

New York's Magnolia Bakery Offers Lessons On Small-Business Success

By GARY M. STERN, FOR INVESTOR'S BUSINESS DAILY

Posted 03/19/2010 06:01 PM ET

In the mid-1990s, chocolate chip cookies and ice cream with butterfat were in vogue. But pity the forgotten cupcake .

When Magnolia Bakery, specializing in cupcakes, opened in a tiny 616-square-foot-store in 1996 on a picturesque West Village corner in New York City, few expected it to last. How many cupcakes could be sold at \$1.25 each (now \$2.75) to support the expensive rent? Moreover, cupcakes were passe.

But the nostalgic feel of the store's apron-wearing staff coupled with the sugary taste of the icing helped draw crowds. When TV's Sarah Jessica Parker and her "Sex and the City" entourage munched on the cupcakes in several episodes in 2000, Magnolia morphed into a cult bakery. It's also become a parable of small-business success.

By 2010 Magnolia had opened three more New York outlets in Grand Central Terminal, Rockefeller Center and the Upper West Side, and one in the Persian Gulf city of Dubai inside a Bloomingdale's outlet. Another will debut in Los Angeles in May. Magnolia's has also spawned a host of imitators opened by former Magnolia employees.

Despite its success, there are no assurances that Magnolia's expansion will succeed. Unless it maintains quality, hires the right people and sustains word of mouth, analysts say it could turn into yesterday's flavor of the month.

Carol Schroeder, author of Specialty Shop Retailing, credits Magnolia's rise to being "in the right place at the right time." She says much of its success was also based on location. Being situated in the media hub of New York helped Magnolia to become a cultural phenomenon. Had it been located in Peoria, Ill., no matter how tasty the cupcakes, no one may have noticed.

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New Owners Expand

Magnolia's original owners, Jennifer Appel and Allysa Torey, spurned opening a second store. But when Steve and Tyra Abrams acquired Magnolia in 2006, they saw the growth potential.

Steve Abrams, a former New York restaurant consultant and bar owner, describes Magnolia's brand as an "experience, not just a product. All products are baked in view. You can smell the icing, rub elbows with the person making it, listen to the nostalgic music." The original store sold one million cupcakes a year and lots of Magnolia's T-shirts, aprons and hats.

To succeed, Abrams decided that Magnolia's internal systems needed to be updated since its prior owners relied on an old-fashioned cash register and nixed computers. He digitized the inventory, analyzed food costs and established an automated phone and ordering system for takeout orders. He beefed up management, installing a controller and two general managers and three assistants to oversee each store.

Though each new store costs a million dollars to build because of high building costs, Manhattan rents and an in-house bakery, Abrams furnished 85% of capital and borrowed the rest from City National Bank. "If I were going to a larger rollout of 10 to 20 stores a year, I'd need to go to an investment bank," Abrams added. So far the expansion is working; each store sells 1 million cupcakes annually.

Abrams is expanding gradually by about two stores a year to ensure quality. After Los Angeles, he expects to open in Boston or Washington, D.C. in fourth-quarter 2011 followed by San Francisco and Chicago the next year. Each store will produce the same cupcakes as the original with no local variations.

Measuring Foot Traffic

Location is critical to Magnolia's success. "I need foot traffic. It's important for volume and to amortize the cost of building out," Abrams said. The West Hollywood store is located near the Farmer's Market and Beverly Center, which should create foot traffic even in car-happy Los Angeles.

Magnolia also built a production facility in Allentown, Pa., that supplies goods for its recently launched mail-order business to accommodate the demand for cupcakes from people outside of New York and Los Angeles. Based on its expansion, Magnolia now has 250 employees, which will jump to 300 once its Los Angeles store opens.

Abrams opposes franchising. "That's the easiest way to lose control of your product's integrity," he said.

Some small businesses grow too fast, which can trigger their downfall, says Bruce Bachenheimer, director of entrepreneurship at Pace University's Lubin School of Business. In order to expand, these businesses must establish a solid "infrastructure including accounting, inventory and payroll systems and a system of checks and balances," he said.

Furthermore, expansion can dilute a product's quality and damage its reputation. "Each cupcake must be as good as the one before," Schroeder said. If Magnolia cuts costs and replaces butter with margarine, its clientele can flee to rivals.

Despite the traps, Schroeder expects it to succeed. "There's an unlimited demand for cupcakes and Wal-Mart's not doing it," she said.

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