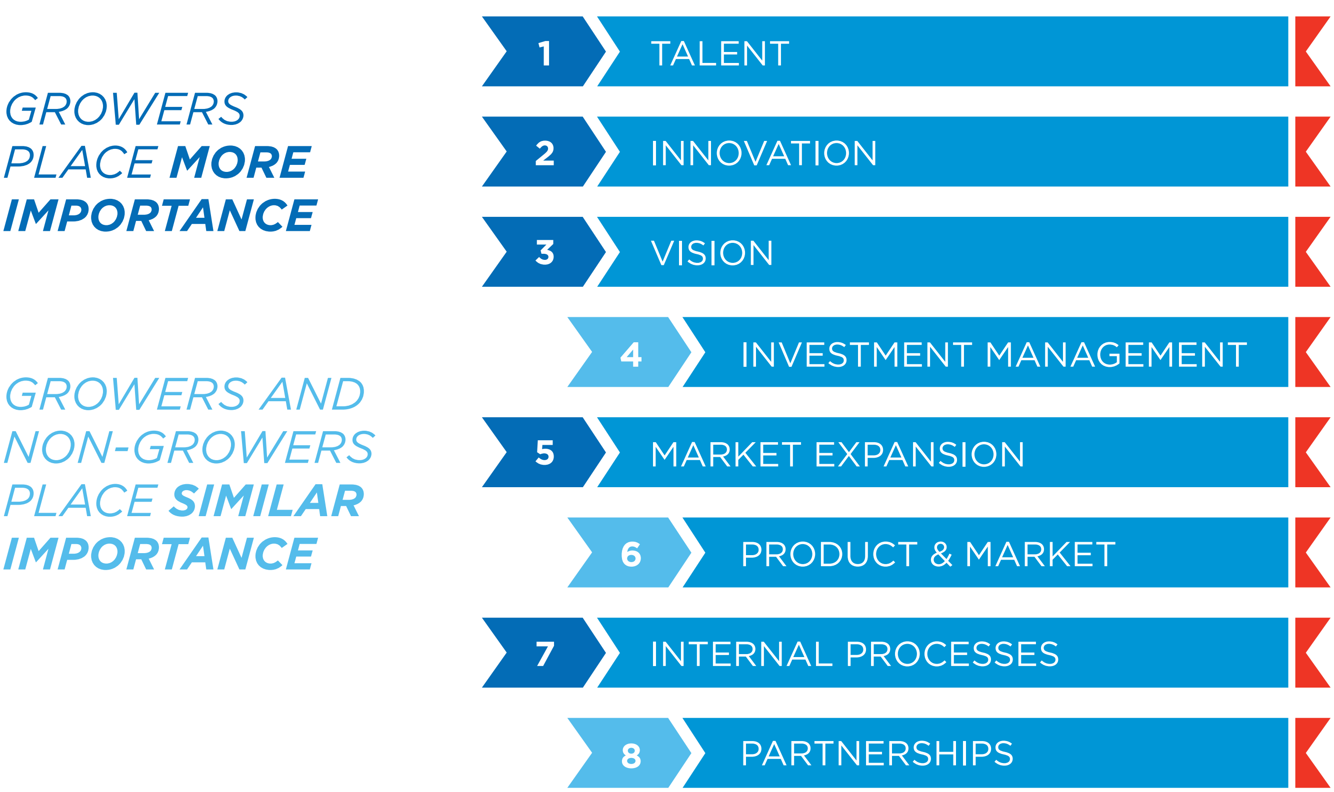
Growers versus Non-Growers:
Differences in Attitudes and Execution

When asked about the importance of eight well-established dimensions of management, the firms in the study tended to have similar attitudes on several regardless of whether they were growers or non-growers. However, when asked how they executed on these dimensions, the research revealed significant differences between the growth groups and the non-growth groups.

Attitude

When combining the responses of the two growth groups (Sustained Growers and Breakout Growers) and comparing to the combined responses of the non-growers (Stallers and Decliners), the growers were more likely to place importance on talent, innovation, vision, market expansion and internal processes than their non-growing counterparts.

DIMENSIONS OF MANAGEMENT



Execution

Despite the fact that growers and non-growers agree, to a certain extent, on which management dimensions are essential to a business, the growers have achieved a level of success that the non-growers have failed to obtain. Clearly, valuing a management practice is not enough to drive growth. Middle market firms must also deliver on those practices, which is exactly what the Sustained Growers do so well.

Across virtually all eight dimensions of management, Sustained Growers consistently rated their companies as outperforming the non-growers on several specific business tactics or functions within each dimension. The Sustained Growers' ability to effectively execute best practices sets them apart from their middle market peers.

Interestingly, these findings are consistent with earlier findings by the National Center for the Middle Market. In the 2012 report Blueprint for Growth: Middle Market Growth Champions Reveal a Framework for Success, the Center showed how middle market Growth Champions—firms that achieved 10%+ revenue growth in 2010/2011—shared similar characteristics. These characteristics included a strong management culture, exceptional talent management, formal growth strategy process, sharper customer focus, broad geographic vision and a focus on innovation, which are consistent with the types of activities at which Sustained Growers excel.

DIMENSIONS OF MANAGEMENT

GROWERS OUTPERFORM *NON-GROWERS ON EVERY DIMENSION*

1. TALENT
2. INNOVATION
3. VISION
4. INVESTMENT MANAGEMENT
5. MARKET EXPANSION
6. PRODUCT & MARKET
7. INTERNAL PROCESSES
8. PARTNERSHIPS

Performance Capabilities
of Sustained Growers

Within each of the eight well-established dimensions of management, middle market companies were asked to rate their performance on specific management tactics or practices. For example, within the talent dimension, companies were asked about their ability to execute on five specific practices: attracting talent, retaining talent, training talent, engaging the workforce and ensuring a skilled workforce. Sustained Growers were most likely to note the strongest performance when it came to retaining talent.

Within the innovation dimension, the Sustained Growers were most likely to indicate effectiveness at evaluating innovative ideas. When it comes to corporate vision, the group was most likely to note management focus on growth as an area of executional excellence.

In the dimensions of investment management, market expansion, product and market, internal processes and partnerships, the most frequently cited capabilities of Sustained Growers were, respectively, maintaining relationships with capital providers, adding head count, focusing on core products, agile decision making and strategically aligning with key suppliers.

	DIMENSIONS OF MANAGEMENT	TOP CAPABILITY
1	TALENT	RETAIN TALENT
2	INNOVATION	PROCESS FOR IDEA EVALUATION
3	VISION	MANAGEMENT FOCUS ON GROWTH
4	INVESTMENT MANAGEMENT	RELATIONSHIPS WITH CAPITAL PROVIDERS
5	MARKET EXPANSION	ADD HEADCOUNT
6	PRODUCT & MARKET	CORE PRODUCT FOCUS
7	INTERNAL PROCESSES	AGILE DECISION MAKING
8	PARTNERSHIPS	STRATEGIC ALLIANCES

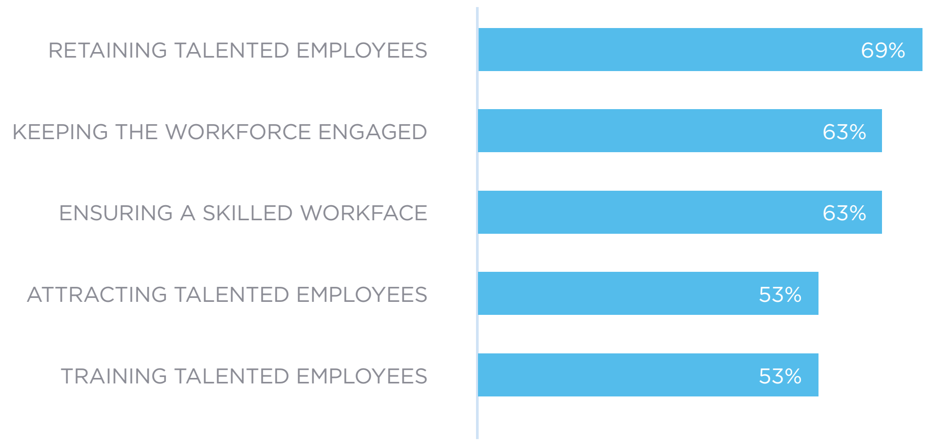
Drivers of Sustained Growth

The ability to execute specific business tactics or actions within each of the eight well-established dimensions of management differentiates the Sustained Growers from the other three growth groups and appears to be the impetus behind the Sustained Growers' enviable growth.

Talent Performance

Within the talent dimension of management, the majority of Sustained Growers indicated very good to excellent performance on all five business actions (retaining talent, attracting talent, training talent, ensuring a skilled workforce and keeping the workforce engaged). Nearly 70% of the Sustained Growers indicated very good to excellent performance in retaining talent, while 63% cited excellent or very good performance in keeping the workforce engaged and in ensuring a skilled workforce.

TALENT PERFORMANCE OF SUSTAINED GROWERS
% RATING AS EXCELLENT/VERY GOOD IN OVERALL PERFORMANCE

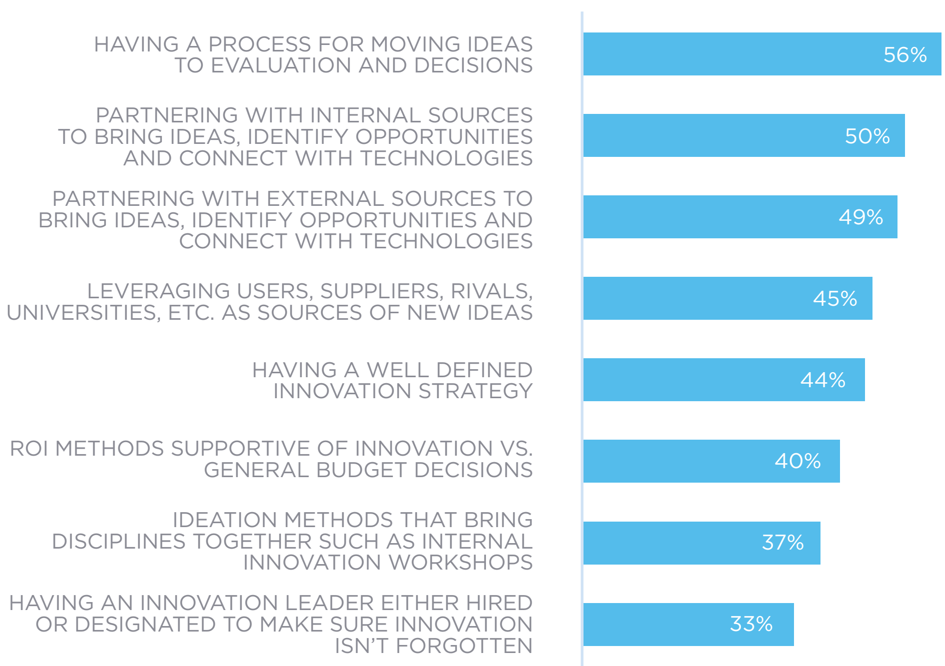


Innovation Performance

Sustained Growers were asked about their performance on eight specific tactics that fall under the innovation dimension of management. A majority of the Sustained Growers indicated that they have a process in place for evaluating ideas (56%) and that they are very good to excellent when it comes to partnering with internal sources on ideas, opportunities and technologies (50%). Nearly half (49%) of the sustained growers rated their companies as very good to excellent in terms of partnering with external sources on ideas, opportunities and technologies.

INNOVATION PERFORMANCE OF SUSTAINED GROWERS

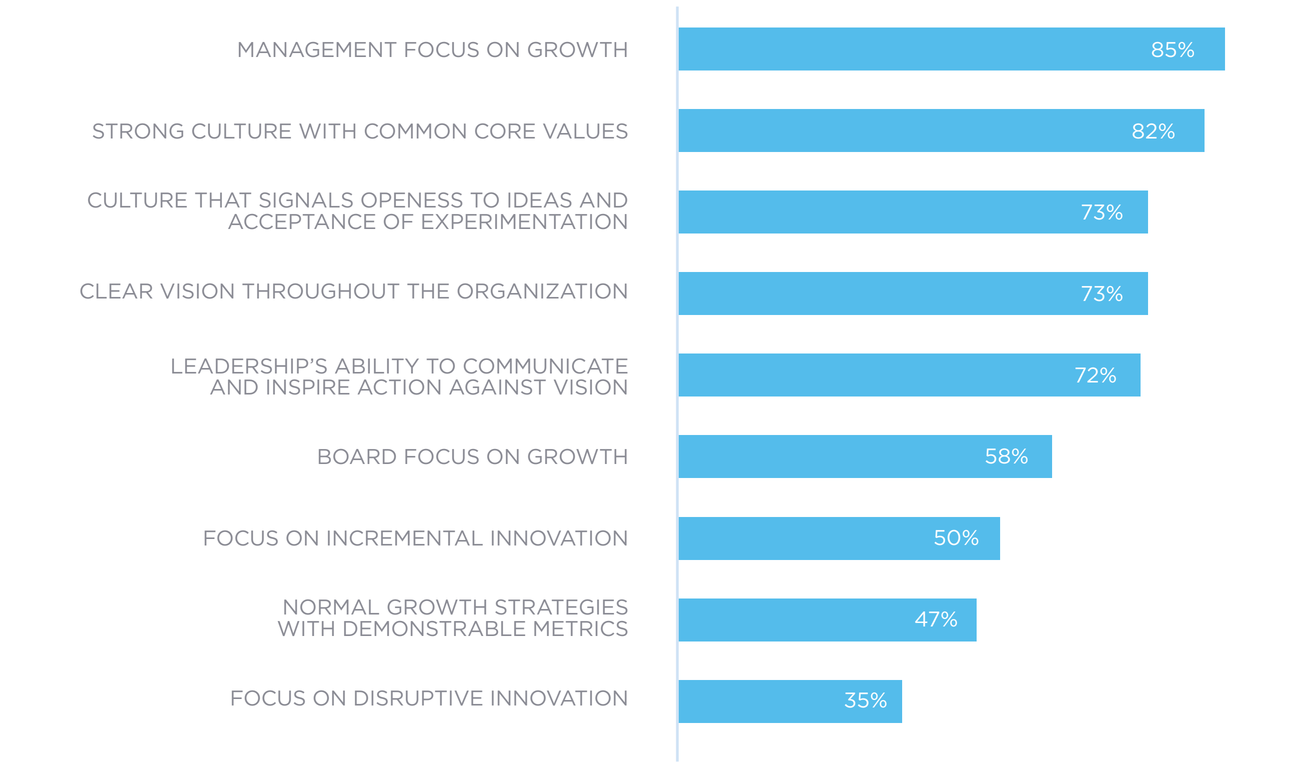
% RATING AS EXCELLENT/VERY GOOD IN OVERALL PERFORMANCE



Corporate Vision Performance

Within the corporate vision dimension of management, a significant majority of Sustained Growers claimed they were very good to excellent at keeping management focused on growth (85%) and at maintaining a strong culture with common core values (82%). Nearly three quarters of Sustained Growth companies considered their organizations adept at creating a culture that encourages ideas and experimentation, projecting a clear vision throughout the organization and communicating leadership's vision.

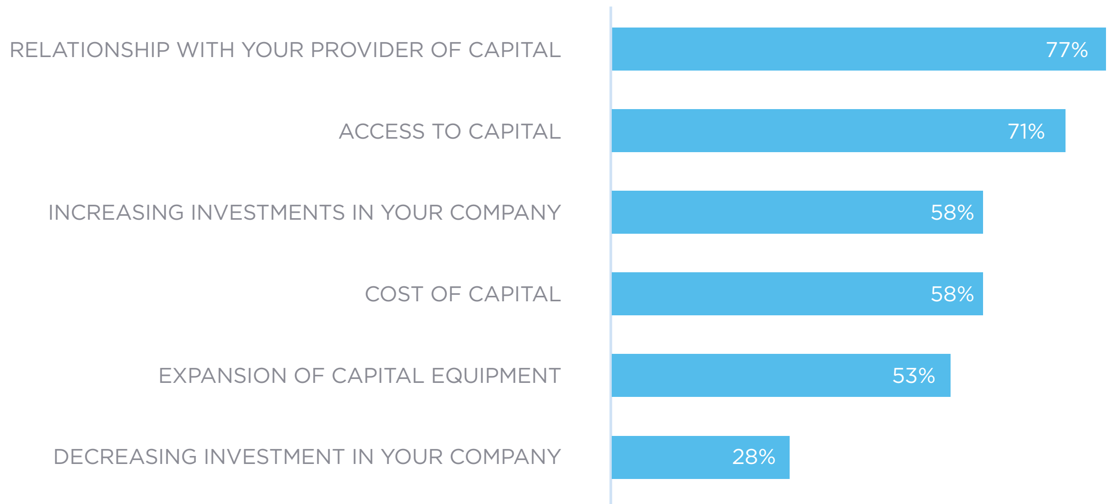
CORPORATE VISION PERFORMANCE OF SUSTAINED GROWERS
% RATING AS EXCELLENT/VERY GOOD IN OVERALL PERFORMANCE



Investment Management Performance

Within the investment management dimension, the Sustained Growers were most likely to cite very good or excellent performance when it came to maintaining relationships with capital providers (77%) and accessing capital (71%). In addition, a majority of the Sustained Growers believed they were executing well in terms of increasing investment in the company, controlling the cost of capital and expanding capital equipment.

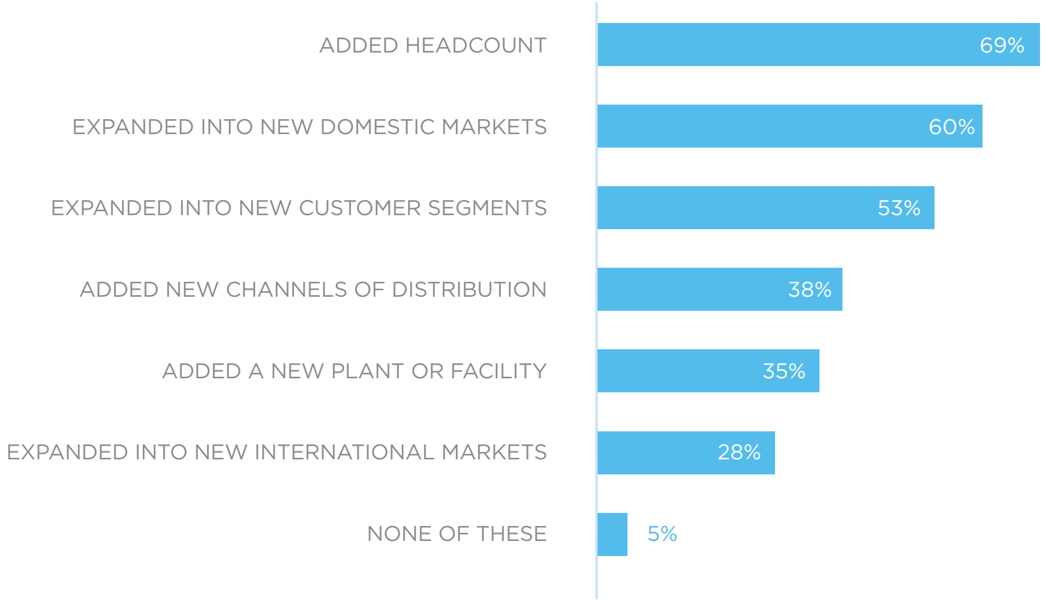
INVESTMENT MANAGEMENT PERFORMANCE OF SUSTAINED GROWERS
% RATING AS EXCELLENT/VERY GOOD IN OVERALL PERFORMANCE



Market Expansion Performance

Virtually all (95%) of Sustained Growth companies have taken some action to expand markets over the past five years. The majority of these companies have added headcount, expanded into domestic markets and expanded into new customer segments. The Sustained Growers were somewhat less likely to add new channels of distribution, add a new plant or facility or expand into new international markets to achieve their expansion goals.

MARKET EXPANSION PERFORMANCE OF SUSTAINED GROWERS
% RATING AS EXCELLENT/VERY GOOD IN OVERALL PERFORMANCE

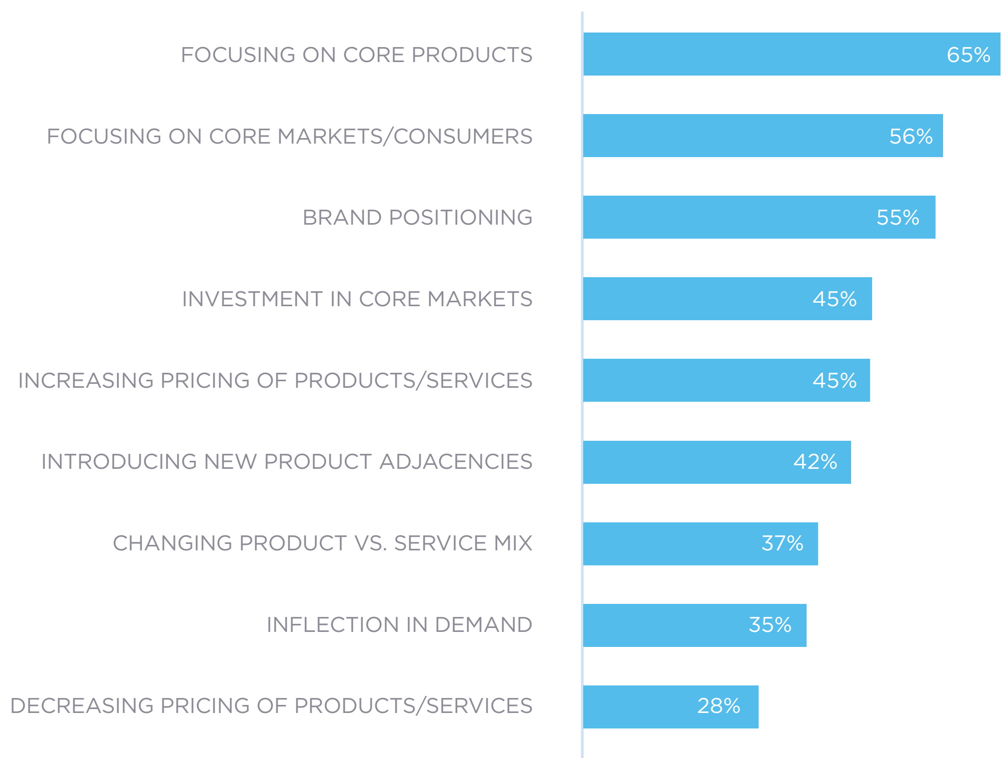


Product and Market Performance

When queried about performance on nine different product and market-related activities, more than half of the Sustained Growers indicated very good to excellent performance on three elements: focusing on core products, focusing on core customers and brand positioning. Nearly half of the companies felt their performance was enviable in terms of investing in core markets and increasing the price of products and services offered.

PRODUCT AND MARKET PERFORMANCE OF SUSTAINED GROWERS

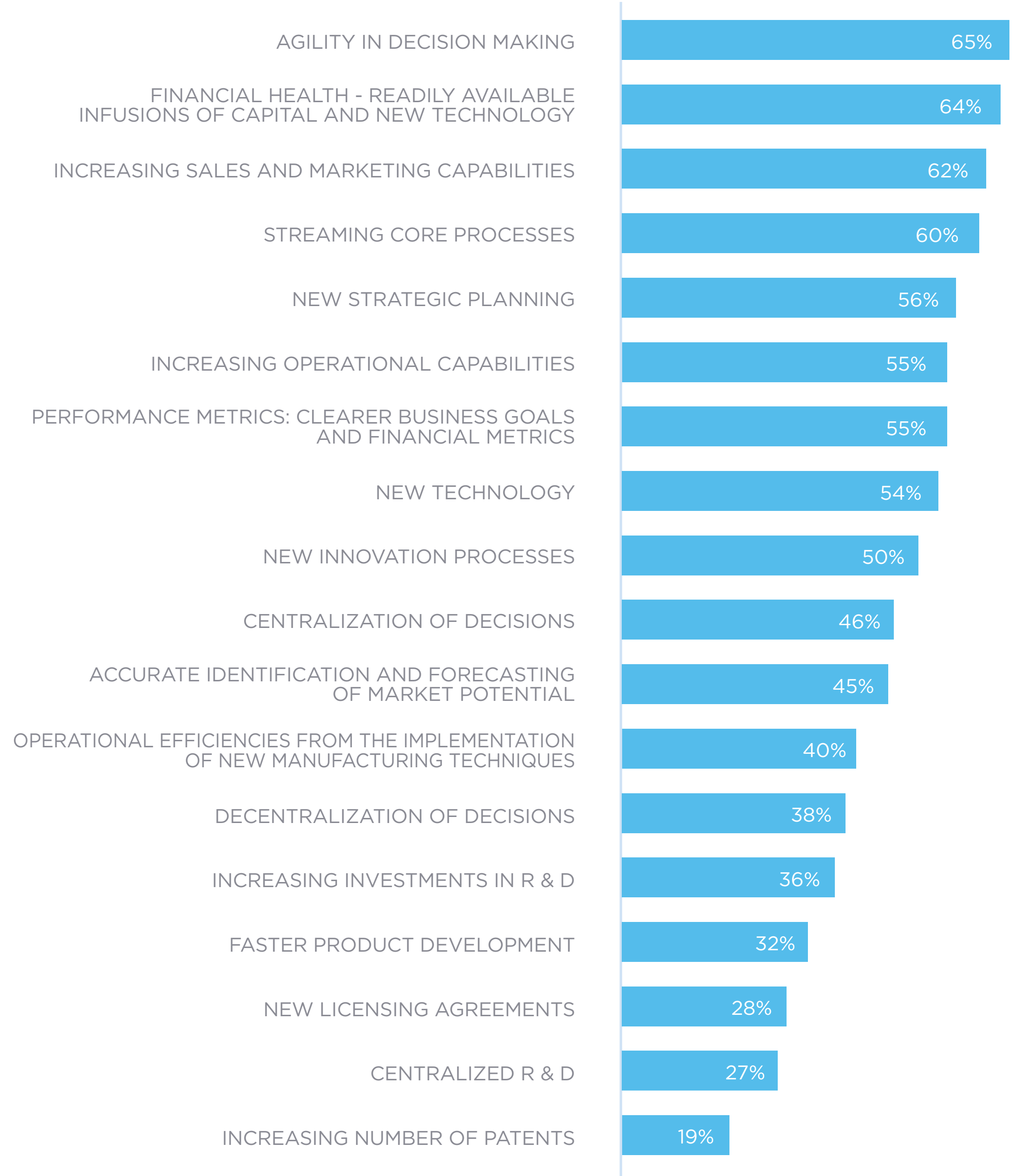
% RATING AS EXCELLENT/VERY GOOD IN OVERALL PERFORMANCE



Internal Process Performance

Sustained Growers are highly likely to perform well on a wide variety of internal process functions. Specifically, 65% demonstrate agility in decision making, while 64% are satisfied with their financial health and 62% are effectively increasing sales and marketing capabilities. In addition, a majority of Sustained Growers are well-versed at streamlining core processes, increasing operational capabilities, clearly defining performance metrics, implementing new planning processes and embracing new technology.

INTERNAL PROCESS PERFORMANCE OF SUSTAINED GROWERS
% RATING AS EXCELLENT/VERY GOOD IN OVERALL PERFORMANCE

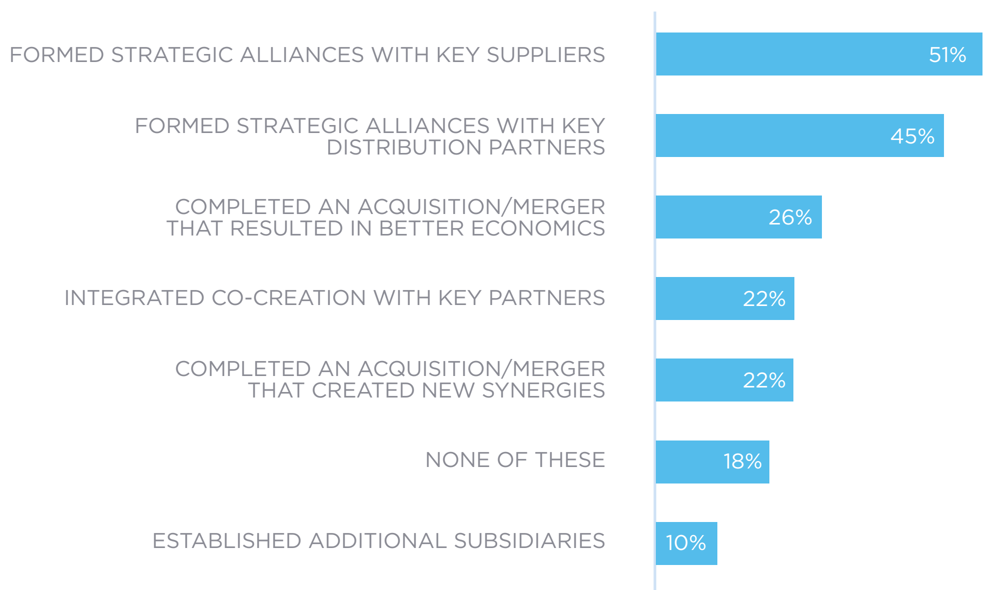


Partnership Performance

Over the past five years, 82% of Sustained Growth companies have made an effort to strengthen business partnerships. The companies focused primarily on working with suppliers and distribution partners. Specifically, just over half (51%) of the companies formed strategic alliances with key suppliers, while nearly half (45%) formed strategic alliances with key distribution partners. About a quarter of Sustained Growers completed an acquisition or merger that resulted in better economics for the company.

PARTNERSHIP PERFORMANCE OF SUSTAINED GROWERS

% RATING AS EXCELLENT/VERY GOOD IN OVERALL PERFORMANCE



Case Study

Sustained Grower: Torani Syrups and Flavors

Torani Syrups and Flavors has thrived for almost 90 years. The secret to the San Francisco-based company's success? Its executives continuously anticipate rough patches and build new roads to overcome challenges. To avoid the inter-generational stumbling blocks common among family businesses, Torani brought on Melanie Dulbecco as its first outside CEO in 1991. Rather than trying to build out the distribution channel itself, Torani partnered with coffee roasters by reviving the company's original product line and adding flavored lattes.

In 2003, the company was enjoying double-digit growth, but Dulbecco and her team sensed a maturing café market. So they launched a vision and long-range planning process with the entire staff, customers and business partners. To achieve the goal of tripling sales by 2012, the company began intensively training and coaching the existing leadership team—including Dulbecco—and recruiting key new members. Torani also focused on innovation—new products included smoothie bases—and developed the retail market.

Cash flow from operations plus excellent long-term relationships with banks helped fund investments, which included technology that allowed the business to keep headcount stable. Torani experienced just one year of flat growth, in 2008. Since then, sales have doubled, thanks to thoughtfully deployed people and processes and constant communication with staff.

"What was wonderful is when we hit [the recession] we had a new executive team in place with really good new strategic thinking," said Dulbecco." And we still had a lot of people in the organization who had been with us through it all."

COMPANY	TRIGGER	ACTION	RESULTS
CA-based manufacturer thriving for over 90 years. Torani®	First non-family CEO, Melanie Dulbecco in 1991. By 2003, a maturing coffee market. Then, The Great Recession hit.	**Talent Development** Intensive training and coaching **Innovation** Developed new smoothie bases. **Corporate Vision** Launched visioning and long-range planning process. Formed excellent relations with banks to fund investments.	Sales doubled since 2008.

NATIONAL CENTER FOR
THE MIDDLE MARKET

The National Center for the Middle Market is the leading source of knowledge, leadership, and innovative research focused on the U.S. Middle Market economy. The Center provides critical data, analysis, insights, and perspectives to help accelerate growth, increase competitiveness, and create jobs for companies, policymakers, and other key stakeholders in this sector. Stay connected to the Center by contacting middlemarketcenter@fisher.osu.edu.

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Fisher College of Business at The Ohio State University is dedicated to training the next generation of business professionals through world-class faculty and a highly innovative curriculum elevated by close partnerships with industry leaders. The market has spoken: a recent survey of corporate recruiters conducted by The Wall Street Journal ranked Fisher second in the nation among business schools with the most sought-after graduates. Stay connected to Fisher via Twitter.

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