Masters of Scale Episode Transcript: Strategy Session

“Strategy Session: When should founders step aside? Where can you find investors? Were pandemic pivots harmful?”

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REID HOFFMAN: Hi, listeners. It's Reid. Welcome to a special episode of Masters of Scale that we call a Strategy Session.

In these episodes, selected entrepreneurs, business owners, and CEOs ask the most burning questions on their minds, what challenges them, what intrigues them, where they see risk and opportunity.

With each question I offer my perspective about steps to take or practices to consider in ways that hopefully resonate for all of you.

For this strategy session, we've partnered with Capital One Business to identify the episode's question-asking entrepreneurs.

And I'm delighted to have Capital One’s Anne Kave with us to introduce each of the questions. Anne, great to have you here.

> **ANNE KAVE:** Hi Reid. Great to be here. I’m so excited to introduce you to the CEOs we have lined up today. We brought together six entrepreneurs from different corners of the U.S. They’re in different industries and at different stages of scale. And they’re all sharing questions that are really urgent for their individual businesses right now.
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> But I think you’ll find that their questions are also kind of universal. They’re the kinds of challenges I hear all the time from other entrepreneurs. And I’m really curious to hear how you answer them, Reid.
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> **HOFFMAN:** Me too!
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> **KAVE:** OK so lets start.
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> **KAVE:** The first question comes from Ben Harrison, who’s the founder and CEO at Jonas Paul Eyewear in Michigan. Jonas Paul offers stylish glasses for kids. They mostly sell online, but also through brick and mortar retail stores. The business grew strongly through the pandemic, but Ben finds himself thinking more and more about the unknown risks lurking in our world.
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> Ben’s question is ultimately about speed. He sees how the pandemic has impacted our perception of risk, and wonders if he should scale more slowly. Let’s listen.

BEN HARRISON: I'm a huge fan of your book *Blitzscaling,* and it was influential in the growth of our company. I'm curious if, in today's post-COVID world, businesses should be thinking about scaling up any differently. We've emphasized "go-go-go," scaling as fast as we can. But how much should we also be planning for potential business disruptions and protecting ourselves? In the new context of uncertainty, how much should the pursuit of hyper growth be restrained in pursuit of sustainable growth?

HOFFMAN: Ben, this is a question that is on many of our minds, and thank you for being a fan of *Blitzscaling*.

Blitzscaling is not an end to itself. It's a strategic tool, an expensive one. Part of blitzscaling is the knowledge that you have zones of maneuverability. It doesn't mean it's risk-free. It's always trying to make blitzscaling itself an intelligent risk. And by the way, risk means that sometimes you fail.

When you know that there are contexts of uncertainty, and those contexts of uncertainty might affect your business that does change the calculus, but part of how it changes the calculus is, well, what is the availability of capital? What is the competition's availability of capital? Because all the time, when you blitzscale, it actually in fact brings in risk. What you're judging is that the risks of blitzscaling, of spending capital inefficiently and operating inefficiently in an environment of uncertainty is less risky than not doing it. Because if the competition gets there, then it crushes my business. That's part of the reason why we say when you want to blitzscale is when you're in a Glengarry Glen Ross market, first prize, Cadillac, second prize, steak knives, third prize, you're fired.

And it may still be in this new context of uncertainty in a post-COVID world that you still have to take these risks either to win that race to scale or to get certain learnings to happen. But it may be that the environments change in which there's less available capital for you that competition is all in a very capital preserving mode and so moderate risks are the only things that you really need to take in order to win.

Blitzscaling is still completely accurate as a framework. What changes is the evaluation of competitors, markets, capital, talent. So the post-COVID world hasn't changed the framework of blitzscaling, but the variables that you analyze as to when you blitzscale, the degree to which you need to blitzscale, and also when you stop blitzscaling.

KAVE: The next question comes from Francis Nwabudike in Houston, Texas. His company, Space Manager, is local for now. But he's got an eye on expanding to new cities and states.

His question is about how best to fund that expansion. This isn't about operational growth but investment. How can he find the kind of transformational capital that's available to Silicon Valley startups but hard to find for many local businesses. I hear this question all the time, and Reid I bet it's one a lot of your listeners share as well.

Let's listen to Francis.

FRANCIS NWABUDIKE: Cash is our engine for growth, but not true expansion. I hear about tech guys doing Series A and Series B funding, but I don't know how that applies to a manufacturing-based, local business. Where do people like me find our investors?

HOFFMAN: So Francis, this is a very important question, and I think many of our audience ask similar questions. My first part of the answer will be when to approach venture capitalists and which venture capitalists to approach, and then the second part will be a more general answer to your question.

Classic technology investors at Greylock and other venture capital firms tend to look for companies that are targeting $1 billion plus valuations as their exit valuation. And exit valuation doesn't mean that the company stops. And so, generally speaking, it's a waste of your time and their time if you don't think that you have a growth path to do that to go to the classic large VCs who are seeking to generate public companies.

One of the mistaken pieces of advice that entrepreneurs are given is to say, "Well, that's what you should be doing." And sometimes you have actually this really valuable, profitable business that provides a great product and service and jobs and so forth but that it's not the outcome for, and you should only target these major VCs when that's the case.

Now, there are a stack of other sorts of venture capital, which can include local firms, can include the strategic arms of large companies. They tend to have less aspirations on what the return on the capital side will be. Dividends or a structured kind of almost like something between equity and debt might be interesting to them. Or if you're talking to corporate venture capital that they have sometimes strategic goals. You might be advancing something that has to do with the strategy of these firms, they might be willing to say, "Hey, look, we'll invest in some."

Now, if those aren't the case, then it becomes very idiosyncratic. Sometimes it's high net worth individuals or their family offices. One of the places that I might look at is, are there significant entrepreneurs or family offices who are local to your area?

Another thing, depending on where you are, is to look at networks of entrepreneurs like endeavor.org who might know of folks.

And the answer is, go to other entrepreneurs and folks who play in your particular industry or your particular region. It becomes a strategic challenge and a strategic opportunity in order to go and find those investors.

This is part of the reason why a lot of folks in the category that you're talking about figure out some way of doing debt financing versus equity. The challenge in equity financing, the reason why firms like Greylock and others tend to only want to target very high growth equity is that trading value in equity tends to be very difficult if you don't either have an IPO circumstance or an IPO possibility which will drive a strategic acquisition. And so I would encourage looking at other kinds of debt-based mechanisms, too, that aren't just the kind of classic bank receivable. There are other debt facilities that do understand, "Hey, there's a higher amount of risk here than just kind of bank receivables, and that's worth still pursuing as a way of getting a return."

> **KAVE:** The next question is about how to balance growth inside an existing, heritage business. It's one I'm hearing more and more from ambitious entrepreneurs. So many companies found themselves pivoting during the pandemic, and many discovered new distribution channels or product lines that unlocked an entirely new direction for them.
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> But that new opportunity can come with new complications. And that's the context for the challenge our next CEO faces. Her name is Kris Buchanan and she runs a restaurant and organic food purveyor in California called Goodonya. Let's hear from Kris.
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> **KRIS BUCHANAN:** Goodonya started as a restaurant 20 years ago, and we're doing very well in the restaurant industry. We do about $2.5 million in sales, without alcohol. But now we have our newer products that we're selling online, protein bars, powders, all kinds of things that are bringing in about $1 million a year. But the costs, margins, and economics of the two different operations are very different. Should I be thinking of them as one business or two?

HOFFMAN: So Kris, by the way, congratulations. The restaurant business is challenging and also being innovative, bringing online products and expanding, especially, of course, driven by recent challenges with the pandemic.

Fundamentally, you can look at these businesses completely grouped together, partially disconnected, and completely disconnected. So let's go from the easiest to the most complicated, which is completely disconnected is the easiest answer. If the future evolution of the business is best directed by a different general manager; there's a different go to market structure; the product is somewhat different in quality; how you invest in it; the fundamental organization of the talent team is different, then you should split the businesses apart.

For example, I'm manufacturing ice cream, and I'm manufacturing tractor equipment. It's like, well, everything's different. Yes, we're manufacturing, but the supply chain, the delivery, the understanding of my customer, the talent and the team, the risk we're taking. I'm not suggesting that's the case in your business, Kris, but it's the way that you go, "Well, that's one that should really split apart."

And there's a bunch of reasons why you say, "Well, look, even if they're fairly different, they wouldn't split apart," which is, well, there actually has to be a fair amount of shared infrastructure or the business won't get that big, won't really be able to manage a different CEO and manager and so forth.

And that gets you to potentially a partially disconnected business. It could still be using the same employment infrastructure in HR, the same health care benefits and so forth. But you're going to have some employees, whether it's a sales team or whether it's a product sourcing team, going to be, "We are totally focused on how to grow this business."

Your question will be how much incentive organization do you have across the businesses? How do you have key people invested in the success of others? Sometimes all you really need to do is kind of a shared offsite or some kind of shared culture for that, although people will be attentive to where the economics go, and that would be a partially disconnected business.

Then what you have is, well, no, it's the same business. Our supply chain, who we're buying from and how we're making that work. And we'd be looking for synergies fairly constantly. So even though we're doing online products with protein bar bars and powders, we'd still want to be trialing and promoting it within the restaurant. Or maybe the things we're learning from the online can help direct things that we're doing in the restaurant business.

And so, those would be the kinds of frameworks for thinking through the analysis of whether or not it's completely clustered together, partially disconnected, or fully disconnected. And if you decide, well, it's probably fully disconnected, you generally want to go to earlier disconnect than you would be comfortable, but have a plan A and a plan B and a plan Z, as I talk about in my first book, *The Start-up of You*, for reconsideration as you go to it.

But you generally want to move in that direction proactively versus retroactively.

KAVE: The next question is about leadership and growth, and about being honest with yourself.

As a business grows and matures, the role of the founder always shifts. New skills are required. New capacities. And at each stage, entrepreneurs everywhere have to ask themselves: “Am I still the right person for the job?” It’s such a poignant question.

Here to ask one version of it is Jeff Braverman, CEO of Nuts.com. They’re a hundred year old family-owned business based in New Jersey that boomed through the pandemic. Let’s listen.

JEFF BRAVERMAN: I’ve taught myself everything, as we’ve built Nuts.com and grown through the pandemic. But maybe my secret sauce isn’t the daily running of a more stable business.

How do you know if you have what it takes to be a CEO at scale? And when do you hire your replacement as a founder/CEO?

HOFFMAN: So Jeff, it's a great question. One that I asked myself. And part of the reason why I ended up hiring Jeff Weiner to be the CEO of LinkedIn.

You and folks in your circumstances, if you want to be the scale CEO, it's worth doing it. Because there's a number of things that you bring to the table that a new hire is very difficult to get to, which is that mission orientation, that long-term orientation, that willingness to take risks, the moral authority for doing so. The set of things that make a founder, owner of a business very committed to a business.

Even when I hired Jeff Weiner, part of what I had realized, and I did a post on this on LinkedIn, that when you're hiring a CEO for a business, you shouldn't just look for skills and expertise and proven track record. But you should look for someone who would be a co-founder with you, a co-owner with you, share the mission with you, to have those kinds of same characteristics that you yourself have in driving a business.

And that's part of the reason why, if you said, "Look, I really want to try to be the CEO," then it's worth that try. Now, you being open-minded, asking the question you did, is very important. Everyone should ask this question because, what got you here, won't get you there.

And so, you have to recognize the game is changing. And that's part of the reason why this question is so important and so smart. As you scale, the game changes.

The nature of the talent that you're hiring, the nature of which risks you're taking, the nature of how you shift towards operational efficiency, the way that you focus more on executive talent and the operations of your executive team. You may be still driving some of the innovation and some of the strategy, but you should really be looking to be getting that from your team.

If the team isn't where you would go, "My exec team can run the business for the next month and I can be in Hawaii." If you're not getting to that point, which is part of what a scale CEO is doing, then maybe you're not the right CEO for it.

And so, the short answer of when you hire your replacement is when you think, "Okay, I'm not the right person for doing that." But also, as you say, "Well, okay. I want to try it. I want to do it." Then you say, "What are the signs that I'm being successful or not?"

Now, another few nuances on this is sometimes you say, "Will I hire a president or I hire a COO?" And sometimes that's the right way to do it. And you have to genuinely delegate authority and say, "This is what their job is, and this is what they're doing." And it's someone who works very closely with you.

That's not the right path for hiring a CEO. A CEO is a person who owns the whole ball. So if you said, "I'm going to spend six months on a skunkworks project." You should have a CEO, not a COO or president.

We're all a combination of strengths and weaknesses. So for me, part of hiring Jeff Weiner is I said, "Well, look, my real strengths," and a little bit like your secret sauce question is, “Innovation in product strategy and business strategy. And solving these really hard things is the thing I wake up Saturday morning thinking about. I should hire someone else who is a scale organization person."

Now, Jeff's super smart. You want a CEO who can recognize and drive strategy and invent strategy. Jeff could do that. But someone I also, I could partner with.

If you're shifting roles, you also have to be good at your new role, you have to be really good, could be an executive chairperson working with them as a board member. But you have to play that role well too. It isn't a faux CEO. If you're like, "No, I'm still going to be CEO," then consider president or COO as an alternative. Good luck.

> **KAVE:** Let’s turn now to the topic of balancing long-term investments with short-term costs.
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> This is one of the trickiest strategic challenges faced by business owners – because you always have to be vigilant about protecting cash flow and profit margins.
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> The CEO we’re hearing from is Dr. Eric Suan, who runs The Retina Care Centers. It’s a group of specialty eye care centers based in Maryland. Dr. Suan’s business requires him to invest in cutting edge medical technology. But the new technologies don’t necessarily cut costs or expand revenues.
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> His question focuses on the tradeoffs – of investing in new high-tech tools when the return on investment is unclear. Let’s listen.
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> **ERIC SUAN:** Some businesses have limited pricing power. In the medical field, there’s a set price for our services, dictated by the government and insurers. Yet our practice is tech intensive, relying on expensive, new computer-driven imaging. How do we justify investing in expensive new tools when the upside payoff is constrained? How can scale solve a business-model limitation?

HOFFMAN: So Eric, great question. It is a classic one of can you make the investments you need to make into something that has sufficient revenues, sufficient profitability.

So, for example, if you said, "I'd like to have a traditional, small family farm, profitable, run from Manhattan." And you're like, "Yeah, that's very challenging." That's the extreme case. So you look at something like this and you say, "All right, well, we have a set price dictated by the government, but the practice and technology is expensive." So what kinds of things would you look at? Well, the answer is, well, is there ways that you can increase the revenue in other ways, value added services.

Is there a way in technology that I can license it or offer some premium services on top? When you say, "Well, constrained revenue, how do I afford more expensive innovation?" To some degree, this is the age-old business answer, which is, well, figure out ways to make the cost structure cheaper or to add in other revenue lines, or change the nature of the business you're in, because changing the math of it is like changing the laws of gravity. And by the way, one of the cool things about business is, to some degree, you can pull off something that looks like the change of the law of gravity. That's the most classic thing within business model innovations.

So another aspect of your question is, should you invest money in technology? And the general answer is you should, because technology will be a part of the future. And then you say, "Well, wait a minute. I won't necessarily purely recoup this in operating margin because I won't be able to increase my price." Sometimes the answer is, well, what will keep you in business and keep the business going is the investment in tech. Sometimes it will cause you to be able to serve more customers, in which case you will be able to, keeping a price fixed, be able to make more money. Sometimes you're just like, "Well, okay, look, it'll only amortize over 10 years, but it'll create a new opportunity landscape for us." And generally speaking, in technology investing, there's frequently a lot of unknowns in the future. It isn't just a pure today's business calculus.

Generally speaking, all companies, even small companies, are all in the process of becoming technology companies. If you have an organization that has 20 people or more, you should have a technology strategy that's not an IT strategy. So you say, "Well, expensive computer driven imaging. Well, there's a whole bunch of things going on, how do I leverage that technology trend that this other company is already investing billions of dollars in?" And getting part of that wave may be part of the answer to your question.

KAVE: This question comes from Mike Lenard, founder and CEO of Takorean – it's a restaurant chain in Washington DC that started with a single food truck.

Like so many business owners, Mike was forced to make some tough calls during the pandemic to preserve his company over time. But he worries that not all of his employees or customers may appreciate that long-term perspective. His question is about the brand implications of making tough calls – and how to respond to customers and employees who don't see the business the same way.

We've heard this before from business owners, and it's an incredibly challenging situation to be in.

Let's hear from Mike now.

MIKE LENARD: During the pandemic, we made the decision to permanently close some of our restaurants that weren't performing particularly well before the pandemic. Sometimes I worry about the reflection that those closings might have on the brand. Either to guests and customers but also even to internal employees who are looking obviously for company growth as well. When you’re forced to make a decision that may look like a retreat, how much do you weigh the potential long-term impact of that negative brand hit against the near-term business fundamentals that are needed?

HOFFMAN: Mike, I'm sorry to hear about the difficulties. COVID created a lot of difficulties for a lot of folks, and for the folks who were lucky enough to be in the technology business, it created some tsunamis that were running behind your business and picking you up, and for other folks, like the restaurant industry, the tsunami was coming for it. Now, the fortunate thing is, when you have an outside circumstance like a pandemic, generally speaking, it goes in the category of, don't waste a good crisis. People will give you a pass. When you're in a crisis, everyone recognizes that you have to make a bunch of sharp decisions including hard ones.

Some people will probably disagree with you that you needed to close the restaurants, but that's okay. And the fact is you showed good leadership by taking hard decisions even if sometimes people disagreed with the decisions you made. And to some degree, what your brand is outside to customers, to employees, suppliers, partners, local communities, all of this is much more what you're doing now than versus what you did. The key thing is to look like you are building into the future now, that you are doing things, that you are innovating, how you're leading, how you're sharing energy.

One of the things that I recently posted about was the loneliness of entrepreneuring, which is even more lonely than the loneliness of CEO-ing, which is already pretty lonely. You're sitting here going, "Well, I'm feeling the responsibility for all of this," but I have to go and project, "I see a great future. I'm energized by it. I'm going in that direction." Now, sometimes you will take a near-term business hit to preserve your brand, but when you're in crisis, people generally understand that you need to make hard choices. And as long as you are like, "I see a great future, I'm building towards it," then that's the thing that you need to be doing.

So it's less focusing on the pandemic's closings or the pandemic's challenges and more focusing on, “We are now going to be stronger than ever, we now have a future that we're really going to be building towards, because here is the game in front of us, and here are the steps, and this is why being on this journey towards this future is so key. And that’s why, this is a future that's opening up for us now post-pandemic and that's what we need to do." And that fundamentally will be what defines your brand.

KAVE: Thanks so much Reid. I love the way you keep us focused on the future, and with such optimism. And I also want to be sure to thank all the CEOs who shared their questions for this strategy session. We appreciate you – your determination, your perseverance, and definitely your generosity in sharing your stories – so that we all can learn. If there’s anything that’s universal in entrepreneurship, it’s that learning can unlock amazing opportunities.

And I want to thank you, Reid, for inviting me to be a part of this strategy session. Our partnership with Masters of Scale is so meaningful to us. We're committed to supporting entrepreneurs, and your passion about it inspires all of us.

HOFFMAN: Well, thank you, Anne, for your partnership in serving entrepreneurs. And for bringing us these CEOs today. Their questions were a great window into the minds of entrepreneurs now.

And for all of you listening. I'm Reid Hoffman. Thanks for listening.