GROWTH STRATEGIES

It's a Stretch

Too small to take on big clients? Not enough big clients to grow? Unsnag your Catch-22 before business growth becomes a self-defeating concept.

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January 1, 2002 10 min read

This story appears in the January 2002 issue of *Entrepreneurs Start-Ups magazine*. Subscribe »

Hal Galvin recently got a huge order from a huge customer. So why isn't he singing "Happy Days Are Here Again"? Because he can't fulfill it. In fact, Galvin, CEO of AlumiPlate Inc. in Minneapolis, says the massive opportunity would require a $10 million investment--enough to generate 20 times AlumiPlate's current annual capacity for applying its patented metal-plating technology--if rolled out across the customer's entire product line. Without the big customer, however, Galvin can't afford to expand his 12-person plant enough to be able to serve such big prospects.

"It's a little bit of a Catch-22," Galvin understates. "You need the customer to get big, but you're not big enough to have the customer."

AlumiPlate's experience is another example of the difficulty of bridging the gap between a good product and enough capacity to satisfy the needs of the big customers who could make it a huge success. Many traditional sources of expansion loans, such as banks, won't help small companies build new production facilities to serve customers they don't yet have. Longer-term investors who might, such as venture capitalists, are viewed as too costly in terms of control and equity by many

entrepreneurs--not to mention that in today's environment, they're almost nowhere to be found.

It's a make-it-or-break-it problem for entrepreneurs, and the issue is especially critical for purveyors of new technology, who can't simply subcontract out their production to other manufacturers.

And it's certainly key at AlumiPlate. Without a much larger production capacity, Galvin can't even attempt to sell his corrosion-plating to potential huge customers such as the auto industry giants. His latest prospect, while pleased with his product in trials, is understandably unwilling to commit to a purchase when the plant to build large volumes doesn't even exist.

Meanwhile, Galvin finds himself trying to grow in a no-man's land where his prospects are customers too small to boost him to the next level and those whose overwhelming needs could cause him to lose his company if he chooses the wrong tool to pay for expansion. "A lot of people don't understand," Galvin explains, "that the big fish can kill you."

Planning Ahead

It goes without saying that many entrepreneurial companies manage to negotiate the impasse. Licensing, joint ventures, progressive expansion--also known as bootstrapping--and other techniques allow their capacity to grow to the point where they can achieve precisely the kind of success its ideas qualify it for. If you anticipate facing such a Catch-22, the first thing to do is plan for it before you need to, says Jeffrey S. Davis, chair of Needham, Massachusetts, small-business management consulting company Mage LLC.

Set up adequate financial controls and record-keeping to convince a potential lender, equity investor, licensee, partner or other entity you are a worthy recipient. Find out what the various sources of expansion capital require. Know, for instance, that banks will lend money against purchase orders but probably won't advance funds until you have the order actually booked. Also study how to negotiate with banks, VCs and others. "Good entrepreneurs think some of these things through ahead of time," Davis stresses.

Don't neglect the human component, either. A big prospect's reluctance to place a sizable order may be due as much to your lack of qualified employees as to a dearth of financial or production wherewithal. Greg Kelly, CEO of 20-person Biotech Corp. in Glastonbury, Connecticut, found it relatively easy to outsource manufacturing of the natural herbal supplements he sells through national drugstore chains. But he still wasn't able to get the big orders until he hired salespeople--who had experience selling to those customers--away from his competitors. "The main thing," says Kelly, 43, "was surrounding myself with people who already had the relationships set up to get in to see the major chains."

LOOK THE PART

Sometimes the absurdity of a Catch-22 is only skin-deep--or, as the case may be, as deep as the clothes you're wearing. John Curtiss, a sales and marketing consultant with Houston-based Silver Fox Advisors, says that failing to look like a worthy supplier can be as big an impediment to selling to big customers as your financial status.

"Act the part," Curtiss advises. That may mean wearing a power suit for meetings with prospects or renting offices at a prestigious address. It may also mean having the poise to refrain from making promises you aren't sure you can keep.

"Anybody can promise the moon," says Curtiss. "But when you can't deliver, that'll be the last sale you make. The trick is to portray yourself with staying power, without setting up expectations in your customer's mind that you can't meet."

Breaking the Impasse

Tools to help you build the production you need range from private equity financing to licensing. Equity investors such as VCs were the expansion backers of choice for Internet companies in the 1990s. Today, VCs are more cautious, and, especially if you're in a less sexy field such as metal-plating, they're slow to throw wads of cash at you, says Galvin. "We're very likely to have a hard time finding an investor," he says. "It's boring manufacturing, and we don't offer the kinds of skyrocket returns some investors are used to."

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A joint venture with another company that has existing production capacity or the cash to build it is a possibility for some firms. But it's important to remember that dancing with elephants gets you squashed. "A lot of guys see a big company they can partner with and then a year later decide they want out of it, and they can't [get out]," Davis warns. "Afterwards, they have this partner on their neck for the rest of their life."

Debt financing offers control-sensitive entrepreneurs a much more comfortable arrangement than taking on an equity investor or joint venture partner. But that doesn't mean it's a cinch. With a customer unwilling to order before he can pay to build the needed plant, and lenders unwilling to provide money without an order, Galvin needs to get a financing commitment contingent on a purchase commitment. So far, he hasn't been able to do that. "Banks weren't interested at all in a project like this because the company was too small and didn't have a history of operating a plant of that scale," he says.

Make sure your sales team also "looks the part." Read "Hey, Good Lookin!" for more information.

Banks and alternative lenders such as factors do, of course, provide financing for receivables. But giving a business upfront cash to fulfill a contract before a receivable has been created is viewed as far riskier than simple factoring, and few lenders will do it for young companies. When the money is to pay for expansion to meet projected demand, rather than to fill on-hand orders, the chances of making a deal fall even further.

That still leaves licensing, a powerful tool for making money off your ideas without having to invest much in facilities to turn them into products. One problem with licensing, however, is that it's expensive. Galvin estimates that if AlumiPlate licensed its patents to a firm that could build the needed plant, he would receive just 2.5 percent of the value added by the plating technology. "If we had the $10 million, we percent of the value added by the plating technology. "If we had the $10 million, we

could get a 30 percent return annually on it," he says. "By licensing, we'd be giving up the lion's share of the return to the source of capital."

Back to Basics

There's still another way to get where Galvin needs to go. It's by selling what he can to small clients who may, over time, provide enough profits to gradually expand to the point that he can service larger customers. If your current small customers grow enough, they may even turn out to be as large as or larger than that big prospect who today remains just out of reach.

That's what happened to Brad Stillahn. In the early 1990s, Stillahn, CEO of Denver-based Adstick Custom Labels, began looking for customers who had more growth potential than the single-location florists and other small retailers he provided with pricing and other labels. One of the companies he hooked up with was a local chain of sandwich shops called Quizno's that had about 40 locations at the time. "Because we were both small, we developed a trust-based relationship," says Stillahn.

Today, Quizno's Corp. owns or franchises more than 1,200 units, and Adstick is still the primary supplier of labels to the system. "The advantage to us is that now we have an operating model to take to another large company with hundreds of locations," says Stillahn, who has 20 employees. "Three years ago we would have been hard-pressed to do that."

Finding high-growth clients meant a major shift in marketing and positioning at Adstick. AlumiPlate's Galvin is facing a similar shift for different reasons. His large prospect wants to use his plating to protect hydraulic fittings for agricultural applications. That's a high-volume, but not particularly high-margin, business. If Galvin bootstraps, he'll need to focus on high-margin, lower-volume applications, and that takes a different sales approach.

He thinks he's found one in semiconductor manufacturing, where key parts of chip-making machines are now made of exotic, costly metals to withstand highly corrosive chemicals used in the plants. Plating saves chip-makers more money, and the higher prices they'll pay make the smaller volumes economical for Galvin. "We'll just have to go after smaller customers where the value proposition is different," Galvin says.

In some ways, lenders' and others' refusal to accept AlumiPlate's proposition is a good thing. Small companies that stretch to take on very big customers can find themselves in an uncomfortable position. "You can easily become totally dependent on that client," says Davis. Entrepreneurs may leave themselves open to potentially ruinous price pressure from that one, all-important customer. And, should the customer cut back on orders or stop ordering altogether, the effect could be catastrophic. "You think it's hard to ramp up?" Davis asks. "It's generally harder to ramp down."

For now, Galvin hopes to avoid being overly dependent on a single client, but he still wants to be able to service big clients by growing gradually and safely. But meantime, he's still looking for someone to loosen the purse strings and help him claw his way out of his Catch-22. "Eventually," he says, wearily but hopefully, "somebody is going to give us the money, and we'll find that big market."

START A GROWTH SPURT

- **Best Banks for Entrepreneurs** is our listing of the nation's most small-business-friendly banks, based on the results of an SBA report on microloans.

- **BusinessFinance.com** is an online directory of thousands of business lenders and capital sources as well as a robust source for anyone who wants to learn more about funding techniques. You can walk through the process of financing accounts receivable, request a free workbook on preparing polished loan requests, study up on finance terminology, and get a referral to a financier suited to your needs.

- ***Where's the Money? Sure-fire Financing Solutions for Your Small Business*** (Entrepreneur Press), by Art Beroff and Dwayne Moyers, is a practical, comprehensive manual for breaking the financial impasse that keeps many entrepreneurs from achieving their full potential. Beroff and Moyers lucidly and entertainingly lead growth-minded business owners through techniques for everything from start-up financing and equipment leasing to angel investors and IPOs. The two offer particularly good advice on SBA-investors and IPOs. The two offer particularly good advice on SBA

guaranteed loans intended to bridge the sort of gap that many face in Catch-22 situations.

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