



## All growth is not created equal

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Ask yourself two important questions about top line revenue numbers to reveal key differences in quality of growth.

Two comparisons are commonly used to gauge how well a firm is growing. First, growth rates of firms are compared to one another. Second, current growth rates are measured against past growth rates. For example, this year you may be growing 3% faster than your nearest competitor and be up 5% over your own prior year growth. While these comparisons convey important information, we recommend shifting focus from the quantity of your growth to its quality. Rather than measure against one rival firm, use industry figures to gauge how much of your growth is due to your firm's management choices, rather than due to your industry's overall momentum. Then look at whether your growth is in areas important to the competitive position of your firm. The quality of your growth is revealed by comparisons with your industry and by examining growth rates in areas strategically important to your future.

When evaluating a mid-market firm's growth outcomes, the most common metric used is year over year increase in top line revenues. Especially in the absence of share price information, it is tempting to use an overall indicator of revenue growth to determine how well a firm is doing.

The common assumption is that a firm with low or no growth is less successful than a firm with a higher growth rate. In many cases, this shorthand is an effective way to quickly size up the relative success of different players. If your firm grew 5% this year and my firm grew 3%, you might assume that you have better products or better management than I do. But be careful of making too many assumptions based on overall growth rate. It is not always an accurate window into the quality of the firm's performance. All growth is not created equal.

Growth rates seem to distill a large number of managerial choices and their complex interplay with competitive, regulatory and environmental conditions to a single number. At the end of any given year, no matter what industry, no matter what changes in ownership or leadership, no matter what level of future uncertainty, we can calculate annual growth rates. These figures are indisputably useful, but painting with such a broad brush hides two important elements of the firm's growth story:

**First: Where did their growth come from?**  
**Second: Where is the growth taking them?**

### Where did their growth come from?

In looking into where growth comes from, a good place to start is by examining any new products, pricing changes or geographical expansion. While this type of investigation may yield useful insights, the most essential information about the first question comes from the industry growth rate. If the majority of a firm's growth came from acceleration in demand across their industry, they may be a relatively passive but fortunate beneficiary of their industry situation. A firm in an industry which is growing at 10% should not aspire to grow at a lower rate. Their logical minimum target would be 10%, based on the assumption that they would either be able to earn their share of the industry's year on year increases by defending a stable market share position or by navigating the competitive dynamics of their situation to achieve competitive parity.

In a slower growth industry, the same 10% annual growth target may be seen as quite aggressive and unlikely to be realized without a powerful mix of underlying growth choices. A relatively small firm with aggressive growth targets in a slow growth industry may have a plan to leapfrog others in their industry using novel technologies, or to steal share from rivals by introducing highly appealing product extensions. If successful, the quality of this firm's growth would be high. High performing firms in low growth industries, regardless of their ownership structure, stand out by virtue of their ability to make and execute choices which capture value in spite of relatively flat sector demand.

### Where is the growth taking them?

This second question may stimulate a useful assessment of the product lines and geographies into which a firm has chosen to expand. Understanding that a firm's growth may be taking them into new channels and into competition with different rivals, does not by itself yield insights about the quality of that growth. Consider the direction of

this growth not only in terms of market and geographic movements, but in terms of its strategic direction.

Financial results and operational contributions only tell part of the growth story. For a firm with a strategic objective of growth in high margin products targeted at a specific segment (e.g; urban travelers or suburban dads), increases in revenues associated with mass market commodity products would be indistinguishable at the top line revenue level. But even if their revenues are the same, sales of different products into different markets take firms in different growth directions.

So-called "bad growth" doesn't contribute to the overall competitive positioning and strategic health of the company. Bad growth could be the result of landing a large contract at a price too low to meet margin targets, or expanding in ways that divert top management team attention from critical priorities on their strategic growth agenda. Chasing dollars may give the appearance of success, but often results in low quality growth.

Rather than assume all growth is created equal, taking stock of growth outcomes through both an industry lens (where is growth coming from?) and a strategy lens (where is growth taking them?) enables us to make judgments about the quality of growth. When managers realize that all growth is not created equal, they are able to see how their growth stacks up against the momentum of their industry. They also are better able to make growth choices well suited to their situation and strategy. Firms pursuing high quality growth often find out the quantity takes care of itself.

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