the loophole letters

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The Art of Scaling.

Why is so little attention paid to human relationships and collaboration? How Interim Executive Managers add value.

The Art of Scaling: How Interim Executive Managers Overcome the Real Barriers to Growth – The Lack of Trust

-By Daniel M. Böhi and Raanan Shenhav

Only a few companies scale successfully – the others die trying. Turning an idea into a multibillion-dollar business is no easy task, whether for startups or innovations within established corporations. There are countless pieces of advice, secret sauces, and practices on why some make it, and others don’t. But none of them consider the importance of change management and trust as keys to successful growth and development. Why is so little attention paid to human relationships and collaboration?

Any economist will tell you that value in terms of IRR/EVA is only created if a venture scales. "Readiness for scaling" is a crucial milestone, often referred to as a set of skills and challenges a company must master to grow rapidly. For instance, having the right strategy/business model, securing access to scalable infrastructure and systems, providing the right people and talent, ensuring sufficient cash for rapid expansion, and executing all plans are essential. It's about "solidifying" strategy, structure, and procedures, reducing unit costs, and achieving exponential growth, which means increased revenue at stable/incremental costs.

However, despite the widely available know-how, skills, best practices, and benchmarks, the success rate of scaleups is alarmingly low: *less than 2% of startups transform into sustainably large and profitable businesses*. What are we missing? If the taught skills fall short, what other element is existential on the journey from startup to scaleup? What are the real barriers to growth? This is the question we will answer in this "Loophole" letter, beginning with highlighting a crucial phase in any startup's journey towards scaling up.

All new companies/startups/ventures go through three specific development phases on their path to becoming sustainable:

1. **Exploration (Innovation) Phase:** This phase focuses on innovation: Is there a market for a new product? Will consumers pay for it? Nothing is fixed; all is possible. The team is focused on the outside world, geared towards learning, pivoting, gathering insights, and adjusting paradigms. The key challenge here is: will the solution/product/service potentially disrupt the market?
2. **Extrapolation (Profit/Unit Cost) Phase:** As growth picks up and consumer demand needs to be fulfilled, this transition phase is about the "techno-economical" and "profit-fit." It involves understanding unit costs and process/fix-cost/transaction costs. The aim is to generate exponential income while keeping costs incremental. And in general, this is the big "lack of knowledge" as the efficient and effective scaling in terms of engineering or supply chain must be figured out every time. At this point, there is proof that the company can tap into economies of scale and generate profits as growth increases without creating diseconomies of scale. The key challenge here is: Can the product/service be produced potentially efficiently in larger quantities?
3. **Exploitation (Efficiency) Phase:** With the product and business model sorted out, the focus shifts inward towards efficiency, standardization, productivity, discipline, and further "solidification" of strategy, structure, processes, and culture while pushing for more growth. The key challenge here is: Can we tap into economies of scale/scope/network?

Once a venture succeeds and grows throughout each round, the cycle starts again as consumers and markets evolve, requiring the leaders and teams to undergo the process of exploration repeatedly. The ability to be an “ambidextrous” organization, excelling in both innovation (“explore”) and efficiency (“exploit”) simultaneously, is a capacity only a few companies possess – approximately 2%. These companies are the real stars, like Apple (for more on the 2% companies, read the BCG article here).

Hence, one of the most significant reasons why startups/ventures don’t make it, is premature scaling. They grow fast, but due to diseconomies of scale, they can’t turn sales into profits. It is the “optimism bias” that makes innovators/founders announce ambition timelines but grossly underestimate what it takes to turn sales into profits. Public announcements of the nature like “it is a matter of a view years” generally become decades in deep tech vertical such as Food-/Bio-Tech.

While for corporates in the Food-/Bio-Tech industries such failures to fulfil high-flying predictions seldomly have a dramatic impact, for startups it can become quickly existential, as short-comings during the scaling phase generally affects valuations, follow-up financing rounds, run-way. The entire narrative of scaling up falls apart, and even if the product has potential, and just needs more time for the “how to scale” being sorted out, the initial hype fades, and current and future investors drop the targets. The innovation cemetery is full of such missed opportunities. Eventually it is down to survival; startups must get scaling right, or they will die!

Based on such observations, Jeffrey Rayport from Harvard Business School introduced the concept and phase of “extrapolation.” The goal of this phase is to figure out how to achieve unit costs where each new customer and booming revenue only incur marginal costs (more on the concept here).

Simultaneously managing rapid growth dynamics (RGD) and achieving a continuous, repetitive, organized, standardized, and streamlined (CROSS) business and operation model is a significant challenge for any venture. This growth and business development phase is characterized by its “fragility.” Meaning that the company is in a “fragile” state as it faces the “complexity” scaling up brings, and therefore, “extrapolation” needs to be understood as a phase with its own principles, processes, tools, and management challenges.

According to our experience, given the complexity of scaling, and being nonlinear by nature, the biggest challenge and barrier lies with management challenges, to be more precise, in building *trust and clarity* for effective and efficient collaboration. Technical, financial and staffing challenges might take time to solve, but they are seldomly a real hurdle; it's just a matter of time. The real barriers are in the “mind-set” of the leadership and teams when they must adjust to a new “paradigm” of operation. The "fragility" of the extrapolation phase results from a wrong strategy, but mostly from this need to change a paradigm and the natural resistance to do so. It's a simple, biological trigger that all humans share: when faced with fragility, triggered by the opposing forces of change versus stability, our human impulses to act and behave are often ambivalent due to basic needs and fears. Depending on the individual and the situation, fragility can trigger fear or satisfaction. These are the real barriers to growth and scaling. In a transition of such magnitude, from exploration to exploitation, where companies move through a higher state of fragility, the ability to build trust and clarity among the leaders and teams becomes the most existential challenge to address.

Here is where experienced "personalities and leadership" can add massive value when they join a team as active, hands-on interim managers. It's not so much their strategic or operational skill set that sets them apart from consultants, advisors, investors, or founders (although they need to bring essential skills and know-how in scaling, achieving healthy growth—fast, profitable, and sustainable). Instead, it's their ability to quickly build relationships, trust, bonds, and define a clear strategy that are essential across collaborating team members when navigating turbulent, fragile waters.

In any company, people/staff want to be appreciated for what they do, seek a meaningful job, and expect proper compensation. However, during a fragile development phase like "extrapolation," the balance between "control" and "trust" is readjusted. Each team member must grow and become more autonomous while forming close bonds/attachments. In this context, trust and clarity are crucial to reducing the complexity a venture faces during the "extrapolation" phase. The primary task of an executive interim manager is to build that trust and clarity.

Mastering the art of scaling, therefore, becomes *the art of building trust and clarity*. When looking for a personality that can bring such abilities to the table, certain traits may help identify them. Of course, they are skilled and experienced, but they often possess a quality called in German "Feinfühligkeit" or "sensitivity." They pay attention and are aware of what is happening with each individual and the team, have the empathy to understand why people behave as they do under pressure, and can act upon this appropriately.

A leader or manager is not defined by their task description or hierarchy. From attachment theory, we know that a mother is not a mother merely by giving birth; instead, it is the survival instinct and need of the newborn to establish a link to the mother. It depends on how sensitively the mother reacts to the need for social interaction by her newborn, which can determine how they interact with the world and groups. Similarly, a manager becomes a leader by responding to their collaborators' need for social interaction. This need is especially intense and high during “fragile and complex” development phases like “extrapolation.”

Having expanded on the importance of “building trust and clarity” for effective and efficient collaboration during the scaling/extrapolation phase, we also highlight the importance of mastering the strategic and operational skills and know-how that scaling requires. But without the ability to build trust and clarity, these skills lead to no results. This is why so many scaleup ventures fail.

At Alphorn Ventures, we place special emphasis on building trust and fostering strong relationships/collaboration, recognizing their critical importance in guiding startups and ventures towards successful scaleups. The impact of our work as interim managers becomes apparent quickly, and we like to measure this through a specific KPI, the “Present Value of the Growth Opportunity” (PVGO). Every startup, venture, or innovation faces a “window of opportunity” to capitalize on market success. During this period, strategic and operational choices determine how effectively a startup can advance its TRL levels to where revenue surpasses costs, achieving breakeven. The paths chosen within this window significantly influence the speed at which the breakeven point is reached, with each strategy and operation having different PVGO, or opportunity costs. Working with scenarios to figure out the ideal scaling path and making everyone is aligned with that path is key.

Our core competence at Alphorn Ventures lies in building trust, selecting the optimal strategy and operational mix with the highest PVGO, and ensuring all necessary skills are in place to execute this path towards breakeven. Our approach is agnostic to any industry or technology, but has the biggest impact in industries with tangible products such as FMCG/CG.

We are just a coffee away from sharing more information and discussing how you can engage with our experienced “executive managers:

Dr. Daniel M. Böhi; based in Switzerland; with a long track record in the international food/FMCG industry, find out more through LinkedIn (linkedin.com/in/daniel-m-böhi) and his personal website (https://madventures.ch/interim/)

Raanan Shenhav; based in Israel; with an extensive background in deep tech startups and scaling, find out more through LinkedIn (linkedin.com/in/raananshenhav) and his personal website (https://www.raananshenhav.com)

Get in touch!

To sign up for the "Loophole Letters" or if you would like to discuss a specific topic in greater depth, please get in touch: info@alphornventures.com

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