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SIZE DOESN'T MATTER— PROFITS DO

Some entrepreneurs are finding that slower growth helps them deliver better earnings, quality, and morale. BY ELLYN SPRAGINS AND VERNE HARNISH

IMAGINE, FOR A MOMENT, A HIGHLY ESTEEMED EXECUTIVE like Intel's Andy Grove or Avon's Andrea Jung answering questions about his or her company's prospects for 2004. New products? Yes—a bunch. Position in the industry? One of the leaders. Projected sales growth? "Um ... we're trying to slow down our growth for the next couple of years."

Huh? Rapid revenue growth has been yoked to power and prestige in the business world for so long that the idea of deliberately decelerating your company seems laughable. Public companies have for decades been compelled to quench Wall Street's thirst for impressive quarterly sales gains, of course. But there are a host of other well-founded rationales for fast growth that can be reduced to one simple idea: Expand or die. "If you're not growing, you're not keeping pace with market demand, and another competitor will come and fill that need," explains Jay Mattie, a national leader for private company services in the PricewaterhouseCoopers Boston office.

So with the economy ramping up, it's worth listening to an interesting collection of company owners—a minority, to be sure, but a growing one—who are becoming proponents of slow, controlled growth. We confess that at first we thought "slow-growth advocate" was a new term for "loser"—someone who can't cut it in a hypercompetitive business climate. But closer examination reveals that many of these iconoclasts reap benefits that are often at odds with an all-growth-all-the-time mentality—higher quality, a more manageable and pleasant workplace, and greater profitability.

"I run my company with this saying: Volume is vanity, and profit is sanity," says Brad Skelton, 36, managing director of Skelton Tomkinson, a heavy-machinery shipper based in Brisbane, Australia, that counts Caterpillar among its largest customers and plans to open a U.S. office this year. Four years ago he raised his fees on nonmachinery accounts in order to deliberately drive away his least profitable customers, and sold off the remaining nonmachinery accounts. By niche marketing and focusing on higher-margin customers, he has increased net profits by 98% since 1999, while revenues—which had dropped dramatically, to $8.2 million—have slowly climbed back to $20 million.

Skelton's revelation that the bottom line matters more than the top line may not be particularly astonishing. But it seems to amaze many business owners. They've been conditioned to chase every additional dollar of revenue so tenaciously that they often neglect to evaluate its effect on profits. "Bigger is better—that's the old Holy Grail. It gets you bragging rights at the bar, but those bragging rights are what drive people to do crazy things," says Paul Schaye, a managing director at Chestnut Hill Partners, a Manhattan investment-banking firm for small and medium-sized companies. Among the traps small-business owners can fall into: taking on high levels of debt to fuel growth, making costly acquisitions, and accepting unprofitable work just to get a foot in the door with some big, prestigious customer. These temptations loom larger now that the economy is growing faster.

That's not to say that you shouldn't strive to build a *Fortune* 500 company, as many *FSB* readers do. But if that's your goal, successful enterprise builders say, you should look closely at your growth potential. About 95% of the 20.8 million nonfarm businesses in this country have fewer than 20 employees, according to the most recent census data. "These are not companies with 19 people on their way to 9,000," says Myra Hart, professor of entrepreneurship at Harvard Business School. "Only a very small percentage of companies will ever grow to be very large."

The ones that do usually have fast growth and big revenue targets encoded in their DNA. From the very beginning, Sam Walton's formula for growing Wal-Mart was to locate stores in underserved rural markets and to offer super-low prices driven by state-of-the-art distribution. Private overnight shipping was an idea that simply would not have worked if Federal Express founder Fred Smith had not had a long-term plan to establish a national package-handling system before opening the company's doors.

Sometimes fast growth is needed to achieve efficiencies. Manufacturers often see production costs drop dramatically as sales volume increases. Companies selling technological products like digital cameras need global distribution to cover high R&D costs and generate quick sales before their gadgets become obsolete.

Successful entrepreneurs emphasize that the key, when deciding how rapidly to grow, is to ask yourself some hard ques-

tions. Will your business model work around the country or the globe? Expansion outside your region could bring in more revenue but also subject you to cutthroat pricing that will wreck your margins. Is your product or service really unique? If so, go for fast growth. If not, you might be better off sticking with a small pool of customers, keeping your marketing and sales costs low, and focusing on maximizing the bottom line.

Ask yourself, too, if a growth-at-any-price approach is creating unnecessary risks. During a sales meeting in 1993, Bob Sapio, then CEO of TriStar Industries, a hardware distributor in Chicago, pledged that TriStar would reach $100 million in annual sales by 2000. He thought that was the size required to go public. Three years later, with his company posting $10 million in sales and $2 million in profit, Sapio acquired American Fastener, a supplier of fasteners used in factory-equipment maintenance and in construction, for $4 million.

He quickly discovered what hundreds of CEOs before him have learned: Most mergers fail, because of culture clashes, benefits that don't materialize, or overpaying. Within a year his company had lost $1.4 million, and he had to sell TriStar to pay off bank debt. "I was so focused on being a $100 million company that it was all I cared about," says Sapio, 51. "I don't know what our profit would have been if we had hit the $100 million mark, but we'd be sitting on $12 million to $14 million in retained earnings right now if I had been satisfied with a $10 million company."

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Far from stagnating, entrepreneurs who de-emphasize sales growth often bring more energy to boosting the quality of their goods and services. "The world is bifurcating into the Armanis and the Wal-Marts," says attorney Gabor Garai, the managing partner in Epstein Becker & Green's Boston office, which focuses on entrepreneurial clients. "The Armanis are very hands-on and understand their customers in a deep and focused way."

All of the entrepreneurs profiled here would say their companies couldn't have become Armanis without a slow-growth philosophy, yet they decelerated for different reasons. For Stuart Johnson, founder of VideoPlus, a producer of communication and sales tools, it took four years of fast growth accompanied by red ink to turn him into a slow-growth fan. At Half Price Books, a chain of 79 bookstores, CEO Sharon Anderson Wright believes that the company culture and bottom line will be healthier if she expands cautiously, opening a new store only when she can send a seasoned manager to a new city to run it. Reid and Jonelle Fujita, founders of Cinnamon Girl, a chain of clothing stores based in Honolulu, want to prevent work from overtaking family life.

Each may find it makes sense to speed growth in the future. But many owners prefer the slower track indefinitely, says Harvard's Hart. "Most entrepreneurs have chosen what they're doing because there's a lot of personal involvement, and they have the ability to pace their work and integrate it into their lives."

THE PROFIT DRIVER

Stuart Johnson, VideoPlus

Like most hungry entrepreneurs, Stuart Johnson, 38, started out hell-bent on revenue growth. No, he didn't ever believe that VideoPlus, the communications firm that he established in 1987 at age 22, would be a *Fortune* 500 company. But in just six years the company, in Lake Dallas, Texas, had pushed annual revenues north of $10 million. So in 1993, when demand for its sales-training videos began slowing, he searched anxiously for the company's next fuel cell. It turned out to be simple and sexy: satellites. By leasing dishes, selling satellite time, and creating content, VideoPlus could help such direct sellers as Avon and Pre-Paid Legal Services keep in touch with their far-flung sales reps. From 1994 to 1998 sales grew by about 20% a year.

This would be a tidy entrepreneurial story except for one detail. While sales accelerated, profits evaporated. By 1998, when revenue surpassed $20 million, VideoPlus had lost more than it had earned during the previous four years because of increased costs and the need for competitive pricing. Johnson's retreat began the day he realized that he would have to invest heavily as the fast-moving satellite industry shifted from an analog to a digital format. He soon decided to refocus on his core business and to concentrate on profitability, not revenue growth. He sold the satellite operation's assets for a small profit in 1998, which knocked off about a third of his sales. Johnson also cut overhead by laying off nearly half of his 80 employees over the next three years. "The employees were not that happy because we had gone through such growth and then so many losses," says Johnson. But today, says Paul Adams, 43, a 14-year veteran and vice president of sales and marketing, "we're at an incredible place in terms of overall morale. When we got rid of the satellite business and got back to what we knew how to do best, it was a relief. It gave us a much stronger sense of control. I've had any number of people walk into the front office and say, 'Something seems to be different about this place. It seems a little friendlier.' "

Indeed, the airy warehouse that houses VideoPlus is filled with casually dressed staffers who adorn their office walls with framed, stencil-style phrases such as "May I help you?" and "We'll fix the problem." Corny as it seems, the sayings reflect the next big change Johnson made: offering superior customer service to the best, most promising customers to grow the bottom line.

To do a better job for Avon, for which VideoPlus initially produced two yearly videos, Johnson and his employees responded positively to last-minute production requests, worked flexibly within Avon's tight budgets, and began attending most of the cosmetic company's events for their sales representatives. As a result, during the past five years the amount of business Avon does with VideoPlus has quadrupled. VideoPlus now creates DVDs and CD-ROMs that Avon uses to communicate with some of its 3.9 million sales representatives, as well as videos, which the reps buy as selling tools. "The company has always met deadlines that other people would say are totally unrealistic. They do everything they can to please. That to me is a com-

pany that cherishes its customers," says John Fleming, Avon's vice president of U.S. sales leadership.

Although he lost his balance chasing after satellite technology, Johnson realized he could still innovate on a more modest scale. For example, VideoPlus was the first in its industry to offer presentation and information tools for sales reps on DVDs and CD-ROMs, on top of video and audio tapes. The newer technologies offered better margins, with little additional investment.

The most gratifying part of VideoPlus's transformation is that Johnson finally feels free to make his own rules about entrepreneurial success. That's why, for instance, he refuses to expand his staff, now at 45, beyond 50 people—the headcount under which, he feels, a casual, family culture flourishes. Of course, this limit also reinforces a bottom-line mentality. Johnson says that the entire staff understands the need to add to profits without increasing personnel.

They've succeeded. While sales have increased by only a fraction of a percentage point in the past four years, Johnson says profits have grown at an average annual rate of 67%. Johnson now spends most of his time selling. Business consultants would probably cluck disapprovingly about his generating 80% of the company's new revenues. But as he points out, "That's the part I enjoy." Oh, yeah—enjoyment. Remember that? Johnson sounds like a slow-lane evangelist when he crows, "I try telling young entrepreneurs that revenue growth isn't the be-all and end-all, but they don't believe me. You don't have to grow 20% a year to be happy, satisfy customers and employees, and make plenty of money." —E.S.

THE CULTURE QUEEN

Sharon Anderson Wright, Half Price Books

Customers don't come to Half Price Books expecting to linger over lattes. They're lucky if they can find a chair in the musty, disorganized stores. What keeps bringing them back are great deals on used books. Right now they can buy a used copy of *The Da Vinci Code*, in good condition, for $12, compared with $15 for a brand-new one at Barnes & Noble. Adding to the draw is the quirky bookworm culture fostered by longtime employees, many of whom have second careers in the arts. "There is a knowledgeable air about the Half Price Books stores that you don't seem to get at the bigger chains," says Amy Cantwell, a 32-year-old social worker from Austin, who visits the store on South Lamar Boulevard regularly. "The staff seems as if they 'live' books."

To keep customers like Cantwell happy, Half Price Books CEO Sharon Anderson Wright, 45, makes sure her stores are the kind of place where friendly, knowledgeable clerks would want to work. Besides promoting only from within to fill managerial positions, she offers health insurance, in-depth training, and profit sharing to full-timers. "Our cash cow is our repeat customers," she says. "The last thing we want to do is to grow too fast and become impersonal."

This simple formula for success has paid off for the Dallas-based chain since Pat Anderson, Sharon's mother, opened the first store in an abandoned laundromat in 1972. Half Price Books, which Wright says is profitable and debt-free, now brings in $120 million a year at 79 stores in 11 states. And the company could easily position itself for faster growth. "There is increased consumer demand for used books," says Michael Hoynes, a marketing officer for the American Booksellers Association, a trade group based in Tarrytown, N.Y. Thanks to bargain-hungry consumers, used bookstores now capture 5% of total book sales, up by about 50% from a year ago.

While Barnes & Noble and Borders open about 40 new stores a year, Wright prefers a more measured approach. Since taking over after her mother's death in 1996, she has opened six to eight stores a year. She regularly turns down offers to be acquired or to sell part of her company. Accepting outside capital would let her expand faster but would crimp her low-price strategy. She can charge so little because she pays to open each new store with retained earnings, refusing to borrow. If Half Price Books grew faster, she would have to pass along the costs of her debt payments. "We were raised as kids to only do things we could afford," says Wright. "Why would I run my company any differently?"

"OUR CASH COW IS OUR REPEAT CUSTOMERS," SAYS SHARON ANDERSON WRIGHT. "THE LAST THING WE WANT TO DO IS GROW TOO FAST AND BECOME IMPERSONAL."

Selling out to a big chain, Wright says, would also mean forsaking the unique—and decidedly noncorporate—atmosphere that has allowed Half Price Books to succeed for more than 31 years. Indeed, Wright was so worried that customers thought she had sold out to Barnes & Noble—which uses the words "half-price books" on the sale annex of its website—that she sued the corporate behemoth to stop the practice. (Barnes & Noble declined comment but faxed over a court ruling saying that Wright's company failed to prove that the phrase was a protectable trademark; Wright continues to pursue the case.)

When Wright does expand, she wants to make sure she gets it right. Contrary to what one might expect, Half Price Books does best in locations with a more upscale demographic than the ones in which large chain bookstores thrive. The average Half Price customer is likely to be middle-aged, with an average income of $50,000; at least 38% have a college degree. So Wright will open stores only in locations near a similar population.

More important, she will expand into a new location only if a longtime manager will move and set up shop. This cuts training costs and expensive mistakes like underpricing rare first editions. Giving longstanding employees plum store-manager jobs also keeps the company culture intact as it opens up in far-flung places. It is that intimate, customer-friendly culture that's made Half Price Books so nicely profitable. —Maggie Overfelt

THE BALANCED CEO

Reid and Jonelle Fujita, Cinnamon Girl

To understand why Cinnamon Girl is one of the hottest new concepts in retailing, think about your last trip to the mall. Gap. Abercrombie & Fitch. Express. Yawn. You've seen them all before. Cinnamon Girl, a tiny Hawaiian women's and girls' apparel chain headquartered in Honolulu, is different. Its stores boast a wholesome, ultrafeminine atmosphere, and its racks burst with sundresses and skirts in original island designs at reasonable prices. The clothes don't shout Hollywood, but that hasn't stopped celebrities from stopping by. Actress Kelly Preston has scooped up a pair of Cinnamon Girl's flower-decorated flip-flops for her daughter, and tennis champ Steffi Graf twice visited the chain's Las Vegas store with husband Andre Agassi in tow.

A fresh idea in retailing is like chocolate cake at a preschooler's birthday party—everyone wants a piece. That's why Cinnamon Girl founders Reid and Jonelle Fujita are being besieged by eager mall operators, retailers, and would-be franchisees. "We get calls from mall owners all over the country who want Cinnamon Girl in their malls," says Jon-Eric Greene, a senior vice president at Colliers, an international commercial real estate brokerage based in Honolulu. "It's one of the few new, unique apparel concepts out there."

"OUR PEOPLE HAVE TO REALLY UNDERSTAND CINNAMON GIRL VALUES, AND THAT TAKES TIME," SAYS REID FUJITA.

With demand like that, you'd expect the Fujitas to be galloping along the path blazed by giant brand-name designers such as Tommy Hilfiger. While Cinnamon Girl's annual revenue growth—between 15% and 20% over the past three years—might make some companies drool, it's turtle-like for a hot fashion concept. By opening stores at a breakneck pace, franchising, and wholesaling the sundresses that are Cinnamon Girl's specialty, the nine-year-old company could easily be four times its current size, with 24 stores rather than six, say retailing experts. With more stores, Cinnamon Girl's sales, currently between $6 million and $8 million, might have soared to $20 million or $30 million by now—or even higher. After all, just two years after his clothing line debuted in 1985, Tommy Hilfiger's sales had grown to $70 million, and his clothes were being sold in more than 60 department stores and 25 specialty shops.

Why are the Fujitas leaving so much money on the table? For Jonelle, 37, who first sold her designs from a 100-square-foot kiosk in 1994, controlled growth answers a bevy of concerns, not least of which is the couple's children: Jolie, 4, and James, 1. "I get tempted by how much money our company could be bringing in by rapid expansion," she explains. "But I don't think the money is worth the extra stress that it can place on a marriage and a family." They pick up Jolie from preschool every day and dine as a family almost every night. "Most of our friends who have children and work do not get to spend as much time with their children as we do," says Reid, 38.

Limiting growth sounds like a sure way to minimize income, but expanding by just one or two stores a year is far more profitable, at least in the short term, for the Fujitas. Under a more aggressive expansion push, additional leasing, manufacturing, and personnel expenses would chew up profits, which usually hover around 10% of sales, according to Reid. And the Fujitas, who own the company, would probably have to give up some equity in exchange for the capital required to launch four or five stores annually.

Then, too, the Fujitas won't compromise the quality of their stores. Growing faster, in the Fujitas' view, increases the possibility of indifferent service, messy stores, and poor displays. They find it unbearable to imagine someone strolling into a Cinnamon Girl without feeling welcomed by friendly salespeople, smelling the spice-scented potpourri, or seeing sundresses artfully displayed, just so, next to pine armoires. "We want everything to be correct for the customer. That means our people have to really understand Cinnamon Girl values, and that takes time," says Reid.

Both the Fujitas grew up on Oahu and graduated from the University of Hawaii, Jonelle with a sociology degree and Reid with one in communications. Jonelle worked at restaurants and hotels before pursuing dress designing. Reid ran H3O, a media company he started that produced a surfer magazine, a local TV show, and a surfing video. In 1996 they married, and two years later Reid sold H30 and joined Cinnamon Girl.

Today Reid focuses on store operations and employees. But it's Jonelle—who designs all of the chain's 35 or so styles and some of its floral-print fabrics—who is behind the stores' girlish aura. "Her designs are special, but in addition this woman is a brilliant visual merchandiser," says Kay Day, a regional vice president for General Growth, a real estate investment trust that owns or manages more than 150 regional shopping malls in the U.S. The Fujitas' distinctive touch has made Cinnamon Girl a bruiser among retailers, with stores averaging sales of $1,100 per square foot, vs. an average of $400 or so for nonanchor mall stores nationally.

The risks for any new retail concept are that it will have only local appeal or that a competitor will copy it. Indeed, the store at Las Vegas's Fashion Show Mall, Cinnamon Girl's first foray onto the mainland, is generating slightly lower sales than the Hawaiian stores, but Reid says that's because of slow mall traffic. In fact, the Las Vegas store stimulated overtures by mall operators such as Simon Property Group, based in East Indianapolis, and developers like Forest City, based in Cleveland, suggesting that Cinnamon Girl's charms will travel well.

Copycats don't worry the Fujitas, who say their vision can't be reduced to a formula. "I love coming up with new products," says Jonelle. "Cinnamon Girl continues to be a wonderful journey." —E.S.

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