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# The value premium of organic growth

Beware of letting acquisitions take priority over organic growth.

Marc Goedhart and Tim Koller

It's not surprising that many executives think about growth primarily in terms of acquisitions. For some, opportunities to grow organically are limited, especially in maturing or contracting product markets. Others are drawn to the allure of high-profile deal making, with its virtually instant boost to revenues and often earnings per share as well.

But executives shouldn't underestimate the power of organic growth. It may take more time and effort to affect a company's size, but organic growth typically generates more value. A look at the share-price performance of 550 US and European companies over 15 years reveals that for all levels of revenue growth, those with more organic growth generated higher shareholder returns than those whose growth relied more heavily on acquisitions[1] (exhibit). The main reason is that companies don't have to invest as much up front for organic growth.[2] In growing through acquisition, companies typically have to pay for the stand-alone value of an acquired business plus a takeover premium. This results in a lower return on invested capital compared with growing organically.

We often see companies pass up organic-growth opportunities because they take longer to boost earnings than acquisitions do. But, given an option, they should probably tip the balance toward what they can achieve organically. ■

[1] We grouped 550 large US and European companies into thirds based on total revenue growth. We then ranked the companies in each tercile by their increase in goodwill and intangibles as a proxy for acquired growth, and again broke them into thirds based on their level of acquired growth. We then compared the median TRS for each of the nine groups. Since our proxy is imprecise, the chart shows the TRS only for those companies with the most and least organic and acquired growth. The sample excludes the banking and insurance sectors, which severely underperformed in this period because of the 2008 financial crisis. It also excludes the extraction and commodity sectors because their performance is strongly affected by commodity price cycles.

[2] There is a selection bias in our sample: not all companies that invest in organic growth actually realize that growth.

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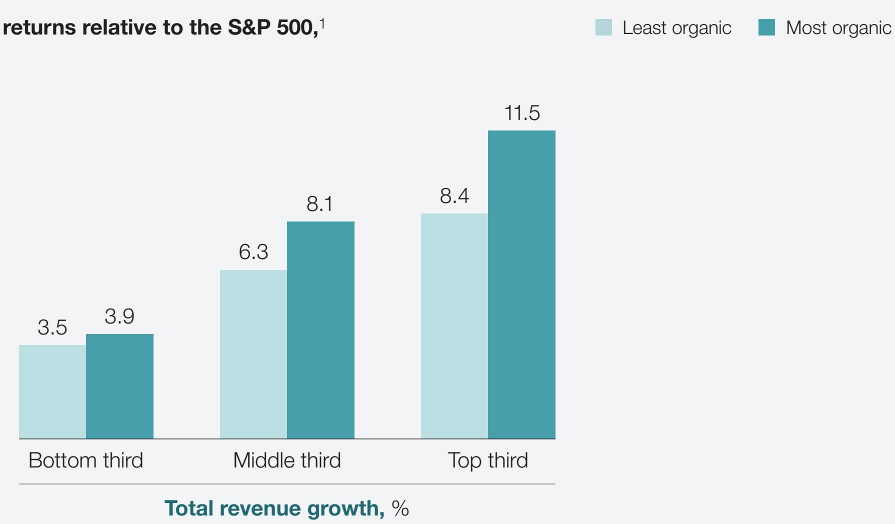
Exhibit

**At comparable total growth levels, companies with more organic growth outperform those with more growth from acquisitions.**

**Annualized excess shareholder returns relative to the S&P 500,**[1]
1999–2013, %




[1] Excludes banks, insurance companies, extraction companies, and cyclical commodities.