GROWTH MAY BRING RICHES OR IT MIGHT BRING A SMALL OR MID-SIZE BUSINESS DOWN. ANTICIPATING CHALLENGES RATHER THAN SIMPLY REACTING TO THEM IS THE BEST WAY TO ENSURE SUCCESS.
For Marty Metro, the thrill of building a business from scratch quickly gave way to the realities of making ends meet. In 2002, Metro created BoomerangBoxes.com, a retail business for buying and selling used cardboard boxes. Sales were good, and the PR the business was receiving was even better. But then the bills came due.

“The sales were actually the misleading part,” Metro recalls. “At the end of the month you say, ‘Oh my God, I spent 29 days with record sales, but I can’t pay my rent.’ I had borrowed lots of money, and I was selling lots of boxes. But I realized that sales don’t pay the bills—profits do.”

Metro used that lesson to pivot the business. In 2006, he launched a more scalable, tech-centric, and better-funded business called UsedCardboardBoxes.com, which he has since built into a profitable, multimillion-dollar business.

The Internet and an increasingly global value chain bring new speed and force to a moment of truth that Metro and every successful small-business owner eventually faces: the need to start acting like a big business. At this critical inflection point, a management team needs to make changes to the business’s operations, organizational structure, and maybe even the management team itself to continue the company’s growth trajectory.

An inflection point can come suddenly. Consider little-known Orabrush’s surprise 2011 deal to distribute its tongue-cleaning utensil in 3,500 Walmart stores or the unsolicited, 100,000-unit order that UsedCardboardBoxes.com received from the retail giant in 2009. The inflection point may also be more subtle, in the form of sustained, steady growth that increasingly weighs down existing infrastructure and staff.

Regardless of the catalyst, growth eventually forces management to acknowledge that the next phase of their business cycle will be very different from the previous phases. If a management team fails to implement the changes needed to accommodate ever-rising levels of complexity in their business, then sudden growth could morph into a sudden crisis.

Through our client work, research, and a series of interviews with industry experts and small and midsize business (SMB) executives, we have identified four signposts that small businesses should use as drivers of change:

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Management teams can become so consumed with growing the top line that they fail to recognize when operations—and their own abilities to manage them—begin to fall behind. The more they scale the business, the more underlying inefficiencies they create. After a while, the leadership team can no longer take the pulse of the entire business. Losing visibility across the business can lead to issues that take longer to identify—and longer still to rectify.

At this point, the business’s growth engine can begin to sputter. Instead of improving productivity, systems slow it down. Employees become less productive. The business may start missing big orders instead of filling them. The challenge for many management teams is anticipating their business’s operational needs before things reach a crisis point.

There are three management thresholds that SMBs need to plan for:

- Creating the dreaded org chart. All businesses start by hiring on an as-needed basis. But at a certain point (usually around $10 million in revenue) companies have to put a layered management structure in place—a much-maligned but important aspect of maturity otherwise known as middle management. There’s a tradeoff, of course. In return for better-structured, more efficient processes, costs can rise faster than sales. Adding a layer of middle management can eat away at profits even further, increasing the urgency to take in more revenues to cover the additional expenses.
• **Bringing in the suits.** At a certain point in a business’s growth, the CEO changes. When revenues pass $20 million, for example, the CEO no longer has the capacity to be involved in every transaction or attend every customer meeting. To avoid a slowdown, the CEO may have to consider bringing in a professional management team to add the strategic discipline that’s required to drive sustainable growth beyond this threshold.

Bob’s Discount Furniture, a US company, confronted this reality in the mid-2000s, when founder Bob Kaufman and his three partners saw limitations to their abilities to grow and manage the company. They made a decision to sell to a private equity firm which they knew would bring in new management.

The first to arrive was Bill Ballou, who was hired as CFO in 2005. Six months later, the board hired a new operations executive to run warehousing and distribution. Six months after that came a new CEO: Ted English, the former chief executive of the TJX Companies. Ballou’s first task was to rebuild the financial and operational reporting structure. “We formalized warehouse operations reporting, store-level reporting, and the assessment of potential properties to open up new stores, with all the financial metrics behind a new store,” says Ballou. “That had not really been done before. The original partners built a wonderful business, but a lot of things they did were by feel, and we needed to formalize and professionalize decision-making and reporting processes.”

• **Connecting all the moving pieces.** At a certain point (let’s say $75 million), the star widget or service that jump-started the company may begin to run out of growth potential, and it becomes time to add something else. Or the company may see the need to expand into new geographies or industries. Or both. Regardless of how the changes come about, with diversity comes complexity. IT systems, buffered by key performance indicators and business processes, are no longer a luxury—they’re a necessity.

As a company passes through the different management thresholds, it’s critical to keep in mind that foresight is easy to lose. “You have to be forward-looking and understand the critical points that could be problematic downstream,” says Ballou. “You have to make sure you have the lead time required to address any issues so that you can satisfy the growth requirements when you get there. The worst thing any executive team can do is try to grow at a faster rate than they can handle, because that often creates chaos and the entire business will suffer.”
Careful planning can go out the window quickly when a business experiences a sudden surge in new business, such as an unexpected order from Wal-Mart or a product going viral and creating a flood of consumer demand. This type of shock to the system can seriously upset existing logistics and fulfillment systems.

Orabrush, maker of an innovative tongue-cleaning device, had built an impressive online business and was aggressively courting physical retailers, including Wal-Mart, to expand its business. But it was not prepared when the retail giant suddenly called in 2011 with an order for 735,000 Orabrushes to be distributed in 3,500 stores.

“That was one of the big wake-up calls for me,” says Jeff Davis, an early Orabrush investor who became CEO in August 2010. “That’s where I was worried that we didn’t have sufficient capability.”

The short-term solution to an unexpected surge of business is often a large dose of elbow grease. Everyone pitches in, with the tacit understanding that a positive experience for the new customer will likely lead to more business.

A big order is often a mandate for change, however, because even if by nature the management team is conservative and risk-averse, it has to make changes to satisfy demand. An order from Wal-Mart can propel a small business into a new growth stage—if it can upgrade its infrastructure to support the increased burden.

“For us, Wal-Mart’s order was a big a-ha moment,” says Metro, from UsedCardboardBoxes.com. In 2009, after its initial pivot, Metro’s startup was three years into its rapidly growing e-commerce business selling used cardboard boxes to individuals and local businesses. It had created a robust online marketplace for buying and selling boxes and nine physical distribution centers across the US. But nothing could prepare Metro for the order he received from Wal-Mart one afternoon: 100,000 boxes by the end of the week, with more likely to follow in the next two weeks.

The order convinced Metro to remake his consumer-focused business into a high-volume supplier of boxes to large companies. “I thought, if I can build a B2B marketplace of tractor trailers of boxes, there will be plenty of boxes to [support the consumer business]. That’s when we really changed our focus to go after the big boys.”
Most small businesses tend to start out locally. But technology and a global economy have made it much easier for businesses to extend their operations quickly across borders. For a management team without prior international experience, global expansion can be a huge challenge—and a significant inflection point for the direction of the business.

While the processes for managing the supply chain have improved dramatically, the most important factors in global expansion—local experience and knowledge—remain frustratingly analog. Not only must management teams know the markets they wish to enter, they also must understand the specific strengths and weaknesses they bring to each market. Only then can they identify the best way to leverage key competencies, such as customer relationships, technical knowledge, or industry expertise, into new markets.

For many companies eyeing global expansion, the biggest issues generally revolve around logistics. Drive Medical Design and Manufacturing is a fast-growing manufacturer of durable medical equipment. From its base in Port Washington, NY, the company has expanded its distribution facilities across Canada, the United Kingdom, Germany, Romania, China, and Taiwan. Several of these facilities have come via acquisition. The company’s approach is to let these distribution companies operate
Independently initially but to eventually roll them into the same systems and processes used in the US business.

Drive’s senior management understands that as the company grows, they will need to find new ways to differentiate not only Drive’s products but also its distribution methods. “We’re looking at more agile supply chains so we can handle unexpected events like an interruption in China,” says William Cerniglia, Drive’s CIO. “We want to create a lean distribution method, like Amazon, to get products to our customers faster.”

Globalization can come quickly for an online manufacturer or retailer. Gone are the days when a company could carefully craft an international go-to-market strategy based on market research and competitive analysis. Once you get that first online order from a customer in Argentina or Korea, you’re suddenly an international distributor.

That scenario has played out at Orabrush, whose business grew rapidly on the back of an aggressive and innovative social media strategy featuring YouTube videos about bad breath. “Even though we never localized that content, it quickly went global,” said Davis. “We were getting calls from countries wanting to distribute our product or put it in their retail stores.”

Using this reverse-marketing model, Orabrush focused first on creating high levels of awareness online and then secured the distribution channels as demand grew. Orabrush now has a retail presence in 15 countries.
Different types of small businesses will take varying approaches to investment. For example, hyper-growth companies—those that have a product or a business model that they believe is going to take off quickly—are much more willing to invest ahead of the curve. They want to put the infrastructure in place to support the growth when it comes, so they are often open to outside investment.

Family-owned businesses tend to be more conservative, particularly if the original owners are still in place. They generally focus on low-risk, incremental investments, carefully weighing all options before pulling the trigger on large capital expenditures or external funding.

That’s a prudent strategy, especially for management teams that don’t want to give up control of strategic decision-making. For most businesses, the best source of capital is cash flow from operations.

At some point, however, achieving growth objectives may require even the most conservative of ownership teams to consider external capital. During its first 15 years, Bob’s Discount Furniture grew steadily and was profitable. But by the mid-2000s, founder Kaufman and his partners realized that for that growth to continue, they needed an infusion of funding. Selling to a private equity firm gave Bob’s the structure and financial support needed to accelerate growth. The sale and subsequent investments to upgrade Bob’s operations and infrastructure had a big impact: During its first 15 years, the company had launched 18 stores; in the 6 years after being acquired, the company grew to 43 stores.
Four Steps for Staying Ahead of the Inflection Points

Shocks to the system are likely to happen along the path to growth. But what steps can you take to manage them rather than waiting for them to happen to you? Here are four best practices to help management teams embrace the inflection points of their business instead of hiding from them.
1. Always Look Big—Even If You’re Not.

Companies rarely do business through a single channel anymore. Customers expect access to a brand through a variety of physical and virtual touch points. SMBs need to make sure that their customer interactions are consistent and professional across all channels. Every interaction, particularly with larger customers, must be consistently high quality. Steps may range from making sure you have a professional-looking website to supporting EDI and other standards that enable your systems to integrate with customer’s existing financial and supply-chain systems.

Technology, obviously, is the great equalizer for small businesses trying to look bigger than they actually are. It can bring a level of sophistication and standardization to a business of any size to help it compete globally. The ability to speak a much larger business’s supply-chain language can reduce the amount of time it takes to produce and fulfill orders and to open new doors to collaboration.

Technology can also help a business scale more quickly by expanding the workforce or by building or buying new facilities. More businesses, especially post-recession, are particularly wary of adding headcount at the risk of having to cut back again in the next downturn. Technology doesn’t replace people, but it can help businesses increase the existing workforce’s productivity and efficiency.

Future investments in human capital may be focused more on vertical skills, such as engineering, rather than administrative or other general skills. Businesses are finding that by automating more processes, they can do more with fewer people and redirect some of those costs toward engineering or other specific expertise.

2. Keep Resources and Infrastructure Flexible.

Most small businesses are understandably hesitant to invest heavily in systems, facilities, or other infrastructure ahead of demand. It’s better to focus on lower-cost capabilities that can scale along with the business. For example, identify areas where the business can support variable resources, such as hiring contractors instead of full-time employees or renting instead of buying facilities or equipment, to avoid making large capital expenditures.

Scalability also involves building shareable and repeatable processes. There’s no need to reinvent the wheel to accommodate new customers, new product lines, or global expansion. Drive Medical, for example, has grown overseas both organically and through acquisition. The acquisitions required the management team to come up with a way to harmonize the business’s supply-chain processes as much as possible around the globe.

“The goal is to bring our systems [to international facilities] and just hand them a book so they can implement quickly,” says Cerniglia. “There will be some changes in terms of local pricing or freight requirements, but we want to keep the heart and soul of distribution and warehousing as vanilla as possible.”

Similarly, a critical element of UsedCarboardBoxes.com’s growth is a standardized distribution model that ensures consistency across the network. “Our business is about boxes, vendors, and customers,” says Metro. “We built a system that allows us to add more boxes, more vendors, and more customers without changing our policies or our processes. It’s all about scalability and not attaching little things as you build the business. I would never start a business that didn’t have that scalability from the start.”

FOR MOST BUSINESSES, THE BEST SOURCE OF CAPITAL IS CASH FLOW FROM OPERATIONS. AT SOME POINT, HOWEVER, ACHIEVING GROWTH OBJECTIVES MAY REQUIRE EVEN THE MOST CONSERVATIVE OF OWNERSHIP TEAMS TO CONSIDER EXTERNAL CAPITAL.
3. Be Ready to Change the Business Model.

Not every “manna from heaven” order is worth celebrating. Metro, for example, learned a valuable lesson about what can happen when the big players come calling: not every high-volume sale leads to profits. “Wal-Mart is so huge that you have to be careful,” he says. “If you don’t want to sell at the price they want, they can always find someone else who will.”

At the same time, a big order can signal an opportunity to change up your business model, as Metro discovered. The Wal-Mart order convinced him that a B2B model could be much more lucrative over the long term than a consumer-oriented commerce site. His team re-jiggered the business, building an online B2B marketplace that delivers tractor trailers full of boxes across the country, not just small bundles to consumers and local businesses. “We used to sell $100 moving kits,” he says. “Now, our average order size is a $7,000 truckload.”


No matter how proactive a business tries to be in planning for growth, the reality is that unexpected turns are inevitable. And there are only so many resources SMBs can devote to adding new capabilities at any given time. A big order from Wal-Mart may warrant changes across the entire business, but that doesn’t mean you can make them all at once.

When unexpected events provide a shock to the business system, management teams have to prioritize the most urgent needs. A good rule of thumb for prioritizing: Start with the customer and work backwards. For many businesses, this translates to ensuring that they have enough inventory, and enough capacity, to deliver a full order on time.

If you finally land a big customer but can’t deliver what it’s looking for, word will spread quickly and the chances of another big order from it or any business like it is unlikely. But if that first large customer is happy, it may keep doing business with you, providing critical capital that can be used to address other operational gaps.

The customer-first approach has worked for Drive Medical as it has expanded into retail and other new businesses. “We’re a very entrepreneurial company, so we probably take more risk than some other businesses might,” says Cerniglia. “If something blows up, our approach is, ‘Fix it and take care of the customer as quickly as possible.’”

Outside Expertise

We spoke with three SMB experts about the inflection points small businesses face. Here are the highlights.

What are the signposts that tell a leadership team that growth is starting to outpace operations?

Steve Niesman, CEO and president, itelligence North America: There are inflection points that are revenue based and customer driven. When you cross certain revenue thresholds, you ratchet up the level of pace and intensity. These milestones impact the supply chain, the accessibility of talent, and the need for technology.

How does global expansion affect the operations of SMBs?

Karl Stark, managing director, Avondale Strategic Partners: You need to look at the key capabilities you bring to the table—such as customer relationships or specific technical or industry expertise—and how you leverage them into a much bigger part of the world. The key is to take one piece that you’re good at and leverage it into another segment. You can also consider mergers and acquisitions or partnerships for entering new geographies. Look for partners who can provide you with complementary pieces of the puzzle.

How does a business get out in front of all these changes instead of simply reacting to them?

Grant Fraser, CEO, Navigator Business Solutions: If you’re sure you want to make the leap to the next tier of business, then have a clear plan, with clear metrics. Will you have enough cash to add new offices and new salespeople? It’s a lot easier to define what your metrics should be when you’re thinking out in front of the changes.
Don’t Let Growth Drive You Off a Cliff

Growth is what it’s all about for SMBs with ambition. In their drive for more revenue, however, they must also keep in mind the implications of growth on the rest of the business. Keeping a watchful eye on the signs of a company’s growing pains—and taking proactive steps to minimize those pains—can help to ensure that a business makes a smooth transition from small to big.

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