The Fractional CFO | Why Growth Gets Harder at $10 Million| Transcript

Grace Reynolds & Jeff Hummel
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Grace Reynolds:

Jeff, thanks for getting together. And I think let's kind of share some of the things that we've been experiencing as we have been dealing with companies that are kind of hitting a really interesting inflection point, and it's that $10 million mark.

Jeff Hummel:

Yeah. And I think I see a lot of clients where they hit that and it just starts a whole new process for them. And they start getting worried and they start having issues, and they think they're doing something wrong. And actually it's the exact opposite. They've done something really right. For a company to get to 10 million in revenue, that's a big deal. But it's just the processes and procedures that they used to get them there are not the policies and procedures they need going forward.

Grace Reynolds:

That's very true. And I think you and I both experienced this and have both helped companies kind of get across that mark. And it really kind of comes down to understanding, hey, what do we need to do differently now? How do we need to build the new infrastructure to get us to that next level? And when I think about it, I kind of start with the founder and hey, founder's done a great job, very entrepreneurial, gotten themselves to where they're at. Really oftentimes just on sheer guts and sheer motivation on their part to do it. But you get to a certain point, that doesn't work anymore. Can you kind of share some of the things that you've seen with the founder when they get to this point?

Jeff Hummel:

Yeah. Most of the time the founder did exactly what you said. Basically they started the business, sometimes these things started in the garage and they go through. So as it grows, the founder's almost involved in every decision and making almost everything by instinct. They know everything, they can make decisions fast and that's going to go. And quite frankly, it's their butt on the line. So they want to be involved in everything. You start getting the $10 million and all of a sudden that instinct becomes the constraint.

Them wanting to be involved in everything becomes a problem. There's just too many decisions, too many people for anybody to do it by instinct. And as you're growing, that person, if you're in the office, can just tell, can drive by a project, see if it's on site or is going well or not, can see from the staff inside just by walking around knowing if they're stressed, if something's not going right. Well, when all of a sudden that's more dispersed, he or she's not going to be able to see everything to know on. So then it becomes a constraint and decisions start being delayed.

Grace Reynolds:

So what do you see good founders doing when they hit that point and what should they be doing to kind of help continue that growth?

Jeff Hummel:

A good founder when they hit that point understands that and then starts building the proper foundation that you need. And it's not just delegating for delegation's sake. It needs to be a more structured process. Developing a management layer underneath them that's built on clearly defined roles and clearly defined responsibilities. It's not go see Steve. We've been at places where it's not go see the COO, not go see the VP of marketing. It's go see Steve. And Steve ends up dealing with customer issues, HR issues, and that's just not a format that can carry you forward. So it's clearly defining that management structure, clearly defining those roles, giving them actual authority and building a structure of accountability and then also creating a reporting structure that gives them the proper information that they need to make those decisions based on data and criteria as opposed to gut instinct.

Grace Reynolds:

Agreed. And I think individuals, when they sit there and they're looking at that company and then going and going, "Okay, what do I need to do?" You've got to build that trust in your team and you've got to build a good team and you need to be able to say, "All right, I'm going to trust that you can make those decisions."

Let's maybe talk the next thing that I kind of see, which is process. Oftentimes when you're a small company, hey, everybody's in the same room, be it virtually, be it on site, everybody understands there's kind of this great tribal knowledge. Now all of a sudden things are getting bigger, not everybody's in the same place. They're not processes defined and there isn't a good definition around, "Hey, this is what this person needs to do and this role needs to do and this role needs to do and these things need to be done." I see a lot of that and just that absolute lack of process is really a big struggle for some of these companies.

Jeff Hummel:

Yeah. And it really starts with standardization. You said before, it's like tribal knowledge, it's being passed down and sometimes it's your pricing or your quoting depends on who is doing it because it's just you get onboarded, it's whatever I tell you to do. And so it's like the telephone game that we played as kids and you know the way that works. Every time you hand it down, a little bit gets lost. So what I see, what I try to advise clients to do and the ones that really do it well, it's standardize processes first, then document those processes so that you don't have to worry about it being handed down, document them, make sure everybody knows where they are. And then third, then you start building systems around those processes. If you start trying to build the systems first, which is what I see a lot of people try to do, you spend a lot of money on software that actually creates more problems.

So you need to standardize things first, document the process and then build those systems. And it's hard sometimes at companies that grew up being entrepreneurial and fast and they see, why do I have to go through all these hoops anymore? But it's not bureaucracy for bureaucracy's sake. It is creating scalable systems that can help you go to the next up to 20 million, up to 30 million by investing that foundation.

Grace Reynolds:

And I also think when we're talking about process, great you document them, but make sure you're training everybody on it and make sure everybody understands that. Because if you don't, hey, all that process documentation is great, but hey, we need to be following this. And this may be different than what we've done in the past. Doesn't mean what we did in the past was a wrong thing. Just means, hey, we need to evolve here. We need to make sure everybody's on the same page and operating in a similar way.

Jeff Hummel:

Right. And it doesn't just mean once you standardize and once you document these processes, that doesn't mean they should stay stagnant. At places I've been, it's like we've made it part of, hey, it's got to be updated once a year, made it part of somebody's performance review to be like, hey, these are your processes. You have to go through and it's like you document the day you did them, that you updated them and they had to be signed off and reviewed by somebody so that you make sure that these processes, you go through documenting them. And to your point, how many times do you see a client where they do have standardized processes, they do have them documented and they go back and they reference a system that you had two times ago because nobody's looked at them in five years.

So it's important to understand that it's constantly evolving and technology changes. You could have done a lot of processes five years ago that doesn't understand how AI works and what you could do and things that you are now doing so that if somebody came in new and looked at this, they're learning what you did five years ago, not what you're doing now, but it's your documented process.

Grace Reynolds:

Yeah, very much so. Let's maybe talk about something you already mentioned, which is that organizational structure and the fact that your organizational structure that you had when you were smaller, you've outgrown it. And that informal process that works really well when you were smaller just doesn't work now because again, you're not all in the same place. You have people now that aren't the multitaskers that everybody used to be. You've got some specialty there and getting everybody to kind of work together, that informal structure just doesn't work anymore.

Jeff Hummel:

No, and it gets back to, it's exactly what you said. It's training and it's making sure we have these processes documented and somebody understands what they're supposed to do. Because again, you start having the problem of if everybody's used to going to the founder or going to one other person, they start seeing them get overloaded and if they don't know exactly where to go, they weren't trained where to go, then everything grinds to a halt because they don't want to put more on that person's plate and then they don't know where to go. And then you start getting people start to try to create things themselves or again, going back to, "Hey, this is what I think it is."

And then I tell you what I think it is, you tell somebody what you think it was, which may have been a minor version of what I said. All of a sudden you get to the point of, again, nobody knows what the processes are. So it's making sure you have all these things documented, making sure people are trained, and then more so also knowing, having them in a spot where they know where to go and look for them.

Grace Reynolds:

I also think you need to make sure that the compensation structure, the performance requirements of everybody, again, as they evolve, need to be very specific and also need to kind of support the overall mission of this evolving company and that those ideas don't compete with each other, that you don't have different groups and different departments kind of saying, "Nope, this is the priority or no, this is the priority." That that's all kind of together as well and very documented.

Jeff Hummel:

Yeah, correct. And when you said on compensation, that's a big one because if you have some point in time when companies start getting five, 10 million start to grow, all of a sudden those compensation plans tend to diverge. And when it first started and it was what was good for the company was also good for the individual starts diverging a little bit and then all of a sudden now you've got a structure that maybe leads a little bit more towards better for the employee if they do this and you're relying on that person putting the company first instead of themselves. And most of the time, most people are going to go look into how to maximize their own compensation. So it's looking at that as you evolve to make sure those plans still do align so that your employees benefit when the company benefits, not your employee benefits separate from the company.

Grace Reynolds:

Very much so because nothing helps your organization more. Let me say it this way, you're going to run into some big problems if the people that are working for you aren't on the same page as you are, and that isn't in their performance review or isn't part of what you're expecting them to do and that hasn't been clearly stated. You're going to run into a lot of problems and things are going to go into divergent channels instead of everybody rowing in the same direction, which is what ultimately you want to do.

Jeff Hummel:

Yep.

Grace Reynolds:

All right, let's pivot a little bit and let's talk about something that I think is near and dear to both you and my hearts, which is financial complexity and the fact that as you continue to grow, hey, your revenue may double, but the financial stuff that's going on underneath doesn't double, it quadruples and it may even be even exponentially higher as you continue your journey of growth. Let's talk a little bit about that and kind of what we see in terms of the financial complexity. I know that when we're talking about looking at, let's start with customers, it used to be all in one person's head with the founder, right? They could tell you. Now all of a sudden you've got multiple customers. Let's talk a little bit about some of the things that we may need to explore with that as we're getting bigger.

Jeff Hummel:

Yeah. So like you said, so most companies start out and they focus on basically how much money am I making? How much cash do I have in the bank? Do I have enough to make payroll next week? How are we going to go? Now you're going to start looking into pricing strategy. You're looking at margin compression because you start having a couple of percentage points. At a lower level, it's five, $10,000. You start getting into more and more revenue, all of a sudden that can be $100,000, $500,000. Now all of a sudden at a dollar level, that's a lot more material than, not to say $10,000 isn't important, but $500,000 versus $10,000, completely different. You've also, at that point in time, are starting to have to make bets with your money, which involves having to do financial complexity.

Maybe you have to go out and start exploring bank financing, bringing in other investors, looking at that, do I want to go out and go to sell away some of this to a private equity company? Do I want to go out and get a line of credit so I could go? Because to get to that next level of growth, you're making bets like hiring ahead, you've got to build that foundation. So you've got a lot of working capital needs that are going along with your customers. And also it's looking at customers, your customer that was your biggest revenue, that's been your biggest customer for years, maybe your least profitable.

And it's also having to dig down and look at that segment profitability, that customer profitability to be able to go, as we're going to sit there and make these bets and invest, this may have been the channel that I thought was where we were going to go, but you look at it and say that's my least profitable business. So this part of your business as you grow may have been the smallest part that got you to 10 million, but is going to be the biggest part to get you to 20 or 30.

Grace Reynolds:

And then let's maybe talk about some of the other things, right? So typically you come in with a pretty simplified set of financial systems, usually one tool, right? Now all of a sudden you're bigger, you're needing to understand this, and you know what? The system or systems that you have cobbled together don't necessarily work really well with each other. You get some difficulty in doing your invoicing, which very key process, or hey, you're having difficulty tracking your receivables or all of the things that go on underneath the covers there to be able to understand, hey, what's my cash flow really looking like? That gets a lot more complicated when your dollar signs are getting bigger and you need to make sure that what's going on underneath there, that you have a good visibility to everything underneath.

Jeff Hummel:

Yeah. And that's where I see the companies that struggle have a problem because you started a lot of times with all the accounting being done in one spreadsheet and Excel is great in the fact that it can do whatever you want it to do. Problem is it can do whatever you want it to do. And sometimes you have the one person that maintained that spreadsheet, all of a sudden they leave, nobody knows how to do anything.

And I think to your point, when you start talking about that's the time when you start investing in systems. And the ones that I see struggle are the problem is they go, "Oh, I'm having a problem in this area, so I'm going to go get the CRM and I'm going to go buy best in class and do this." Then it's, "Oh, we're having a problem. Oh, let's go look into our ERP or our general ledger. Let's go get best in class in that." And then they go and it's like, "Over here, I got an operating system we got to go. Let's go get best in class in that." None of them talk, none of them do anything, where it's they really need to sit down and figure out, document, again, document all their processes, get everybody together, figure out what we need, ask every group what the requirements are, and then go look and try to.

I'm not saying you have to implement it all in six months, you're never going to, but create that roadmap to be like, "Okay, we're going to put in the CRM here and then we're going to go to a payroll system here and then it's ERP and you're going to map it out, but make that choice so everything works together and you're making, as you're building the infrastructure, you're thinking with where you want to be in mind because I've seen the ones where they go and put this in and you only have the three things that matter to your marketing team on this, but then you want to feed it into the operating system and now you need five.

So now you have to figure out how to make that work and you're already putting a bandaid on the new system you put in. Then you go feed that into your general ledger and when you want to do forecasting and you need more. And now all of a sudden you're putting band-aids on top of band-aids of the new system you just got. So after five years of taking all your people's time, putting all this stuff together, you've got a system that's already broken. So it's kind of understanding where I need to be and making sure I get there the right way. And I think the companies that really invest that time and do the research and look in are the ones that really hit the ground running when they all get going.

Grace Reynolds:

And hey, look ahead and let's build for a future.

Jeff Hummel:

Yes.

Grace Reynolds:

Let's plan ahead for a future. Let's plan ahead for something that's going to be bigger and let's make sure that we build that infrastructure to be able to support that.

Jeff Hummel:

Yeah. My father-in-law's a mechanical engineer, my mother-in-law's an architect, and we always kind of talk about it as having the foundation. If I build a foundation for a five-story building, it's hard to add five more stories onto it. So it's building that foundation that basically it may be more than you need right now, but a foundation that can make you be able to go to a skyscraper, even though right now you're only at five stories.

Grace Reynolds:

So along with this, I think another interesting aspect of the growth cycle is bringing in people and the, let's say, hiring challenge thereof, right? You're trying to bring in more support because you obviously are going to outgrow the level of people that you currently have, not just from a knowledge standpoint, but also from just a capacity standpoint. You're going out and you're hiring new people, and it's hard to bring in new people when you've built this culture and you've got to be very careful about it, especially in management hires because you don't want to bring somebody in to alienate the great people that you have. You want to bring somebody in that's going to be able to help your team grow, develop, and reach and start to do new things. How do you see some companies doing that in a successful way?

Jeff Hummel:

It's really hard to do at $10 million. Especially thinking from the finance side, like for a CFO, the capabilities that you need to run a 25, $50 million company are different than the capabilities you need to run at 10, but you need to hire somebody that understands what they need to do at 10, but that understands what you need to be at 25 and 50 and also understands how to get you there. And that's the problem, and what makes it hard at $10 million is a lot of times you hire somebody that can run that 25 or 50 million. They come in, they don't want to create the systems, they expect them to already be there. So finding somebody that's willing to dig in, roll up their sleeves, go through the process that we just described is hard to find to get there.

And it's also, to your point of wanting to make sure you include everybody in the process and you get them there. You don't want to come in like a bull in a china shop and say, "I know better. This is what we're going to do. I can't believe you guys did it that way." What you need to do is come in, really understand what everybody did and then walk them through. That process that I just described of making all those choices and go is getting those people in a room. And sometimes it's as easy as not telling them, it's asking them and being like, "Okay, why do you do that?" Because a lot of those people, that's the only place they worked. The systems that they have are the only ones they know. And where I've had success in the past is pulling people into the room and then start saying like, "Hey, it's like at this client or at one of my other jobs, it's like we were able to do this and this." And then all of a sudden it sparks their ideas.

And then what I see a lot of times is they come back in. They come back in and ask with more ideas to go. So it's finding that leader that can hop in and get that group involved with coming up with ideas and actually coming to that leader and asking them, "Hey, have you ever thought about doing this? Have you thought about doing this?" So that you can bring them along. Then you can change everything that they do, but as long as they feel like they got a voice in the process and were brought along for the ride, they are going to follow you wherever you go. And it's finding somebody that understands that and quite frankly, that's kind of a unicorn. So it's hard for people to do a lot.

And it's also hard for, I think the founder sometimes to want to turn away. He may have had the same bookkeeper or a controller or something that has been great for 20 years to get you to 10 million, but a lot of those people are really good at telling you what happened and to get the next step, you need somebody that can help you look at what you need to do, who can start creating that forward-looking, those forecasts, the cash forecast, your P&L forecast, your balance sheet forecast to understand because a lot of what we talked about of them taking on risk, it's what adds to that complexity is you may have banks where all of a sudden they have bank covenants. Now all of a sudden some of the decisions, you have to sit there and go, "Ooh, how does this impact it?"

I had one place where I went and worked. There are two different levers we could pull at the end of the year and one made us really close to flipping a bank covenant. So we had to basically build that into our forecast process to make sure like, "Hey, if we did this, is that going to create problems down the road?" Because you don't want to find out those things after the fact. You want to be able to deal with them in the first place. So it's finding somebody that understands how to build all that.

Grace Reynolds:

And can build that collaboration with the folks that are still there.

Jeff Hummel:

Yes.

Grace Reynolds:

Get them to grow, get them to change, get them to evolve much like your business has to evolve as well. I will say that has been something that I know you and I have both done over our careers. That's not necessarily an easy challenge, but when you get through it's a super beneficial one.

Jeff Hummel:

Yes.

Grace Reynolds:

So let's maybe talk one last thing here that kind of wraps into this, and we've kind of both touched on this, data and good data visibility. We talked about it in terms of, hey, your systems need to evolve. Hey, your processes and procedures need to evolve. All of this stuff needs to evolve, but at the end, all this needs to evolve, but you also need to build in, hey, a lot more data granularity, a lot more ability to get in and do analysis, especially as you're continuing to evolve so that you have access to the data for you to be able to make better decision making. Where do you see some companies succeeding at this?

Jeff Hummel:

If they focus on really four big ones, and I think we've talked about them tangentially as we talked, customer profitability, being able to get enough detail so you can understand it doesn't matter what the revenue is, am I actually making money on this customer? Could I make. So maybe I don't want to be at a customer that's this big. Maybe I want more customers that are smaller because we're more profitable. And that also kind of pivots into looking at your product and service line margins. Like we talked about earlier, the product line you were in that was your main money maker may not be the one that's going to take you to the next level.

And it's at a much bigger scale, but think of Netflix. Think of how Netflix started. Think of Netflix is supposed to be a competitor to Blockbuster who doesn't exist anymore when you used to be able to see them everywhere. But if Netflix had just really doubled down on mail order DVDs and not gone to look into streaming, what would they have been? When Netflix first started, that mail order DVD was 80% of their revenue. Now it's none. So it's understanding at a smaller scale, but which one's going? It may have to be able to see into the future looking at that data to know that, "Hey, I need to pivot."

And part of that is also getting them to look at cashflow forecasting, doing regular forecasting, and then doing operational capacity look at, which is what I find a lot of clients at this level don't do. So it's understanding if I go out and sell, am I selling more than we can do? Or have I hired people too much and now I don't have enough work for everybody I just brought in to do?

Because the last thing you want to do sometimes is get too far ahead of your skis, try to chase that growth, and then all of a sudden get the things and then not be able to deliver because the reputational risk that that causes really can stymie that growth trajectory. So you want to make sure that you grow smart and by understanding your operational capacity, that helps you because you need to have your sales and your operational people aligned so that you're hiring ahead of that growth, but you're not over hiring and can't perform.

Grace Reynolds:

Agreed. So let me maybe kind of circle all this back because I know we've kind of talked some really big themes here. If I look at this, it's, "Hey, you've done some great work to get to this point." And I mean, I applaud companies that get there because a lot of companies don't make it that far. But when you get there, you need to stop and you need to say, "Okay, what's the new infrastructure I need to build underneath in order to be able to continue this growth?"

Don't be afraid of change. That's probably the one big lesson that I've learned, the one big lesson that when I'm talking to my clients, change is good. It's scary, but it's good, but let's have a path that we're on. Those are some of the lessons that I'm trying to impart on the client as they continue on this growth trajectory. What are some things that you would add to that?

Jeff Hummel:

I would say that I have to tell them that they have to think of it as a transition, not a continuation, because obviously you've hit this point, it's time for you to pivot and start transforming your company into where you want it to go next. And that's a process that's probably never going to stop because if you just continue the processes that got you to a certain level, it gives you a ceiling. It'll get you to that level and actually it'll be lucky if you stay there because eventually it's going to start getting to the point where you start seeing diminishing returns. So it's understanding that, "Hey, I've hit this point. I've got to transition. This is where we've got to go and build that infrastructure that we just talked about."

But also understanding that you're now probably on a perpetual state of change. It's never this transition is going to work, you got to build that foundation, but you also have to understand, start using some of these things that you've put in to know that, "All right, now I'm going to have to start changing. But when I hit this point, I'm going to have to start changing."

And it's where you really get into spending less time looking at the income statement and the balance sheet and what you did in the past, and more time looking at those forecasts and looking at your operational metrics so you can understand where you're going to go in the future and if you can pivot quickly. Because sometimes in some of these businesses, waiting for your financial statements, by the time you get them and look at what happened, it's too late. So you need to be able to put these things in place so that you catch things right away. With the way technology changes today, with the way things change, you want to make sure you're on the front end of change, not the back end of it. So that's what I would just keep telling them, think of this as a transition, not as a continuation.

Grace Reynolds:

And that's a space that I know you and I play very well in, and we advise our clients a lot about this. And we're here to support them through that transition and bring the knowledge base that all of us have here to be able to help them on that journey. Jeff, great conversation. Thank you.

Jeff Hummel:

Thank you, Grace.