Organic vs. Inorganic Growth – Pros, Cons, and an Investor's Perspective

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Introduction

Every company loves to see growth – it's a signifier of potential success and that things are "working" within the organization. However, not all growth is created equally.

In general, growth is considered either organic or inorganic. Organic growth comes from expanding your organization's output and by engaging in internal activities that increase revenue. Inorganic growth comes from mergers, acquisitions, and joint ventures.

A business can see two types of growth—organic and inorganic. Organic growth happens when the business grows by its own efforts and performance. On the other hand, inorganic growth happens when the business needs external support, such as merger, acquisition, and takeover, to grow.

What is Inorganic Growth?

Inorganic growth requires mergers or takeovers. An increase in the company's business activities will not do in this case. Through this growth strategy, the company can expand its wings to new markets. This is considered as the fastest way to grow. Opening branch offices in new locations is an example of inorganic growth.

Acquisitions is a way of gaining instant access to a bigger market share and, thereby, increase earnings. However, this technique takes a little longer to integrate the new employees with the former ones.

Inorganic Growth in Sales

The most effective way of assessing a company's growth is through sales. Sales growth can result from promotions, introducing new products, and improving customer service, and are categorised as organic measures. Such sales occur naturally and not through the acquisition of another company or by opening new stores. Organic sales are considered to be an indicator of company performance. Inorganic sales growth is analysed to research on organic sales.

Advantages of Inorganic Growth

- When two companies merge for the sake of inorganic growth, the companies' market share and assets increase.
- The merged companies get to enjoy benefits, such as additional skills and expertise from the new staff. It increases the possibility of obtaining capital.
- Higher chances for the company to grow and increase market share.

Disadvantages

- Quick growth of the company may lead to substantial risk and additional debt.
- Integrating acquisitions may cause large upfront costs and management challenges.

- Additional management may be required.
- The direction of the business may change all of a sudden.

What are the benefits of each type of growth, and what type of growth do most investors prefer to see?

Pros of Organic Growth

- **Management knows the company inside and out.** Since organic growth occurs in a relatively tighter-knit organization, management knows the company strategies and operations more intimately than an organization that has recently undergone a merger or acquisition. This means the company is typically able to adapt to changes in the marketplace more quickly.
- **Less integration challenges and restructuring.** During a merger or acquisition, there's typically restructuring of personnel and operations that occurs to manage the new volume of business. This can often mean layoffs, changes in the leadership team, and overall figuring out how to monitor more employees and assets. During organic growth, integration challenges or management/personnel changes are typically more gradual, which can feel more comfortable and natural for the internal culture.
- **Stay true to your dream.** Without mergers or acquisitions, entrepreneurs have more control over the direction the business is headed.
- **It's more obviously sustainable.** Sustainable growth is the ultimate goal of any company. Without organic growth, there's no investor interest, little possibility of becoming an acquisition target, and virtually no chance that the company will become vibrant enough to sell. Bringing in consistent or growing revenues is a sign that things are working within an organization and is an important step in business success.

Cons of Organic Growth

- **Growth can be significantly slower.** Since there's no infusion of market, product, assets, or resources, a company growing organically must do so at a sustainable pace. This means growth can't overshoot the personnel, support, and resources available.
- **May decrease your competitive edge.** We all know that the best way to succeed in any industry is to out-play your competitors. If your competitors are growing quickly or if your industry has high M&A activity, then growing too slowly can mean you'll be quickly overtaken by competitors.
- **There is sometimes a glass ceiling.** Businesses that rely on organic growth often find that they lack the resources to continue to grow in a way that allows them to achieve their goals. As business and customer needs grow, receivables and other cash-consuming items and resources grow as well.
- **Competition drives the market.** M&A activity is like dominoes—once companies in an industry begin merging, it puts the heat on all the other companies to grow more quickly than is organically possible, or they may be left behind. Competitor's influx of resources and business may allow them to lower prices or employ other tactics to steal market share, making it more difficult for smaller companies in the industry to grow.

Pros of inorganic growth

- **Growth is much, much faster.** Many businesses nearly double or triple their client list with a business merger. Since this growth occurs through a transaction, this inorganic growth is much faster than is possible for organic growth.
- **Gain an immediate increase in market share.** One of the greatest benefits of a merger or acquisition is the increase in market share. Through inorganic growth, you are gaining the benefits of an entire company's prior sales and relationships, which means you're immediately gaining markets and clients that you otherwise may not have had access to.
- **Increases knowledge and experience.** By combining your company's forces with those resources of another company, you are gaining the knowledge and expertise of their key players. This increased knowledge and experience means you have a stronger roundtable in making strategic decisions moving forward.
- **Create a stronger line of credit.** It can be easier to take on debt financing after a merger or acquisition as some inorganic growth results in a stronger line of credit with the combined value of the two businesses.
- **Gain a competitive edge in the market.** Your newfound resources, assets, and market share, means—if the implementation goes well—you will be a force to be reckoned with in your industry. You're setting a new pace for growth that can push you ahead of competitors and give you a strategic advantage in pricing, purchasing, volume, and overall reach.

Cons of inorganic growth

- **Significant upfront cost.** Funding a merger or acquisition usually means a sizable upfront cost. If your company doesn't have cash on hand, you'll likely have to rely on taking on debt, which can make the merger or acquisition less attractive to investors. If the integration doesn't go well, this could also mean a lot of debt that you're suddenly unable to pay off.
- **Management challenges.** The sudden growth from a merger or acquisition generates complexities associated with properly scaling operations such as systems, sales, and support. Without proper management of growth, a merger or acquisition's roots won't be able to take hold and the integration will ultimately be unsuccessful.
- **Financial systems sustainment.** There are plenty of operational aspects that an organization can fumble through inorganic growth. Since finances support all company actions and is a key for all future growth, not having systems in place that can sustain the new growth is a huge (and unfortunately common) mistake.