How Fast Should Your Business Grow?

Many companies operate under the assumption that there is no limit to growth, as long as sales can increase. Growth, however, can easily outstrip a company's financial resources. The key is to determine an "affordable growth rate."

To accomplish this, the affordable growth rate (AGR) formula can be used. This formula assumes that: (1) sales can increase only as quickly as assets; and (2) debt will grow at the same rate as equity.

Based on these assumptions, AGR indicates the financial performance necessary to support expected sales growth. The formula also identifies how fast the company can grow without changing its debt structure. Thus, it is an effective planning and budgeting tool.

To determine the AGR, multiply retained earnings by the annual percentage increase in the "stockholders' equity" figure on the balance sheet. For example, a company retains 80% of earnings (distributing the rest as dividends), and achieves a 30% return on stockholder equity. In this case, the AGR is equal to 24% (.80 x .30). This means that by maintaining a 24% growth rate, the company can also maintain a constant debt-to-equity ratio. A faster growth rate would force the company to either increase the ratio or sell more stock.

Certainly, it is important for all business owners to plan the growth of their company. By using the AGR formula, the necessary cash flow to pay current expenses can be maintained.

Copyright © 2006 Liberty Publishing, Inc. All Rights Reserved.