

Serving Second-Stage Companies

By Penny Lewandowski and T.J. Becker

A DIFFERENT APPROACH TO CLUSTER DEVELOPMENT

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INTERNATIONAL
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*The Power of
Knowledge and Leadership*



serving second-stage COMPANIES

By Penny Lewandowski and T.J. Becker

For the last two decades, industry cluster development (the geographic concentrations of companies, suppliers, service providers, and institutions in a particular field) has generated considerable interest – and opinions – in economic development circles. Many view clusters as the key to growing jobs, attracting new companies to a region, and catching the attention of funders and press.

Yet instead of only focusing on specific industries, why not target and support growth entrepreneurs according to their stage of development? This is an alternative view of cluster development that's intriguing because it enables entrepreneur support organizations (ESOs) to look at – and serve – their audience in a very different way.

Growth companies can be found in all sizes of firms and share commonalities within their respective developmental stage. For example, startups need help with business plans, microfinancing, product development, and finding initial customers. In contrast, second-stage businesses already have a proven product or service under their belts. They're dealing with more strategic issues as they strive to gain a stronger foothold in the market and win more customers. And larger companies have altogether different needs. (See sidebar)

Whether they're in construction or bioscience, animal health or alternative energy, when it comes to business dynamics, entrepreneurs in the same stage put on their pants the same way each morning. Think of it as a horizontal cluster cutting across industries instead of a vertical cluster aligning a specific industry.

Both industry- and growth-oriented strategies are important to balanced economic development, but



Economic gardening, an entrepreneur-oriented strategy for economic growth, is especially effective for helping second-stage companies.

the former is more often served by industry-specific organizations. This leaves entrepreneur stage clusters as a wide-open field for ESOs and economic development organizations (EDOs) – which can be especially important in a region where business assistance has become a saturated market.

THE SIGNIFICANCE OF SECOND STAGE

Founded in 1985 to support entrepreneurship, the Edward Lowe Foundation focuses on second-stage companies (those with 10 to 99 employees and about \$1 million to \$50 million in annual revenue) because it believes they have the greatest impact on the economy. Take job creation: From 1993 to 2008 second-stage companies represented only 11 percent of U.S. resident establishments but nearly 36 percent of jobs, according to YourEconomy.org, the foundation's online research tool, which uses data from the National Establishment Time-Series (NETS). During that same period, second-stagers generated 25 percent positive U.S. job growth, more than double their market share.

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Established in 1985, the Edward Lowe Foundation is a nonprofit organization that supports entrepreneurship through research, recognition and educational programs, which are delivered through entrepreneur support organizations (ESOs). The foundation has a secondary mission of land stewardship and is committed to preserving the natural resources and historically significant structures at Big Rock Valley, its 2,600-acre home in southwest Michigan.

A DIFFERENT APPROACH TO CLUSTER DEVELOPMENT

Industry clusters have long been a hot topic in economic development circles. Yet there's an alternative view of cluster development: Targeting growth entrepreneurs not by industry but according to their stage of business development. This article looks at why stage cluster development makes sense – especially when it comes to second-stage companies – and how support organizations can identify and reach out to this significant segment of entrepreneurs with resources that will help them continue their growth journey.

In addition to their disproportionately larger share of jobs, second-stagers often have national or global markets, so they bring outside dollars into their community. Many are setting new trends in innovation and discovery. And they help boost a community's human capital by recruiting talented employees.

Although funding and resources exist for small business and startups, second-stagers have traditionally been ignored in the business-assistance market. Yet that's starting to change due to the recent recession and a growing awareness of how many jobs second-stagers create. Indeed, while the foundation was pushing the concept of second stage for many years, now we see it starting to pull us. More organizations are recognizing the significance of this alternative cluster and are developing resources to help it continue growing.

GRABBING THEIR ATTENTION

Yet serving second-stagers is no cakewalk. And finding them can be downright painful.

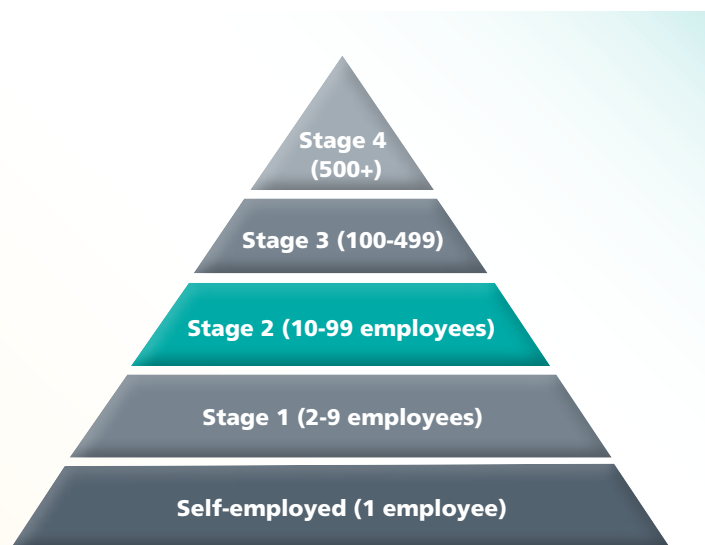
Chalk it up partly to the phenomenon Michael Gerber identified in "The E-Myth." Second-stage entrepreneurs are so busy working in their businesses that they don't have time to work on them. They don't have time to read an e-newsletter about government resources that are available to them. They don't have time to accept a visit from a representative of their community college or SBDC.

If you want to get them to attend an event, it's going to take more than an email invitation. Be prepared to make repeated phone calls – and you may even need to show up on their doorstep for some serious arm-twisting.

So what will draw them out of the woodwork? In our experience, it's the programs and events that specifically target their pain points or bring them together with individuals and resources that, in everyday life, are challenging for them to access.

Many organizations have had tremendous success with CEO forums where growth entrepreneurs hear how founders of larger companies have grown their business. Take the Economic Development Council (EDC) of Collier County (FL), which holds CEO forums on a quarterly basis. Not only do these events help entrepreneurs network with each other, they also help the EDC build relationships with second-stagers and serve as an entry point to other programs and services it offers.

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AN ANATOMY OF BUSINESS STAGES

When discussing business stages, the Edward Lowe Foundation uses five different categories, based on employment:

Self-employed (1 employee) — This includes small-scale business activity that can be conducted in homes (cottage establishments) as well as sole proprietorships.

Stage 1 (2-9 employees) — This includes partnerships, lifestyle businesses, and startups. This stage is focused on defining a market, developing a product or service, obtaining capital, and finding customers.

Stage 2 (10-99 employees) — At this phase, a company typically has a proven product, and survival is no longer a daily concern. Companies begin to develop infrastructure and standardize operational systems. Leaders delegate more and wear fewer hats.

Stage 3 (100-499 employees) — Expansion is a hallmark at this stage as a company broadens its geographic reach, adds new products, and pursues new markets. Stage 3 companies introduce formal processes and procedures, and the founder is less involved in daily operations and more concerned with managing culture and change.

Stage 4 (500 or more employees) — At this level of maturity, an organization dominates its industry and is focused on maintaining and defending its market position. Key objectives are controlling expenses, productivity, global penetration, and managing market niches.

Granted, these are soft boundaries that fluctuate depending on a company's industry. Yet because the categories reflect management and compliance issues occurring at different developmental stages, they work well for building a framework to find and serve growth companies. The foundation has been using these stages for several years and they resonate well with both entrepreneurs and support organizations.

Similarly, recognition events such as the foundation's Companies to Watch awards program have multiple benefits. For honorees, it offers increased visibility, new business opportunities and a chance to meet and interact with other growth entrepreneurs. And through its nomination and judging process, Companies to Watch helps support organizations – both those who host the event and those who often serve as event sponsors – garner introductions to companies that are typically difficult for them to meet or even know about.

"The Companies to Watch program is a great filter for us," says Jeff Barry, a partner at Plymouth Management Co. in Ann Arbor, MI, which manages two venture capital funds.



Recognition programs like Companies to Watch not only celebrate fast-growing companies, but can provide ongoing opportunities for entrepreneurs to network and grow.

Plymouth typically looks for growth companies in the Great Lakes region that have \$1 million to \$10 million in annual revenue with scalable products and intellectual property that can be protected. "About half of the Companies to Watch honorees meet that initial criteria for investment, which means they're an excellent source of deal flow," Barry says.

THE POWER OF PEER LEARNING

Similar to organizations that serve specific industry clusters, when developing resources to serve a business stage cluster, it's important to understand their MO.

Although startup entrepreneurs are eager to show up for a workshop or seminar, second-stagers are skeptical of traditional educational venues and networking. They prefer to learn from people who have walked in their shoes – or are walking in them now. That's why peer learning is a cornerstone for many of the foundation's programs, such as PeerSpectives roundtables.

Led by trained facilitators, PeerSpectives roundtables typically involve 8 to 12 business executives from non-competing industries. The system revolves around con-

fidentiality and experience-based learning rather than advice giving, and it features a structured protocol that ensures a balanced discussion.

Participants may be initially hesitant about the cross-pollination of industries, but quickly find out that it's actually a huge advantage, especially when it comes to innovative thinking. Trying to solve problems with people in the same industry typically heads down a path of conventional thinking while industry outsiders can remove blinders and lead to breakthrough solutions.



COMPANIES TO WATCHSM
CELEBRATING SECOND-STAGE ENTREPRENEURS

Below is some feedback from PeerSpectives participants:

"From roundtable discussions, I've gotten new ideas about cash flow management, how to better communicate with bankers and leverage assets. Other big takeaways have been on personnel. In the past, I didn't look ahead and anticipate staffing needs, which resulted in hiring too quickly – and bringing on the wrong candidates. Now I've learned to be proactive and be on the lookout for candidates before we become desperate. I've also learned how to handle the firing process better and do it with grace and respect. No leader likes firing anyone, but it's important to prune your garden at times in order for it to grow."

– Jerry Singh, president and general manager of RTI Laboratories in Livonia, MI

"Even if you don't have use for the information at the moment, you'll have use for it at some point. It's like a case study that I get to see in action each month – and how it plays out over the year."

– Tim Walter, founder of T.F. Processors in Elk Grove Village, IL

"Hearing others talk through their issues gives me insight into how people process problems. There have been many 'aha' moments when I can see why a problem exists for someone else, and how it might exist in some form in my business. And even if I don't have that specific issue, I might have a process for solving it that I can share."

– Christen Carter, founder of Busy Beaver Button Co. in Chicago

Whether it's a structured discussion, experiential exercise or casual campfire chat, peer learning is the cornerstone of the foundation's leader retreat program.



In addition to solving mission-critical problems, peer-learning programs solve a big problem for many entrepreneurs: isolation.

Peer learning is also a major component of the foundation's leader retreats, which are held at its 2,600-acre learning campus in southwest Michigan. Similar to the PeerSpectives roundtables, leader retreats help participants think differently and glean insights on a wide variety of issues – from personnel issues to aligning mission and vision.

In addition to solving mission-critical problems, peer-learning programs solve a big problem for many entrepreneurs: isolation.

"Entrepreneurs are lonely animals," points out Pete van der Harst, president of Portable Church Industries Inc. in Troy, MI, and one of the foundation's retreat participants. "We don't believe anyone on the earth is doing anything even close to what we are. So being able to bump into a group of people and finding out that – whether they're making jam, designing tile or doing computer-tech support – we're all dealing with the same basic issues builds a lot of camaraderie."

John Coleman echoes these sentiments. "When I signed up for the retreat, I wasn't sure what to expect, but meeting the other second-stage business owners was terrific," says Coleman, president of LookInTheAttic & Company Inc., an online hardware restoration business in Ypsilanti, MI. "Even though some had been in business for 20 years and some for two years, we all shared the same issues, which was really exciting. It was like having your own fraternity – or joining a fraternity and finding out you all have the same major."

ECONOMIC GARDENING

Another way to serve your second-stage cluster is through economic gardening, which is an entrepreneur-oriented approach to economic growth that focuses on helping a region's existing companies grow larger. Unlike peer learning or CEO forums, economic-gardening programs take a one-on-one approach.

Economic-gardening specialists function much like an outsourced team of experts. They swoop in and quickly help CEOs identify ways to accelerate growth – and point them to new tools and information to make better decisions. They're like a SWAT team of sorts, delivering strategic weapons and tactics from a business-dynamics perspective.

Some of their tools include:

- Sophisticated databases to identify market trends, potential partners or competitors and unknown resources often buried deep inside industry information.
- Geographic information systems to create color-shaded, density maps that profile customer expenditures, psychographics or demographics – or show gaps in market coverage.
- Search engine optimization tools to raise visibility in search engine results and increase traffic on websites.
- Social media monitoring applications to track websites, blogs, and online communities and see what people are saying about companies and products – and reveal important market influencers.

Case in point: A health sciences company had developed a new product to help research labs in the fight against cancer. Yet the company was having trouble getting its foot in the door with prospective clients. By leveraging social media, economic-gardening specialists were able to include the company in online conversations, which increased awareness for its product and paved the way to increased sales.

Another example of economic gardening in action: While working with a CEO of a water-pump company, an economic-gardening specialist saw a correlation between successful bids the company had won at a certain water-table level. The researcher, who was a GIS expert, pointed the company to areas with similar geological characteristics, which led the company to increase its business substantially and even attract international clients.

Speed is an important hallmark of economic-gardening programs. The research teams are trained for quick engagements with entrepreneurs. They identify issues, provide information, and then let the entrepreneur take the ball from there.

It's important to note that economic-gardening programs typically don't reside within a single EDO or ESO because of the costs and infrastructure required. Yet these organizations play a critical role in referring entrepreneurs into the economic-gardening network.

THE ENTREPRENEURS' ENTREPRENEUR

In addition to educational programs and resources, EDOs and ESOs play an important role in shaping an entrepreneurial culture.

For example, entrepreneurs often lack resources to build relationships with the news media and key stakeholders in the community. Someone needs to communicate – and make connections for them – on a variety of fronts:

- Working with government agencies to help them understand the needs of growth entrepreneurs and lower barriers associated with permits and regulations.
- Making sure second-stagers are covered in the local press to raise awareness for who these companies are, what they do, and how important they are to the economy. This can be especially important if you have growth entrepreneurs that are selling their products or services outside of the community.
- Establishing relationships with business, civic, and government leaders, so you can connect second-stagers with decision-makers they normally wouldn't have access to.
- Cultivating a climate of diversity. Entrepreneurs respond to diversity because they themselves are diverse, not only in gender and race but also mindset.
- Encouraging a comfort level with losing as well as winning.

FINDING YOUR OWN PURPLE COW: COMPETING AND COLLABORATING SUCCESSFULLY

As communities strive to beef up job creation and prosperity, business assistance for entrepreneurs has been an increasingly crowded arena. Yet competition isn't a dirty word. It's all about learning how to compete.

If you're serving the same audience as another EDO or ESO, you can take a different approach. Look for a niche your organization can fill that no one else is after. It's what author Seth Godin preaches in his book "Purple Cow: Transform Your Business by Being Remarkable." The key to success is to find a way to stand out – to be the purple cow in a field of monochrome Holsteins. Otherwise, when everyone looks alike, entrepreneurs become confused and frustrated.

Competing successfully means knowing what other kids on the block are up to. That's where resource or asset mapping comes into play. Resource mapping identifies programs and partnerships that exist in a region, best practices, what's working well and what could be made better. It enables organizations to avoid duplication of resources and identify gaps that need to be filled.

Resource mapping can take a variety of forms, from formal surveys to networking events.

For example, the CED in Research Triangle Park, NC, hosts an annual event called "Meet the Area Entrepreneurial Support Organizations." ESO participants include a wide pool of nonprofits, ranging from small business technology development councils to groups serving women in life sciences.

During the first half-hour of the event, each ESO representative gives a quick elevator speech about what their organization does. Then, for the next couple of hours, the audience has a chance to visit organizations' tables and mix and mingle. "The event is very upbeat and easy to do – and it has a lot of benefits," says Joan Siefert Rose, CED president. Among those, the event:

- Enables regional entrepreneurs to tap into resources available to them,
- Reinforces the CED's reputation for being at the center of connecting resources, and
- Gives nonprofits a better understanding of their services and where they might be overlapping.

"Granted, to some extent, organizations in our region are competing for the same dollars, but we have more commonalities than differences," Rose adds. "If you start with the idea that you're there to help the entrepreneur,

it becomes clearer how organizations can work together. If the region does better, we all do better."

Becoming a purple cow can also help EDOs and ESOs strike successful partnerships – which have become especially important in recent years as organizations are pressured to do more with less funding.

Collaboration sounds great in theory, but can be difficult in practice. You may be collaborating for a common cause but each of your partners probably has a different agenda.

Effective collaborations:

- Are discriminating. Don't say "yes" unless it makes sense for your organization.
- Make it clear who is lead dog and who will play a supporting role.
- Leverage the resources of each partner and avoid overlaps.

"Each partner should be made stronger by the collaboration," says Stephanie Steffens, director of the Colorado Workforce Development Council. "That's the challenge — getting the right partners to the table, helping them understand the value they bring and increasing the value of their individual organization by being part of the collaboration."

Failure is simply part of the entrepreneurial experience and even successful entrepreneurs suffer setbacks – although they quickly jump back in the game. Communities that are risk-tolerant and comfortable with change become magnets for entrepreneurs. And that's important, because a greater number of entrepreneurs helps with networking and sharing information.

Admittedly, working with second-stagers is hard work, but it's highly satisfying. For one thing, these entrepreneurs are incredibly optimistic – even when the economy is bleak. They've found a product or service that's successful, and they're passionate about taking their business to the next level. It's exciting to work with second-stagers and help them find what they need to keep growing.

Clustering by stage enables you to be more efficient at serving growth companies – and produce a better return on your investment. And, by targeting your services to match the needs of specific stage clusters, your organization can differentiate itself.

What's more, organizations are not just influencing one business segment, they're also impacting how their communities look. Entrepreneurs have the power to change the economy, but EDOs and ESOs have the power to change their environment and accelerate their success. They are the entrepreneurs' entrepreneur.

SOME FINAL WORDS

We see stage cluster development as a huge opportunity for EDOs and ESOs. Not that industry clusters aren't important. But industry cluster development is a top-down strategy that's best done at the federal and state level where looking at the big picture is a priority.

At the community level, industry cluster development is tough to do. It sounds great, but the reality is that you may only have one or two companies that fit into the industry clusters your state is trying to target. You might be able to capture some funding for companies you have in those industries, but you can't build your entire development strategy off someone else's criteria.

Clustering growth companies by stage makes a lot of sense. As a bottom-up strategy, it's more inclusive of the companies in your communities. Clustering by stage enables you to be more efficient at serving growth companies – and produce a better return on your investment. And, by targeting your services to match the needs of specific stage clusters, your organization can differentiate itself. 🌐

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