CORPORATE ANALYSIS

Organic Growth

The Organic Growth Rate is an indicator for a firm´s sustainable growth potential, driven and supported by its own, internally generated resources. When comparing the Organic Growth Rate with a firm´s actual growth rate, one can conclude whether the current growth momentum can medium- / long-term be sustained - or rather not.

The Ansoff Matrix is – among others – nicely summarizing an illustrating a set of strategic corporate growth concepts. In implementing any of such strategies, finance has merely a support function. – Therefore, from a Corporate Finance point of view focus is on which financial sources have been used so far. But even more relevant: Which financial resources can be approached or need to be developed to implement and support a strategic growth concept in future. The Organic Growth Rate helps to better understand the debt capacity to fund growth.

Organic Growth can be defined as the expansion of a firm's operations from its own, internally generated, resources: Therefore, growth through acquisitions, mergers, but especially growth foremost funded through borrowing – alas: additional debt – is not regarded as organic.

In essence, there are two intertwined sources which can be deemed as a firm´s own resources: On the one hand a firm´s net profit, and then also the cash flow a firm generates. - Net profit is a straight-forward figure easily derived from the income statement: It is the amount left after all payments done and precautionary provisions filled. - The cash flow of a firm is ultimately also based on net profit, but a complex set of adjustments for cash in- and out-flows has to be made to end up with the appropriate net position.

Now, part of the net profit may be paid out to shareholders in form of dividends: This is cash leaving the firm and ending up in the pockets of the shareholders. The rest - not paid out - also belongs to the shareholders, but indirectly only, as it stays in the firm, in a sub-position of the equity, called retained earnings. These retained earnings represent the accumulated historical profits not having been paid out as dividends. Logically, over time they increase the overall equity position.

Now, retained earnings are the principle basis to pursue (organic) growth, whereby the organic growth potential is actually even larger than merely the increase of the equity through net profits not paid out as dividends: As the equity position is increased by an increase of its retained earnings, one could subsequently also increase the firm´s financial liabilities by up to the same percentage as the increase of the equity: Thereby, the company´s overall financial leverage would stay constant (or possibly even be decreased). Alas: As long as the balance sheet grows by the same percentage as the relative increase of the equity - or less than that – one may say that such growth momentum is organic, in principle driven by the firm´s internally generated funds. - On the other hand, if the growth of a firm´s balance sheet exceeds that of the equity position, then this growth must foremost have been supported by assuming additional debt. In such case both, a firm´s leverage as well as its risk profile would have increased.

Therefore, the Organic Growth rate is a swift indication by which means the growth of a company has been supported - from a financial point of view.

ANSOFF MATRIX

		PRODUCTS: EXISTING	PRODUCTS: NEW
MARKETS	EXISTING	MARKET PENETRATION	PRODUCT DEVELOPMENT
	NEW	MARKET DEVELOPMENT	DIVERSIFICATION

BALANCE SHEET

WORKING | CAPITAL

ASSETS | DEBT

EQUITY

TOTAL ASSETS
= LIABILITIES + EQUITY

INCOME STATEMENT

REVENUES
- COST
= EBITDA
- DEPRECIATION
= EBIT
- INTEREST
= EBT
- TAX
= NET PROFIT
- DIVIDENDS
= RETAINED EARNINGS

BALANCE SHEET

WORKING | CAPITAL

ASSETS | DEBT + Δ%

+Δ%
EQUITY + RETAINED EARNINGS

⊕

TOTAL ASSETS
= LIABS + EQUITY +Δ%