Economist Intelligence Unit

The Economist

Scaling SMEs
Building a flexible platform for growth

A report by the Economist Intelligence Unit

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About this research

Scaling SMEs: Building a flexible platform for growth is an Economist Intelligence Unit report that discusses how high-growth small and mid-sized enterprises (SMEs) are scaling their organisations to provide resources for growth whilst ensuring flexibility to respond quickly to changes in market conditions; the role of technology in scaling SMEs; and success factors in scaling headcount. The findings of this briefing paper are based on desk research and on in-depth interviews conducted by the Economist Intelligence Unit with founders and managers of SMEs and other experts.

For the purposes of this report, SMEs are defined as businesses with annual revenues below $750m. In the context of businesses of this size, scaling is defined in this report as developing an organisational structure and operational platform to ensure sufficient resources for sustainable growth. Scaling is therefore understood here to be distinct from growth in the volume of business that the company conducts.

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- Thomas Eisenmann, professor of business administration, Entrepreneurial Management Unit, Harvard Business School, US
- David Howden, chief executive officer, Hyperion Insurance Group, UK
- John Evarts, chief financial officer and chief operating officer, Mediafly, US
- Ricardo Pansa, chief executive officer, Nutriplant, Brazil
- Jason Lippitt, managing director, TMAT, UK
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Executive summary

Small and mid-sized enterprises (SMEs) play an important role in economies across the world. In the European Union, for example, SMEs employ two-thirds of the workforce—but create 85% of new jobs. Still, as they grow, many SMEs face constraints on their resources. Especially in times of economic uncertainty, expanding resources carries considerable risk; yet, amid intensifying competition, SMEs must prioritise growth in order to survive.

This need to pursue growth raises the question how managers of SMEs can best provide additional resources to enable continued expansion, whilst ensuring that investing in these resources does not threaten the viability of the firm. The answer lies in scaling the organisation by building an operational platform on which to deliver growth—whilst maintaining the flexibility that is critical in enabling management to respond to changes in market conditions. In short, these businesses are pursuing growth whilst remaining resilient.

Examples of successful scaling among SMEs provide useful insights into how high-growth businesses are tackling this challenge. This briefing paper, based on desk research and on in-depth interviews with founders and managers of SMEs and other experts, discusses how businesses are building flexible platforms to provide resources for continued expansion. The report discusses operational strategies for scaling the business; the critical role of technology in scaling SMEs; and key issues in scaling headcount.

Here are the key findings of the research:

- **High-growth SMEs set operational strategies to scale the business.**
  As part of corporate growth strategies, SMEs are setting out how they expect to scale their operational platform to ensure they have adequate resources to be able to deliver on the firm's corporate growth strategy. Defining the future organisation is a first step in setting such an operational strategy.

- **For some SMEs, scaling entails new structures and processes.**
  As part of efforts to scale their businesses, SMEs are putting in place new, formal, organisational structures. They are also drawing up policies and establishing processes, for example around human resources or finance. These processes are often standardised, repeatable, and automated, and pave the way for the organisation to 'take care of itself'.

- **IT tools and systems are increasingly accessible to SMEs.**
  High-growth SMEs have better access than ever before to information technology tools and systems, for example cloud computing

and enterprise resource planning systems. These resources are now widely available on an as-needed basis, reducing capital requirements and costs, and providing scalability, flexibility and resilience.

- **A balanced funding structure can support the scaling process.**
  Experts say that a sound cash position and solid cash flow are important prior to scaling, as subsequent business growth puts pressure on working capital. Maintaining high-quality financial statements and a balanced funding structure are additional success factors in scaling a high-growth SME.

- **Sound HR capabilities are the key to scaling headcount.**
  Some managers take only experienced recruits; others prefer to train recruits. Either way, sound human resources capabilities are critical to scaling headcount. Interviewees caution that an SME may outgrow some employees as it scales—but say that there is no room for unproductive employees in a high-growth business.

- **Preserving company culture is critical as SMEs scale.**
  Business managers say that preserving the company culture is among the most important—and one of the most difficult—elements of scaling. Artificial or complex values do not scale well, according to interviewees; the key to success appears to lie in simplicity of the values underlying the company culture.

1 An operational strategy for scaling

As high-growth small and mid-sized enterprises (SMEs) expand, many arrive at a point where their continued growth is held back by operational constraints—insufficient resources to deliver goods and services. This resource shortfall may include technology, headcount, and more. "The key to scaling is to have adequate resources available to you for when you're ready to expand," says John Evarts, CFO and COO at Mediafly, a US-based SME that provides media technology services to businesses. "From an operational strategy point of view, part of my role at Mediafly is to move the business to a place where the infrastructure can best support our products and our sales team."

In response to these constraints, many managers of SMEs choose to scale their organisations to provide an operational framework for further business growth. Scaling can provide a platform on which management can deliver its growth strategy, and can pave the way for the transition from dozens of employees to thousands of employees; or from tens of millions of dollars of annual revenues to hundreds of millions of dollars. "It's more exciting as the company gets bigger, because the magnitude of the numbers changes," says Sean Zimdahl, co-founder and CEO of UK-based recruitment business Aston Carter.

The millions of SMEs across the world play an important role in the economies of both developed and emerging markets. SMEs account for two-thirds of employment in the European Union, for example, but create 85% of net new jobs, according to data from the European Commission. SMEs are an important force in creating new jobs, in driving innovation, and in increasing competition. While expanding resources amid widespread economic uncertainty is risky, managers of SMEs must prioritise growth in order to survive. The key to growth lies in successful scaling.

Aston Carter is a case in point. Within three years of Mr Zimdahl co-founding the business in 1997, the firm won a number of large clients—a pivotal moment that required that Aston Carter scale its organisation. "We put together very strict working models and repeatable practices that allowed us to grow the business more," recalls Mr Zimdahl. "That came hand in hand with being more strategic about technology investments. And we were also able to scale the business from a personnel perspective." (See *Critical factors in scaling headcount*, p 10.)

As SMEs grow, many are including in their corporate growth strategy an operational strategy that spells out how the business will deliver that growth. David Howden, founder and CEO at the UK's Hyperion Insurance Group, describes it like this: "It is not just the strategic direction of what products we are going to sell, and what countries we are going to sell them in, and how we are going to sell them," he says. "It is how are we going to put the right operational infrastructure in place to allow that to happen? As you get larger, you've got to work out—early on, before you need it—how you put the operational structure in place."

A first step in scaling the operational structure is defining the future organisation. At Hyperion, Mr Howden decided on a decentralised structure. "We started off by saying that the way we're going to build this business is by not having too much central control; we're going to build a more fluid, flexible business." Management decided to keep the organisation lean to maintain flexibility: "The head office is very tight so that if we do hit something, we can react quickly." Martín Migoya, co-founder and CEO of Globant, an Argentinian software developer, agrees: "The secret to having a flexible organisation is to have a very efficient SG&A [selling, general and administrative] structure," he says.

Prior to scaling the business framework, managers are also defining the company's focus in terms of operational effectiveness. "One of the key developments over the last five to ten years is that there are a lot of 'back office' functions that you can outsource," says Bryan Pearce, Americas director at Ernst & Young's Venture Capital Advisory Group. This enables greater cost flexibility, he points out. "But what are the things that you really have to be good at yourself?" he asks. "Those are the things that are initially critical to your business." (See box: *In-house or outsourced?*)

New structures and processes

SMEs often put new organisation structures in place as part of their scaling strategies. "A typical problem is that the business doesn't have the kind of systems and structures in place to provide confidence to an investor that the business has really got the capacity to grow," says Oliver Bayne, an official at the UK government's Department for Business, Innovation and Skills. Scaling often involves shifting away from a loose, informal structure around the CEO to a tighter, more formal organisational framework.

Indeed, Mr Migoya of Globant in Argentina believes the key to success in scaling is for the founders,

In-house or outsourced?

SMEs planning to outsource back office or administrative functions such as information technology support or payroll processing have a wide range of options. As SMEs scale up, outsourcing provides them with the resources they need to support their growth—on a flexible basis.

Yet, as SMEs grow larger, some managers say they increasingly view capabilities in areas such as information technology or human resources as being strategic to the business. With greater scale, and greater resources, these managers argue that the benefits of taking those functions in-house outweigh the cost and flexibility advantages of outsourcing.

Here are two examples of firms that outsourced these functions during their early growth phases, and later took them back in-house:

- When Sean Zimdahl, CEO of UK recruitment business Aston Carter, scaled his business, he outsourced IT support. Later, the firm built up its own team. "As the business grows, you want to keep as much of it in-house as you can," Mr Zimdahl says. In-house staff understand the culture of the company and can be held accountable, he says. "If I call my IT department and say our Utrecht office is down, they know that there is nothing more important than to get that office up and running again."
- David Howden, founder and CEO of Hyperion Insurance Group in the UK, explains that his firm made use of outsourcing to deal with the company's human resources activities. "But now we're going the other way," Mr Howden says. "If we're really serious about that, if it's really a core part of our business, we actually need to 'in-source' it and start doing it ourselves."

owners, or managers to move aside. "The main thing is to get out of the way," he says, "and to establish processes that are not dependent on any of the founders." Accordingly, experts interviewed for this research say a crucial step in scaling SMEs is establishing simple departments, management structures, reporting lines, communications channels, and more.

Scaling also entails drawing up policies and disciplines, and establishing standard, repeatable processes around areas such as administration, finance, and human resources. "Our systems allow us to multiply the productivity of each individual by standardising and automating many of the everyday procedures, such as purchasing and invoicing," says Ricardo Pansa, CEO at Brazil-based crop science firm Nutriplant. Processes like these are critical to scaling, as Mr Zimdahl demonstrates: "Once you have got the right infrastructure and expertise in place to help you manage the business, pretty much everything in the organisation takes care of itself," he says. (See box: *Aston Carter—Processes and disciplines around cash*.)

Aston Carter—Processes and disciplines around cash

Sean Zimdahl co-founded recruitment business Aston Carter in the UK in 1997, funded by a loan from his parents. Following rapid growth and a private equity investment, the business was acquired in 2011 by Allegis Group of the US, the world's fourth largest recruitment and staffing firm, and now generates annual revenues in excess of £300m.

Among the lessons Mr Zimdahl has learnt along the way is the need for processes and disciplines around cash management. "We brought in a management consultant to look at our business when we got to £10m of revenues," he says. The consultant's finding: Aston Carter was not efficient enough in converting sales into cash. "That was brand new to me, given I had never been trained to be an accountant, and had never run a business before," recalls Mr Zimdahl.

The company then put in place the cash management procedures that had been lacking, and built relationships with accounts payable staff at client companies. "By the time we got to £50m, the flow of funds in and out of our account, and the disciplines we had in place, were embedded, which means there was never a concern after that," according to Mr Zimdahl.

Processes and disciplines like these are all the more important in the current economic climate, says Mr Zimdahl. "That is where smaller business, particularly currently with the lack of funding in the business community, will fall down, because they don't have the financial disciplines in place or the knowledge of how to chase an invoice and make sure it is paid."

2 Leveraging technology to scale the SME

Information technology is an important issue to address in scaling the operational platform, according to business leaders. And as they scale their organisations, high-growth SMEs may have a distinct competitive advantage over larger enterprises: The speed at which technology is changing. "Some large companies are lumbered with old systems that are slowing them down, rather than speeding them up," says Mr Howden of Hyperion. "One of our competitive advantages was that we built the business from scratch and therefore we weren't saddled with legacy systems."

What is the key to success in leveraging technology to scale the organisation? "You need to have a very inexpensive, flexible, dynamic and scalable IT platform," according to Brian Protiva, co-founder and CEO at ADVA Optical Networking, a Germany-based provider of network equipment. Mr Protiva comments that SMEs today have better access to IT capabilities than in the past. "It's much easier to get your hands on good IT at an affordable cost," he says.

Improving IT capabilities at an affordable cost often starts with cloud computing. High-growth firms no longer need to tie up capital in server farms or other hardware as they did in the past. Lars Hinrichs, CEO of Germany-based venture capital provider HackFwd, says that none of the

Special purpose technologies—A cautionary tale

Thomas Eisenmann, professor of business administration in the Entrepreneurial Management Unit of Harvard Business School in the US, advises that SMEs are more likely to succeed in scaling if they rely on general purpose technologies, such as computers that can be put to many different uses, rather than special purpose or custom built technologies, such as systems that are designed for specific and limited uses.

A cautionary tale in the use of special purpose technologies is that of Webvan, an online grocery business in the US. "They designed automated warehouses and had to write software and design conveyor belts, robots and all that jazz," Professor Eisenmann says. After ploughing through a billion dollars, the business failed in 2001.

There is a plain lesson to be learnt from Webvan. "The more special purpose the technology is, the more you will be subject to delays and capacity constraints," Professor Eisenmann points out. "The more you rely on general purpose technologies to invent, build and deliver the stuff you're doing, the easier it is to scale."

firms in his portfolio have servers—or the capital to tie up in servers—and that they access computing power in the cloud from notebooks. "Anything else would be insane nowadays," Mr Hinrichs says. "The prices for the cloud, with endless computing power, are decreasing every single day."

Mediafly is one SME that has used cloud computing to build a flexible platform for growth. Without access to the cloud, Mr Evarts says, Mediafly would have needed to invest in IT systems to host data, IT teams to manage the systems, plus capacity for redundancy and disaster recovery—a huge commitment in capital investment and ongoing cost. Now, though, Mediafly is able to "use a cloud-based provider that has all those capabilities on an as-needed basis," he says. "Having limited fixed costs associated with our business model is a huge benefit as it keeps us flexible."

Beyond the financial benefits, cloud computing offers further advantages. Mr Evarts notes that cloud computing also enables greater accessibility of management information. For example, Mediafly is using an online accounting software that automates invoicing, billing, reporting and other financial processes, he says. "Having a cloud base means that we can solve these issues from anywhere, figure out what the task load needs to look like, and deploy resources in real time. The cloud makes information so much more accessible."

Access to management information tools

Interviewees agree that management information systems are becoming more widely accessible to SMEs in general—a further factor that is enabling high-growth SMEs to scale their operational platform. Jason Lippitt, managing director of TMAT, a UK-based manufacturer of acoustic materials for agricultural vehicles, uses the firm's ERP system for budgeting and planning. Such a system may have been out of reach of a firm like TMAT in the past, Mr Lippitt points out. "A company of this size would have run on spreadsheets a decade ago," he says. "It can be done that way, but it needs more human intervention to analyse the information."

The growth of software-as-a-service models is also bringing sophisticated management information systems within reach of SMEs. "Now, the whole software-as-a-service movement is just disrupting the competitive advantage that for a long time large companies had over start-ups, which was access to sophisticated systems and data collection," says Linda Rottenberg, founder and CEO of Endeavor Global, a US-based not-for-profit organisation that supports promising entrepreneurs across the globe.

Ms Rottenberg points out that these systems are now accessible to even the smallest SMEs. "I think entrepreneurial firms used to assume that sophisticated technology was beyond them," she says. "Now they're realising that they can have fully loaded ERPs [enterprise resource planning systems] and CRMs [customer relationship management systems] on their iPads and on their mobile phones. Everyone from the smallest merchant can now turn an iPad into a cash register, and now even a two-person company can have access to ERP and CRM systems."

Financial preparation for scaling

Before managers of SMEs scale the operational platform of their business to enable further growth, they should ensure the business is prepared in financial terms, experts warn. In interviews, company founders, CEOs, and other experts highlight the following areas:

- **Keep a strong cash position.** Many businesses fail during periods of rapid growth because, in their excitement to grow, they lose sight of their working capital. Company managers should not take their eye off their cash position and their cash flow as they scale.
- **Keep funding balanced.** Ensuring a balanced capital structure means the business will be more resilient if there are significant changes in market conditions. This way, movements in interest rates, and other market changes, are less likely to threaten the business as it scales.
- **Maintain high-quality financial statements.** As SMEs grow, it is possible that new clients or new suppliers will scrutinise the firm's financial position. Sound financial statements and balanced funding will help reassure prospective business partners.

3 Critical factors in scaling headcount

Many experts in SME growth argue that scaling the business is about people just as much as anything else. A critical question to raise, according to Thomas Eisenmann, professor of business administration at the Entrepreneurial Management Unit of Harvard Business School in the US, is: "Have you got managers in place who know how to run a bigger operation?" In many cases, the answer is no. "Another step change in a business's scalability is bringing on board individuals who have been there and done it," says David Whileman, partner and UK managing director at private equity firm 3i Group.

Besides the skills and experience of senior management, a further success factor in scaling headcount in an SME is the firm's capabilities in recruiting. Martín Migoya of Globant in Argentina explains why: "You need to have a very good recruiting team," he says. Selecting the people in the first years of the company is crucial, he says, "because that will be the DNA of your company in the following years, and that DNA will be extremely important for the future potential of the company."

Some managers and experts argue that the single most important rule in growing the company's headcount is to attract the best possible talent. Says Lars Hinrichs: "The best people can always work for the best companies; and the best companies can always attract the best people." Mr Hinrichs cautions that particularly fast-moving companies such as technology start-ups may be better to leave a position open rather than settle for second best. "If you settle for second best, your company gets slower," he says.

What is the key to success for SMEs to attracting and retaining the best talent? "First of all, it is having a very aggressive policy as far as the money is concerned," says Eduardo Schaeffer, the CEO of ZAP, a Brazil-based real estate portal operator. "ZAP pays well compared to the competition." And to reduce staff turnover, Mr Schaeffer says, "we focus on building a corporate environment that's very challenging and very rewarding." That includes continuous training, extra-curricular activities, and on-site healthcare. But it also includes empowerment, according to Mr Schaeffer. "One of the things that ZAP believes is an incentive for employees is that everyone is empowered to test new things, new procedures, new technology," he says.

By contrast, others view investment in training as the key to scaling headcount. Sean Zimdahl explains that Aston Carter primarily recruited graduates when it was scaling its business. "The ability to scale up was around some strong learning and development and induction programmes, where we were able to skill up graduates that came into the business," he recalls. "We had a very repeatable process for getting junior people into the business, and we were promoting people very quickly through the business."

Nutriplant does much the same, according to CEO Ricardo Pansa. "Our strategy has been mainly looking at building our talent in-house," he says. "In that we have been more successful than in trying to hire professionals from the market that have had experience in different companies, mainly because the people that we hire early on become more loyal and committed to the business. And I believe that this also true for many other small businesses."

A number of experts point out that as managers scale up the business, it may outgrow a small number of its existing employees. Larry Gould, founder and CEO of UK-based translation and interpreting firm thebigword, says that employees who work well in a small firm may not work well in a larger firm. "It is a very painful thing," Mr Gould says, "but you have to ask 'have we the right people to take us to a bigger and more secure place?'" This is echoed by Mr Howden, the CEO of Hyperion. "Staff retention is extremely important to us," he says. "You do, however, have to ensure that you focus on having the appropriate skills for the next steps in a high-growth business."

What's the secret sauce?

When discussing lessons learnt from scaling their operational platforms, many managers of high-growth SMEs emphasise that company culture is a critical factor in scaling successfully. Lars Hinrichs is one of several executives who refer not to company culture, but to DNA. "I think that the company has a DNA, in terms of the values, goals, mission, vision, how it behaves, what it's like to be an employee of the company," he explains. Without that DNA, he says, scaling will not be successful. "If there is no DNA, you don't have anything to build on."

As SMEs scale their businesses, preserving the company culture is one of the toughest challenges. Defining, identifying, and articulating the culture is no easy task. Mr Evarts of Mediafly asks: "What's the secret sauce? And how can you capture it, articulate it, and replicate it? From an operational strategy point of view, it is critical to figure out the things that are special

Retaining the Hyperion culture

"If you're going to build a great business, the only thing that really matters is getting the culture right," says David Howden, founder and CEO at Hyperion Insurance Group in the UK. "We have a very strong culture: Employing the right people; empowering them; zero politics; very focused; very driven."

"That Hyperion culture is our biggest competitive advantage against much, much bigger competitors," says Mr Howden. "The biggest risk to my business is: How do I retain that culture as I get bigger?"

It was easy when there were ten people in the business, he recalls: "You went out for a drink, and it was slaps on the back and what have you." Even as the business grew to 230 people, retaining the culture was straightforward, Mr Howden says. "In 2008 we took all 230 people to Scotland and spent three days talking about the group and interacting together."

Now, though, with well over 1,200 people in the group, it's harder to retain the culture, according to the CEO: "I get on planes and I fly around all round the world and I go and visit those offices and I stand there and talk to them about the culture of the business and where the business is going. But it gets harder."

Now, Hyperion is training 24 of its brightest stars on its Future Leaders Programme, according to Mr Howden. After completing the programme, he says, these 24 employees go off to work in Hyperion offices spread across the world. "Part of this programme is for them to drive the culture," he says.

about Mediafly and to institutionalise them as much as we can." At Hyperion, meanwhile, Mr Howden describes the firm's culture as its biggest competitive advantage—and losing the culture as its biggest risk. (See box: *Retaining the Hyperion culture*.)

One of the keys to success appears to lie in the simplicity of the values underlying the corporate culture, according to experts in this area.

"Company culture needs to be connected with values that people share," says Mr Migoya of Globant. "Company culture cannot be built on artificial things, on values that people don't share, or on values that are difficult to understand." Aston Carter's Mr Zimdahl appears to take a similar approach. "We spend a lot of time working on the vision of the business, our mission as a group of people, and our values," he says.

Does growth become easier with scale?

Is it easier to take a business from $1m to $2m in revenues, or from $100m to $200m? Answers from managers of high-growth SMEs vary.

When the SME is smaller, say some interviewees, it may have trouble gaining traction. The business is trying to cover its costs, to pay its bills, and to grow. A lack of internal resources and expertise is often a challenge for smaller SMEs.

When the SME is larger, it may be easier to win business from large global companies. Furthermore, following scaling, the company is likely to have systems, processes, and expertise in place to better manage the business.

Yet, growing the business from $100m to $200m requires a different mindset in the firm, as this requires strong internal communication among a larger number of people.

At the same time, as an SME grows further, it faces the continued challenge of increasing market share. As Brian Protiva, co-founder and CEO at ADVA Optical Networking, a Germany-based provider of network equipment , says: "You're now in the game of fighting for big dollars against the leading companies in the industry."

Conclusions

As SMEs expand their businesses, many face constraints on their organisational resources, hampering their ability to deliver on their growth strategies. These resources include technology and headcount. Ramping up resources amid uncertain economic conditions is risky, of course—yet managers must prioritise growth in order to survive.

Building a flexible platform for growth may be the answer. Leading SMEs are putting in place operational strategies in order to do this. The basis for this operational platform is a robust organisational structure and processes. Technology and people are just as important in scaling the operational platform for growth.

From the experiences of owners, founders, and managers of SMEs that have succeeded in scaling their organisations, it is possible to draw a number of lessons and conclusions. These include the following:

- **For SMEs, resilience and flexibility are critical.** The pace of business is continuing to accelerate, competition is continuing to intensify, and economic uncertainty is continuing to linger. Amid these challenging market conditions, resilience and flexibility are increasingly important as SMEs pursue growth.
- **SMEs now have better access to tools and capabilities to scale the business.** SMEs now have a growing number of options to scale the organisation and maintain flexibility. In part this is due to access to technology that is more cost-effective and flexible than in the past, and in part it is due to the increasing availability of IT tools and systems, and improved outsourcing options.
- **SMEs are gaining competitive advantage over larger enterprises.** Improved access to tools and capabilities, and better opportunities to scale the business, are factors that are shifting competitive advantage away from larger enterprises towards SMEs—providing SMEs with new opportunities to compete.

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