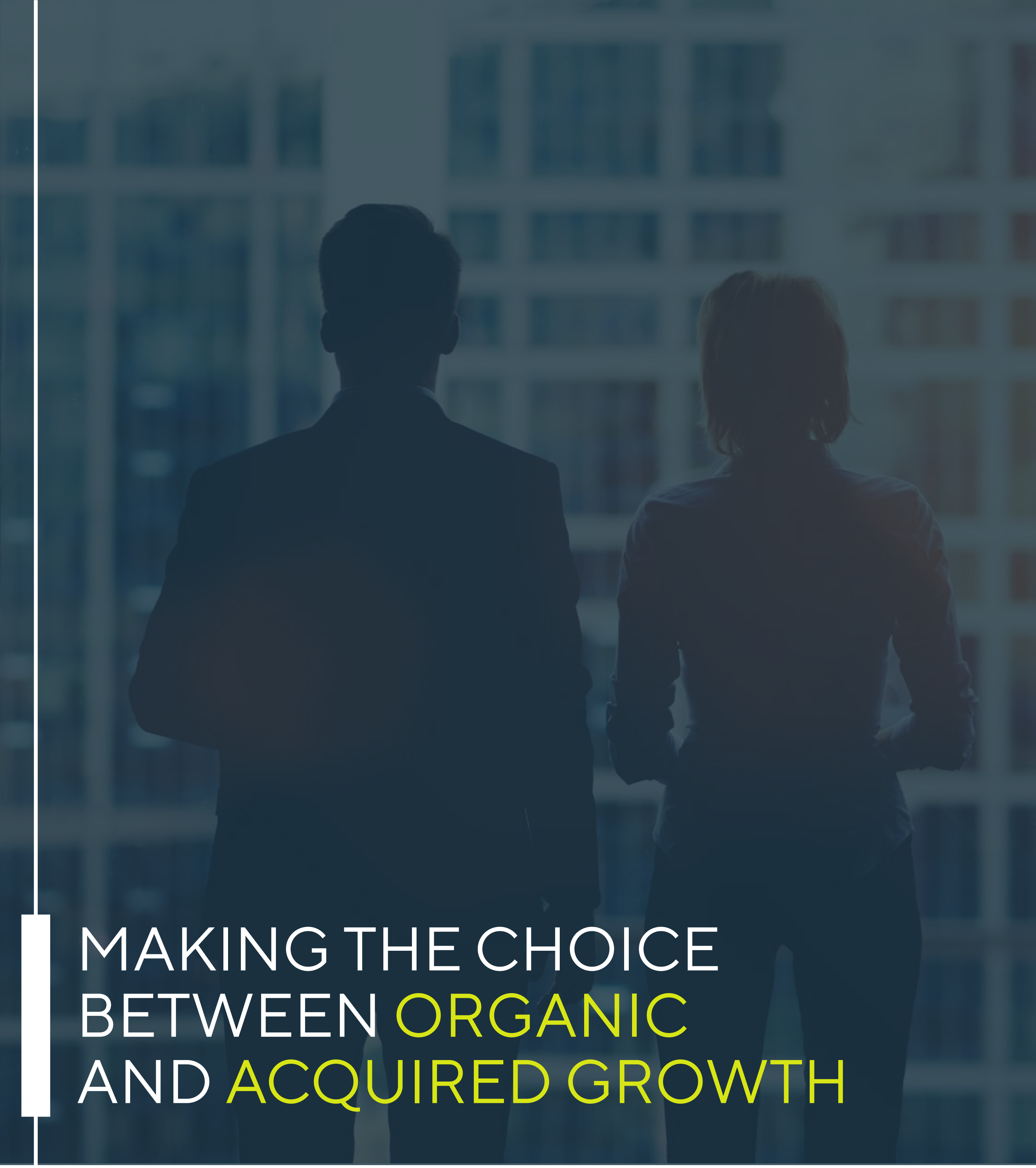

MAKING THE CHOICE BETWEEN ORGANIC AND ACQUIRED GROWTH

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ORGANIC GROWTH
= business expansion by increasing output of goods and services, customer base expansion, or new product development.

ACQUIRED GROWTH
= business expansion by obtaining majority stakes in, and taking control of, other firms.

From time to time, executives face the strategic choice between growing their business organically or through acquisitions. In ProSales' assignments, we help clients to build capabilities for generating organic growth over time, as well as reap benefits from expected acquisition synergies. In both kinds of assignments, our experience is that the analysis preceding the choice of growth mode is often far too shallow. In other words, growth initiatives in general would benefit from more analytical rigour. Secondly, some capabilities required for succeeding with organic growth, are absolutely crucial also when acquisition is the chosen mode of growth. In the long run, acquisitions cannot fully compensate for insufficient organic growth capabilities.

The purpose of this article is to support leaders in making a more informed choice of growth mode, as well as advice on design of long-term sustainable growth strategies.

THE GROWTH CHALLENGE

A growth mode is the way in which an organization seeks to expand its business. Different growth modes have different characteristics.

Many industries experience weakened growth. For many firms the aftermath of the post-financial crisis, together with technological shifts, globalization, and changes in the buying behavior of customers, have redrawn the competitive landscape for many firms. Meanwhile, the pressure for continued growth remains, which leads many executives to consider deploying new strategies for growth.

GROWTH MODE: ORGANIC OR ACQUIRED?

Besides growing organically, executives have a range of alternatives to organic growth, such as acquisitions, joint ventures, licensing agreements, or alliances. However, the most evident trade off that executives face is the choice between going for organically generated growth, as opposed to an approach based on acquisitions. This choice of **growth mode** should be made with respect to relevant **criteria** for growth, as well as the organizational **capabilities** available for mastering the different **growth modes**.[1]

[1] King, D. R., & Schriber, S. (2016). Addressing Competitive Responses to Acquisitions. California Management Review, 58(3) (Spring issue), 109-124.

CRITERIA FOR GROWTH

How well a certain mode of growth can support a firm's strategy, depends on three criteria: speed, control, and cost. The first relates to the need for speed in adding new resources. The second relates to the level with which those resources need to be controlled. Lastly, the third relates to the preparedness to accept costs of adding new resources for growth.

Growth mode	Growth mode	Growth mode	Growth mode
Acquired	High	Low	High
Organic	Low	High	Low

Table 1. Criteria for growth and conditions for different growth modes

For instance, if quickly establishing a footprint is critical, while costs are less important, and control of the acquired units is not a priority, acquisitions is the right way to grow. In other instances, when high control and low costs are important, organic growth is the appropriate mode. Below we explain in more detail how these criteria for growth affect the choice of growth mode.

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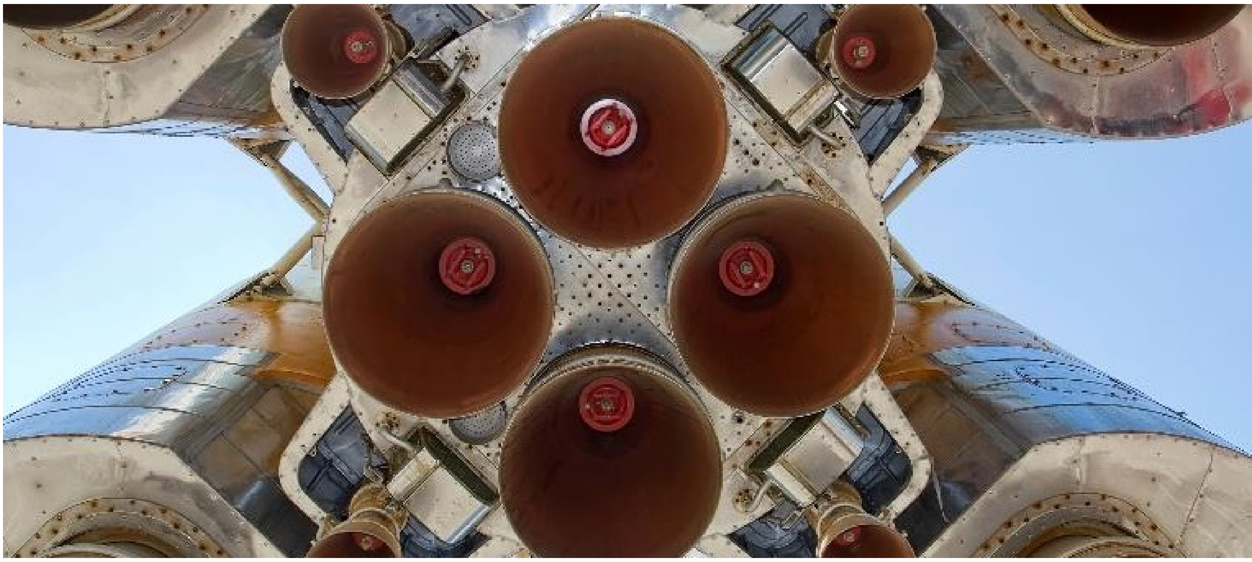
SPEED: HOW FAST DO YOU NEED TO GROW?

Acquisitions constitute a means of outpacing competitors in terms of overall firm size. Aggressive acquirers can multiply in size in the same time it takes competitors just to formulate their strategy for how to grow organically. However, this is a truth that comes with many caveats. A closer examination reveals that speed constraints of a focal firm, only under certain circumstances, suggest growing through acquisitions.

Despite outpacing organic growth in the short run, many acquisitions typically face a long integration period. Organizational integration is necessary to achieve value in most acquisitions.[2] At the same time, integration in many cases reduces output of both the acquirer and its target. Research indicates that the goals of the acquisition[3] are fully realized first after 7-12 years from the acquisition, which nuances the picture of acquisitive growth as always being the best option for firms that looks to grow quickly.

Integration levels typically differ, and research points most clearly to relation-intense acquisitions as sensitive to disruption, and hence in need of a slower integration. One example is industries that depend on deeply integrated customer relationships, where customers can be skeptical of acquisitions, and prone both to reconsider suppliers and to embrace approaches from alternative suppliers.[4] The devil is often in the detail, and sales staff, like most employees, do not appreciate perceived unfairness. Seemingly simple things such as different company car- or travel policies, may cause irritation with staff turnover and falling sales figures as a common result. In short, while acquisitions swiftly can add resources to a focal firm, making use and getting the desired outputs can take much longer than expected.



[2] Some acquisitions take no interest in the target beyond ownership; in certain industries, size matters, and acquisitions aiming at blocking a competitor from accessing their target, achieve their aim immediately.
[3] Barkema, H. G., & Schijven, M. (2008). Toward unlocking the full potential of acquisitions: The role of organizational restructuring. Academy of management journal, 51(4), 696-722.
[4] Kato, J., & Schoenberg, R. (2014). The impact of post-merger integration on the customer-supplier relationship. Industrial Marketing Management, 43(2), 335-345.

CONTROL: TO WHAT EXTENT DO YOU NEED TO CONTROL NEW RESOURCES?

Fast acquisition of capabilities often comes at the expense of control. As depicted above, the level of control that can be achieved in acquisitions, depends on the level of integration. Some firms never get fully integrated, but rather speak of "us" versus "them" as long as 20 years or more after an acquisition. Decisions from top management risk being seen as less important or irrelevant when acquired units perceive themselves as not fully belonging to the acquirer.

Units growing organically over time are more easily controlled than those added instantaneously. This is more important when it comes to businesses with a high dependency on people, where values are more fluid and can vaporize more quickly. For instance, the ability to influence knowledge resources and organizational cultures, has been identified as key to govern organizations and sustain competitive advantage. Organic growth offers the opportunity to create and sustain a more tightly knit organization, where the central value-creating capabilities of the organization can be protected, nurtured, and applied.

COST: HOW MUCH ARE YOU PREPARED TO PAY FOR REVENUE GROWTH?

In practice, acquisition-led growth can often cost more than organic growth, due to buyers paying over the odds, and unexpected integration costs.

Overpayment is one explanation. In theory, the market price reflects the intrinsic value of a firm, and acquirers should not bid more than the present value of future cash flows. However, research consistently points to the difficulty of creating value through acquisitions. "The hunting instinct", that trumps financial theory, implies that executive typically become overcommitted to an acquisition target, driving the price premium beyond the point, where the deal will, per definition, destroy value to the acquirer. Second, even rational bidders will face the difficulty of correctly assessing future value potentials inherent in complex relations to another firm.

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Integration costs is another, since integration processes typically take on their own dynamism. They may imply socio-cultural challenges often stretching many years into the future. Therefore, acquirers often drop in performance of their everyday business during integration. Adding to the immediate financial consequences of high acquisition costs, there are typically long-term effects, such as reduced organizational resilience and flexibility.[5]

Of course, organic growth also comes with costs. However, in contrast to acquisitions that instantaneously add costs by being paid upfront, other projects grow gradually, and allow both for tighter budget control and abandonment if costs become too high.

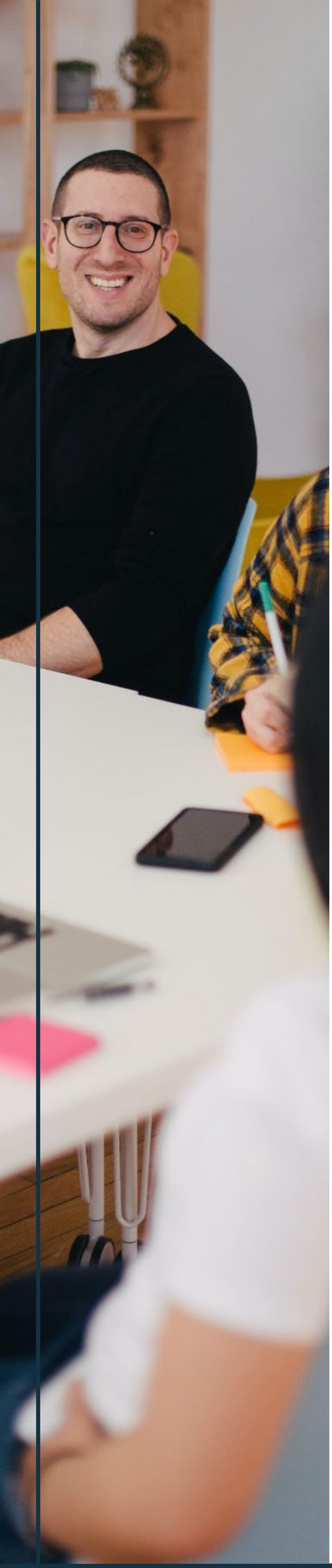
DIFFERENT GROWTH MODES REQUIRE DIFFERENT CAPABILITIES

Considering the need for speed, control, and cost, provides executive with a frame of reference for growth strategy formulation. But organizations also vary with regards to how well they can execute through the different growth modes. Hence, the answer to the question, which growth mode is best for an organization, also needs to be understood through the lens of organizational capabilities.[6] A "capability" defines the level of achievement an organization can achieve in a given task, and consists of organizational skills and processes.

For instance, capabilities for growing organically has to do with the ability to effectively and correctly assessing customer demand, product development, sales, and marketing. Global fintech group Klarna, has an extraordinary capability for sustainable and profitable organic growth.

A clear organic growth strategy, focused offerings that create customer value, and a well-dimensioned marketing and sales organization, has made this company one of Europe's fastest growing.

[5] Shaver, J. M. (2006). A paradox of synergy: Contagion and capacity effects in mergers and acquisitions.
Academy of Management Review, 31(4), 962-976.
[6] Capron, L., Anand, J., & Mitchell, W. (2007). Acquisition-based dynamic capabilities. Constance Helfat, Sydney Finkelstein, Will Mitchell, Margaret Peteraf, Harbir Singh, David Teece and Sidney Winter, Dynamic Capabilities: Understanding Strategic Change in Organizations, Blackwell Publishing.



For being effective with an acquisition-based growth strategy, a different set of capabilities are required, such as target selection, due diligence, negotiation, and integration. Some firms possess extraordinary skills in this area. Global leader in door opening solutions Assa Abloy, has grown successfully using acquisitions and purposefully developed routines, balancing responsibility and control between business units and corporate headquarters. Thereby, they can mitigate some of the challenges of control and cost associated with an acquisition strategy, and be able to enjoy the benefits of quick global expansion.

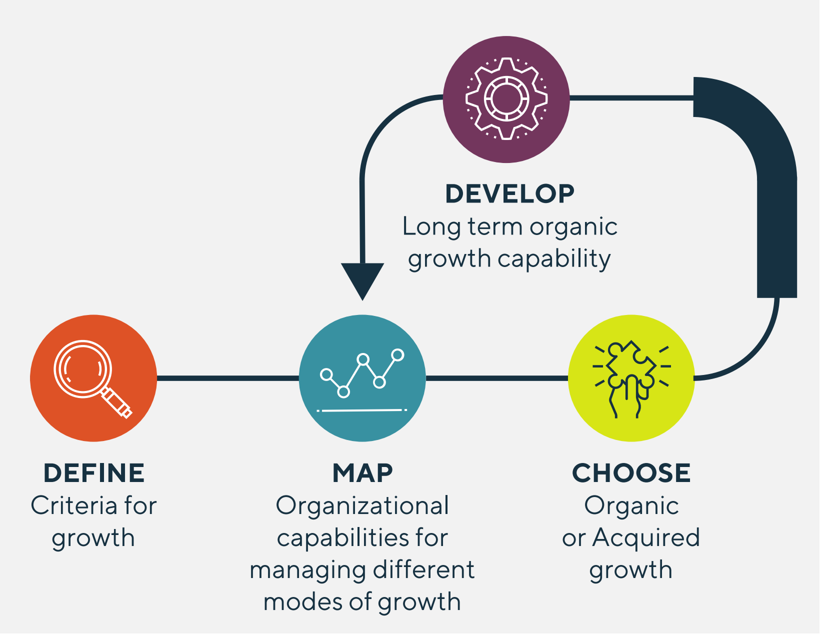
IMPLICATIONS ON STRATEGY: CONSIDER YOUR ACTUAL CAPABILITIES AS WELL AS YOUR GROWTH CRITERIA

The conclusion is that decision-makers, in making the choice between organic and acquired growth, both need to consider **criteria** for growth, and put these in relation to organizational growth **capabilities**. Thus, the message is: firms need to consider not only what they want, but what they reasonably can achieve.

This also implies, that a company that has built a strong acquisition capability, to some extent may compensate for the challenges of acquired growth in controlling acquired objects, and keeping integration costs low. The same logic implies, that a company with a strong capability to grow organically, can compensate somewhat for the challenges of organic growth in growing quickly enough.

THERE ARE NO SHORTCUTS – A SOLID CAPABILITY FOR ORGANIC GROWTH IS A PREREQUISITE FOR YOUR LONG-TERM SUSTAINABLE GROWTH

Whether the focus is organic- or acquired growth, firms need to develop and refine their organic growth capability. Even when the strategy for growth is built on acquisitions, being able to generate continued growth from acquired units is essential. This involves building skills and processes for translating customer needs, and buying behaviors intro attractive offerings and value propositions. It requires crafting solid segmentation and prioritization frameworks. And at the core of this is the establishment of scalable organizational models that allow all functions involved in revenue generation and retention to maximize their contribution to the business. Without these core capabilities for organic growth, firms will long-term be dependent on acquisitions for continued growth. In summary, our advice to you when defining the path to growth for your business is to make sure that it includes initiatives that are aimed at ensuring capabilities for organic growth - even though your strategy may be heavily reliant on acquisitions.



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Svante Schriber is an assistant professor at Stockholm Business School. His research focuses strategic management in Mergers and Acqusitions (M&A). He has developed models to predict and manage synergy realization in the post-acquisition period, as well as competitive responses to M&A.

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