# A White Paper for Boards of Directors

## 'Seven Characteristics of a Highly Successful Social Business'

By David Babington-Smith, 11th May 2020

## Introduction

Would your board like to transform your social business from *average* to *highly successful*? Are you unclear what this means in practice?

## First, some quick definitions and caveats

This paper is aimed at boards that wish to build an *enduring* business for the long-term. By considering research which scans decades rather than years, it looks for the innate characteristics that drive long-term, sustainable out-performance rather than luck or just good timing.

This paper does not seek to provide an A-Z of setting up a business – with topics like product, pricing, timing and strategy. Rather, it summarizes the characteristics which mark highly successful businesses as different to companies which are merely good or average.

## An additional challenge – Riding Two Horses

Social businesses are a relatively new phenomenon. Unlike businesses that seek to provide a socially beneficial product or service at scale (*ethical businesses or low-cost providers*), social businesses are expected to ride two horses at once.

Typically, up to half their budget comes from grants or donations. From this they are expected to give away products and services for free, or at a highly discounted rate. The balance of their budget – potentially in excess of 75% - needs to come from selling goods and services with a commercial return and in a commercially competitive environment.

Not surprisingly social businesses are more complicated and harder to manage. A study by McKinsey[1] shows that that although they are less likely to fail in early years, they are significantly less profitable, grow less quickly and are less scale-able than commercial businesses. Furthermore, approximately half do not collect data on social impact for their grant funders and investors – principally because they don't know how to collect data or because they have no money to pay for it.

[1] '*Scaling the impact of the social enterprise sector', McKinsey & Co, October 2016.*

Does this mean that social businesses cannot become great? Are they are condemned to a future of low growth, low performance and mediocrity?

**Seven identified characteristics**

This paper attempts to outline a potential way forward. It synthesizes what we know about the performance of social businesses from the McKinsey report and other sources, together with the characteristics of what exists within truly great commercial companies[2].

Intriguingly the results are very similar.

Being great is not for the cautious. It takes leadership, focus and clear decisions. If you want your social business to be great, these are the characteristics your board will need to adopt.

## 1 Your level of Ambition

***'Greatness means you stand out above the crowd. Do you want this?'***

Good is the enemy of great. For example, why are there plenty of good schools but so few truly great schools? Ultimately being great is about being the best in your sector. It means showing ingenuity, being willing to take risks, doings things differently, wanting to go the extra mile. If you don't aspire to this leadership, you won't get there.

Research shows that whilst its statistically rare for organization to achieve greatness, it does not require more work or suffering than achieving mediocrity.

Indeed, the beauty of research shows that it requires potentially less work and can radically simplify our lives whilst increasing our effectiveness.

### 1.1 Set the aspiration

If you wish to your business to become high performing it needs to start with a conscious decision; '*Yes, we want to go down this road*'.

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[2] The main research for high performing businesses comes from two seminal studies by Jim Collins listed below.;

- '*Good to Great. Why some companies make the leap …. And others don't',* Jim Collins, Random House, 2001. This study examined the top 11 companies from 1,435 Fortune 500 firms. Over 15 years these 11 companies averaged cumulative returns that were 6.9x the stock market average.
- *'Built to Last*, *Successful habits of visionary companies'*, Jim Collins, Random House (2005). A study of 18 exceptional companies that had an average age of 100 years and which since 1926 had outperformed the stock market by 15x.

These are not the only studies or approaches. A contemporary example is '*conscious capitalism*' – see the study of companies with a 10.5x return in excess of the S&P - https://hbr.org/2013/04/companies-that-practice-conscious-capitalism-perform

Once the decision has been taken at board level, then the pursuit of excellence has to permeate every aspect of interaction, decision making and action at every level of the organization. Everyone is united in the common aim.

### 1.2 Define your ambitious social impact metrics

***What metric makes you better than others?***

If social businesses are about creating a social impact then this ultimately needs to be measured. To qualify as a great social business your results need to be *better* than peer institutions.

For example, the metrics for a school might be higher exam pass rates, perhaps even more impressive by demonstrating that the children predominantly come from poor families. For a green energy producer it might be higher carbon offsets than rival providers. For a museum it might be higher visitor numbers.

Good impact data can help secure additional contracts and grant income, fueling further growth. Increased visibility also helps attract more entrepreneurial and technical talent. Everyone wants to work for a winner

### 1.3 Maintain an equal focus on high profitability and growth

***Avoid the perils of 'friendly but lazy money'***

Great social businesses *also* need to be *explicit* about aiming for superior profitability and growth. After all, this will pay for achieving your above-average social impact targets. In the long-term it is also necessary for you to sustain excellence – retaining competent staff, continual product development and further growth.

An example is a UK chain of schools. It achieves above average profitability by highly inventive and cost-effective use of classroom space, staffing schedules as well as other cost efficiencies. The cash savings enable it to acquire better and more teachers. Combined with a joint approach of improved classroom discipline this leads to improved academic results and higher student satisfaction – a virtuous cycle.

The challenge of many social businesses is that they lack this drive. This is often because they start with concessionary finance such as grants, donations or soft loans. There is rarely a commercial investor pressing for a high return on investment, excess cash generation or ambitious scale growth and so they don't plan for it or feel any need to stand out above the crowd.

The board needs to step in and ensure this attitude stops. The discipline and rigour of growth and profitability is essential[3].

### 1.4 Create a simple dashboard

***If you don't keep a keen eye on this, you will likely fail***

This is typically a one-page summary of KPIs around financial metrics and impact measurements. It provides the key data for the board on whether management is on track to achieve targets.

Like an athlete in training you need to be continually on top of all the data sets, and the drivers of data that contribute to top-level performance.

## 2 The company is the ultimate creation, not the product

The vast majority of companies with truly exceptional performance over the long-term do not derive their success from discovering a 'killer product' from inception. Instead, they build an engine which constantly turned out new killer products.

Indeed, some of the most successful companies in the world ditched their initial products and under-went a long process of trial and error to find the right one. In turn-around situations with mature businesses, the highly successful ones also typically took up to four years to discover a sustainable long-term path to greatness.

If you equate the success of your company with the success of a specific idea then you are more likely to give up if that idea fails. Or if it succeeds you are more likely to have an 'emotional love affair'[4] with that idea and stick with it too long, when you should be moving rapidly to other things.

The essence of a highly successful company which survives in the long-term is one that it is able to translate its core ideology and ambitious goals into the very fabric of the organization – its goals, strategies, tactics, policies, processes, cultural practices, job design – into everything the company does. This means there is constant innovation and improvement. To use a well-known phrase, it means you are creating a company that 'builds clocks' rather than one which just 'watches clocks'[5].

For the board this means spending less time thinking about specific product lines and strategies and more time on organizational design. Is the quality of people high enough? Is there a unifying vision? Are there systems and processes in place that continually stress test

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[3] Examples of high performing financial metrics might include 20%+ annual growth, higher than average net margins (these will be industry dependent) and low levels of debt.
[4] *Built to Last*, p 29
[5] *Built to Last,* p 23

strategy and profitability as well as incentivize innovation? Do you have a system to manage KPIs and are you monitoring the correct KPIs?

Board's don't need a highly charismatic CEO to achieve all this. In fact, research shows that charismatic CEOs are *negatively* correlated with high performing businesses. But you do need exceptionally able CEO and senior management team, which brings us to the next characteristic.

## 3 Don't compromise - get the right team in place

***'Do we have a management team that can drive performance and growth?'***

All the literature agrees that having the right people is key. This means the board needs to ensure that not just the CEO but also an effective senior management team is in place.

### 3.1 Hire the right people FIRST

It is essential not to skimp on hiring the best people. Don't compromise when hiring. If you're not confident then keep looking.

Great companies will sometimes prioritize hiring great people even before deciding strategy.

In a business start-up, good investors will ask probing questions on the quality of the founding team. If the team is incomplete, unbalanced or clearly weak they will typically walk away.

### 3.2 Deal with or remove the weak performers

If you have the wrong people in place you won't get proper execution. Expect a litany of delays, conflict, things going wrong, endless excuses. If you are constantly worrying about how to manage someone, you may have the wrong person in post. Always be willing to give someone the chance to change but if they can't or won't, then act quickly.

High performers are obvious and they will make a difference quickly. The CEO won't need to spend much time motivating them or keeping them focused. Furthermore, there is no systematic data to show that specific forms of compensation are correlated to performance. If you hire the right people they will motivate themselves[6].

[6] *Good to Great*, p 11

### 3.3 Have a CEO that is collaborative, hard-working and conscientious

The majority of CEOs of companies that transformed from *'good'* to *'great'* were self-effacing people with a fierce resolve to do whatever was needed to make their company great. They had an incurable need to produce results. It is not that they lacked ego or self-interest, its rather that their ambition was more for their institution than themselves[7].

Despite the stories of mega CEOs being parachuted in to transform businesses, research shows there is actually a negative correlation of *larger than life* CEOs taking a business from 'good' to 'great'[8].

Whilst it is true that a charismatic CEO can effect a rapid change in share price and performance, all too often this will be followed in subsequent years by a disappointing decline. In Collins study, in three quarters of comparison companies, CEOs set up their successors for failure or chose weak successors or both.

The key to long-term greatness is the senior management team and the processes the CEO sets up with them, which brings us to the next key point.

### 3.4 Strong Generals not Weak Lieutenants

There is an old Business School adage that CEOs should hire people who are smarter than themselves.

Lively and prolonged debate between gifted senior managers invariably leads to better decision-making than and this requires strong generals not weak lieutenants. A classic example is Wells Fargo Bank in the USA. As it became clear that impending new regulation in the USA was about break up the old profitable banking models, Wells Fargo deliberately went on a hiring spree to recruit outstanding people. This was *before* the CEO knew what the new regulation was going to be and therefore what his new strategy ought to be. When the changes finally came the financial impact was brutal. This sector of the banking market fell 59% below the general stock market.

However, Wells Fargo outperformed the market by *over three times*. Why? Because the Wells Fargo team acted as equal partners, ferociously debating in the search for the best answers.

As a result, they came up with the smartest strategies. Competitors like Bank of America had weak lieutenants who would just wait for directions from on high. Strategy was ill informed and poorly thought through. As a result, their profits and share price was hit accordingly[9].

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[7] Good to Great, p 21
[8] *Good to Great*, p 10.
[9] Good to Great, p 42

# 4 Find your passion and do it exceptionally well

**'Transcending the curse of competence'**

Just because something is your core business, and perhaps you've been doing it for years, does not make it the right thing or does not mean you can be the best in the world at it. To be truly successful your board and management need to find one thing you can do *better, faster, or cheaper* than anyone else.

Truly great companies do one thing exceptionally well and stick to it. They don't waste time and money on unrelated activities and acquisitions. Jim Collins calls this the *hedgehog* process and it creates a virtuous cycle of profitability and growth. The hedgehog spikes protect you against constant attacks from competitors (the foxes) so that no one can actually match you on performance and passion.

For a board simply to have a strategy per se is not an indicator of greatness. Indeed, there is no evidence that great companies spend more time on long-range strategic planning than good ones.

## 4.1 What can you be the best at – but only within your area of passion?

Great companies do not just focus on what to do, they focus equally on what *not to do* and what *to stop doing*[10].

If you cannot be the best in the world in your core business, then your core business can't form your hedgehog concept. Once you have found this then stick to it, don't divert. Be ruthless. Sticking to your hedgehog concept does not restrict growth, rather it ensures that growth is only within profitable spheres and that when this happens it is more likely to be exponential than incremental.

Curiously research also shows that great companies are typically not in great industries. Some are in terrible industries but they still thrive and outperform[11].

Finding what you are best at is likely connected to what you are passionate about. In seeking this out don't ask '*what should I be passionate about'* but '*what am I passionate about*'. When passion is excited you are in flow and things become easier and clear….

Another approach is to ask yourself what work makes you feel compelled '*to try to create greatness*'? If you have to ask 'Why should we try to make it great? Isn't success enough?" then you are probably engaged in the wrong line of work![12]

[10] *Good to Great*, p 11
[11] *Good to Great*, p 11
[12] *Good to Great*, p 209

### 4.2 Reach for the stars, push yourself

No athlete won a race by aiming to come second. High performing companies deliberately set ambitious goals that are unambiguously do or die.

These goals are sometimes called 'Big Hairy Audacious Goals' (BHAGS). They are designed to excite staff to achieve the almost impossible. They are simple but profound. People 'get it' right away; it takes little or no explanation', and the purpose of the BHAG is to engage staff and drive them to go the extra mile'[13].

Examples of BHAGs include:

> "To make a motor car affordable to the common man" (Ford, early 1900s)
> "Become the Harvard of the West" (Stanford University, 1940s)
> "To put a man on the moon" (President Kennedy, 1960s)
> "Crush Adidas" (Nike, 1980s)
> "Become number one or two in every market we serve" (GE, 1980s)[14]

BHAGS can be company-wide, or they can be specific to departments. However, if a board is asked by management to approve a BHAG, then it is a powerful sign that management are serious about going for greatness.

## 5 Understand what drives your economic engine

***It should generate unusually high cash and profits***

Great companies build superb economic engines to finance their visions because they attain a profound insight into their economics. They typically identify one denominator which drives exceptional profits over and above their competitors.

### 5.1 Choose one financial ratio

Think about it in this way. If you can pick just one ratio to systematically increase over time, which will have the greatest impact on your economic engine what would it be?

If you have several business lines you might need several ratios. For example, a heritage estate that combines mass visits from the public as well as renting out rooms and open spaces might choose 'profit per visitor' together with 'rental income per sq foot'.

The optimal denominator can be subtle, even unobvious, but the impact on profits *astronomical*.

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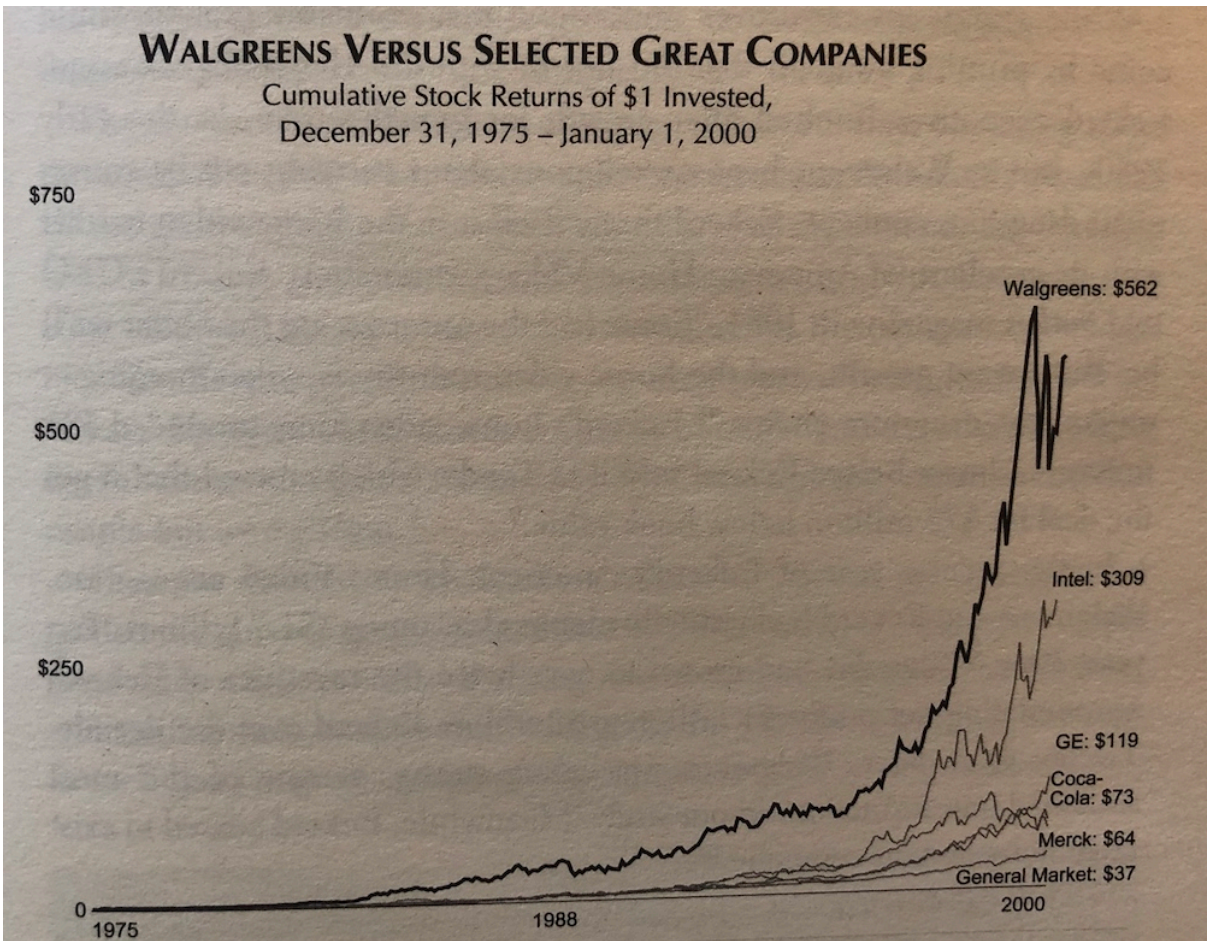
[13] *Built to Last*, p 94
[14] *Built to Last*, pp 232-233

A good example is Walgreens, the US pharmacy chain. They switched from measuring profit per store to maximizing profit per customer visit. And why did this simple change make such a difference? Firstly, they realized that when they had stores clustered together they could generate economy of scale benefits. So, they closed good stores in good locations (often at great expense) and focused on opening new stores in clustered areas. For example, they ended up with nine stores within a one-mile radius in San Francisco.

To these improving stores they then added more high margin services, like one-hour photo developing. More convenience led to more customer visits, then more profit per customer, and more cash for re-investment. This hedgehog concept then gave further protection against the inevitable attacks of competition and created a virtuous cycle of protected growth.

Walgreens then went through a period of enormous growth, most of in the late 1990s, vastly outperforming the market. The following chart shows the incredible impact this simple concept had on their financial performance[15].




[15] *Good to Great*, p 93

# 6 Strong planning & execution architecture

Truly great companies are long in the making and the result of persistent action over a long period of time.

They often did not start with grand new pronouncements, but started modestly. The key was to employ great people. By nature, good people want to be part of a winning team. They want to contribute to producing visible, tangible results.

The key then is to have a framework for them with plan and work within.

## 6.1 Have a world-Class, Investment-Grade Business Plan

The best business plans avoid vague aspirational statements. They feature measurable, clear objectives and experience suggests the best way to avoid soft language is to frame a social business' work in more concrete terms than the traditional-vision-values approach, typically:

1) What problem are we solving?
2) What does success look like for us (include hard facts, statistics contextual data)?
3) Why are we the best organization to achieve this?

The strategy is measured by milestones, KPIs, detailed financial projections for three years, organizational charts and biographies of the senior management team.

## 6.2 Realistically identify the initial investment needed to achieve this

***'Success, not survival'***

Too many social businesses operate with low expectations and therefore fail to raise the significant intakes of revenue – commercial and grant – needed to properly scale up their ambitious social goals.

Board members in particular should be seeking rapid growth of capital and be continually asking senior management "*what do we need for success*" instead of "what do we need for survival".

In the area of grant income low aspirations can be a tragic mistake. Whilst there are enormous sums available for social impact the reality is that the vast majority of this revenue is captured by a small number of organizations such as hospitals, universities and the larger not for profits[16]. If you want to build an enduring organization you may have to be audacious and willing to take on the big-league players.

[16] *It is estimated that just 4% of all non-profit organisations control 85% of all non-profit assets – https://altruistpartners.com/threemusthaves/*

### 6.3 Give senior management freedom and responsibility within a framework

***'Measure against what you said you would achieve, not just what you achieve'***

Once the business plan is complete and the finance in place, the issue moves onto execution.

If the board have already ensured that only great, self-disciplined people have been hired, then the job of the board and CEO becomes much easier – it is managing the system, not the people.

Allow managers the freedom to change and adapt their departmental strategy, so long as they know they are still accountable to delivering on their annual goals. However, there are times when failures will happen. Its natural when taking risks. When they occur failures should be reviewed, lessons learnt and without negative consequences for the people involved

### 6.4 Lead with a culture of discipline and rigour

When you have disciplined action, you don't need excessive controls – and when you combine a culture of discipline with an ethic of entrepreneurship, 'you get the magic alchemy of great performance'[17].

The board should ensure that discipline, accountability and rigour is a key aspect of board and management culture. Language used by high performing businesses include *'discipline', 'rigor', 'focus', 'accountable', 'responsible'* and a *'fastidious attention to detail'*.

If it is modelled by the board at the top, it is more likely to become embedded at operational level by management.

### 6.5 Constant re-iteration – Creating the 'Flywheel'

Good to great transformations never happened in one fell swoop. They were all built on incremental change. No matter how dramatic the end result. Like pushing a great flywheel, it can take a lot of effort to get the thing moving at all but once it starts it will eventually reach momentum

Elements of a vibrant flywheel will include high levels of new product development, constant and rigorous debates (but unity once a decision is made), a regular information flow to give management the right facts to manage the business effectively and finally a culture where employee's views are heard and acted upon.

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[17] *Great to Good*, p 13

## 7 Underpin with a deep commitment to core values and the long-term

Creating a great business goes beyond just making money. Within the process you need to uncover your higher-level core values. These will become your leading light as well as setting your moral compass. They can become particularly invaluable when you are not sure which particular path to follow – e.g. 'we could take either of two decisions, but which is likely to conform *most* to our values'?

Core values signal authenticity to your clients and inspire confidence. They mark you out as unique and special in the market place. They may even inspire others to follow your example.

Each value is unique to a company and its leadership. Some may be apparent from the onset, others may emerge from the school of hard knocks or simply over the passage of time – but it is important to avoid bland generalizations.

And finally ensure these values are embued throughout the company, from induction to regular reiteration during discussions on strategy and even everyday business.

**Summary – The distinctive nature of a High Performing Business**

| High Performing | Poor to Average |
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| **1) Your level of Ambition**<br><br>Explicit in aiming for a High Performing Business<br><br>Ambitious targets for impact, growth and profitability. | **1) Your level of Ambition**<br><br>Good enough is acceptable.<br><br>'Impact' infrequently or poorly measured |
| **2) Your Ultimate Advantage**<br><br>The company – its people, processes and culture, is the great creation, not the product. | **2) Your Ultimate Advantage**<br><br>A competent CEO and good product are all that is needed for success. |
| **3) Your Team**<br><br>Prioritize ensuring the right team. If not, deal with weak performers and / or replace if necessary with an A-team.<br><br>A CEO who is collaborative and focused on gearing up the team to '*turn the flywheel*'.<br><br>Senior staff are 'Strong Generals' not 'Weak Lieutenants'.<br><br>Strong and vibrant debate on all key issues of strategy.<br><br>The right new people are continually hired to cope with the growth.<br><br>Ongoing significant investment in staff development | **3) Your Team**<br><br>Do not address weaknesses in staffing. Skip build-up and jump straight to strategy formulation or execution.<br><br>A CEO looking for a quick win, a flashy programme to make it look like they are leading.<br><br>Leadership if any rests only with the CEO. Below this, weak Lieutenants wait passively for instructions from on high. Little serious internal debate on strategy or direction.<br><br>Company revenue growth slows from a failure to hire the 'right people' to sustain the initial growth.<br><br>Low expenditure on staff development in order to maximize profits. |

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| **4) Your Passion & Vision**<br><br>Identify what within your space makes you most passionate and what you can be best at.<br><br>Focus your energies here. Be single-minded and don't divest elsewhere.<br><br>Create ambitious goals – 'Big Hairy Audacious Goals' (BHAGs) as a stimulus to exceptional progress. Developed through an iterative process, sometimes over several years.<br><br>Focus on continual self-improvement and beating yourself. Outperforming competitors is a by-product.<br><br>Make major acquisitions after breakthrough (if at all) to accelerate momentum. | **4) Your Passion & Vision**<br><br>Play it safe. No aspiration to excellence. Profit maximization is the ultimate metric.<br><br>A plethora of activities, some outside your sphere of real knowledge or competence.<br><br>Embrace fads and engage in management hoopla, rather than confront reality.<br><br>Focus primarily on beating the opposition.<br><br>Make major acquisitions before breakthrough, in a doomed attempt to create momentum |
| **5) Your economic engine**<br><br>A clearly identified financial metric that drives exceptional cash generation – e.g. 'profit per customer' as opposed to 'profit per store'.<br><br>Exceptional profitability regardless of industry average. | **5) Your economic engine**<br><br>Based on the sector average.<br>Income sources may be diffuse and lack syngery.<br><br>Profit growth restricted by sector averages. |
| **6) Your Planning & Execution**<br><br>Follow the pattern of disciplined people *('first who'*), disciplined thought, disciplined action.<br><br>Investment grade business plan. Ambitious targets quantified with action plan and clear delivery timetable. | **6) Your Planning & Execution**<br><br>Jump right to action, without disciplined thought and without first getting the right people on the bus.<br><br>Woolly business plans. Grand aspirations but little detail on real finance needed, how goals will be achieved and timetable. |

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| Senior management given flexibility in achieving goals, but held accountable.<br><br>A culture of rigor and professionalism in deciding strategy and reporting back.<br><br>High R&D spend<br><br>Thoughtful harness of appropriate technologies once you know your Hedgehog concept, to accelerate growth<br><br>Constant re-iteration of ideas. Each generation builds on the work of previous generations; the flywheel continues to build momentum. | Bureaucratic controls. Blame culture stifles risk taking.<br><br>Little debate on strategy. Often top down directives. Managers the report back on what was achieved, not what was *supposed* to have been achieved.<br><br>Low R&D spend. Just milking profits.<br><br>Knee-jerk investment in technology changes just to do something, fearful of being left behind.<br><br>New leaders keep introducing radical changes and new fads. |
| **7) Your Vision**<br><br>A vision unique to you and your experiences. It's your powerful motivation over and above making money.<br><br>Provides a compass to help decision-making during uncertainty<br><br>Authentic and infectious. Customers '*get it*' and it helps increase sales, profitability and profile.<br><br>Staff are all aligned with vision and enthusiastically cite it in their deliberations. | **7) Your Vision**<br><br>Vague and bland. Perceived as a 'box ticking' PR exercise.<br><br>Frequently ignored or forgotten by staff.<br><br>Customers are probably unaware, or if they are, do not engage.<br><br>Staff may be cynical and don't use it as a compass during decision-making. |

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