Profitable growth: Avoiding the ‘growth fetish’ in emerging markets

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Abstract Growth management is a challenging but critical corporate strategy facing the fast economic growth in emerging markets. An overemphasis on growth would lead to the growth fetish, where growth is unqualified and seen as an end in itself. By examining the performance of 105,260 firms in key sectors of Brazil, Russia, India, and China (BRIC) from 2002 to 2011, this study presents quantitative evidence that supports a profit-oriented strategy as a more effective path to sustained profitable growth in emerging markets. To further support this argument, this study also provides qualitative evidence of a group of 70 sustained high-performing firms that are superior to their peers (the top 500 private companies in each of the BRIC countries) in terms of profit, growth, market share, and efficiency over a 10-year period. The study shows that sustained profitable growth requires qualified sales growth (i.e., organic growth), competence-based and competence-enhancing growth, and continuous product diversification.

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1. The ‘growth fetish’ in emerging markets

Aiduo was a Chinese manufacturer of VCDs (video compact discs) in the 1990s, when the VCD market in China was growing rapidly. Aiduo enjoyed its initial success by heavily investing in marketing. In 1996, it paid 4.5 million RMB, approximately 1 year of the firm’s profit, to hire famous movie stars to represent its products. These marketing efforts paid off and sales increased from 0.2 billion RMB to 1.6 billion RMB in 1997 (Wu, 2000). In 1998, the firm paid 0.21 billion RMB for a 5-second slot of advertising on China Central Television. To further acquire market share from competitors, Aiduo initiated price wars by aggressively reducing its products’ prices. Aiduo’s only strategy at that time was to grow bigger...
and bigger. Although it achieved tremendous growth in a few years, profitability declined when market growth started to slow. Moreover, since the core technology of VCDs was controlled by foreign firms, domestic Chinese firms such as Aiduo were not in a position to raise prices. In 1999, Aiduo encountered a debt crisis; it was unable to repay the heavy debts it accumulated during periods of rapid growth and during its ill-timed price war. In December 1999, the firm declared bankruptcy. It only took 4 years, a relatively short time period, for Aiduo to rise as a star and then disappear from public view.

Growth is clearly desirable, if not mandated, but what type of growth? An overemphasis on firm growth can lead to a 'growth fetish,' where growth is unqualified and is seen as an end in itself, as illustrated by the failure of Aiduo. This type of growth can easily lead to overextension and is particularly acute in emerging markets because manufacturing facilities, managerial talents, and physical infrastructure—all requisites that support growth—are limited by underdeveloped market institutions (Khanna & Palepu, 2010). In this article, we advance the case for 'profitable growth'—that is, integrated high sales growth and profitability—examine the correlates of firms that have successfully pursued this particular growth trajectory, and present recommendations for firms in emerging markets.

2. Not all growth is necessarily good in emerging markets

Although GDP (gross domestic product) growth provides firms in emerging markets the opportunity to grow rapidly, achieving sustained growth is not an easy task. Unlike larger multinationals in developed countries, firms in emerging markets are typically younger in terms of operating in a market-based economy. Hence, growth is associated with the unleashing of pent-up market demand, new consumers, and evolving market segments. Much like treatises on growth in developed economies, larger size is equated to market power (Knickerbocker, 1973).

In our view, however, sustained growth in emerging markets does not mean an unqualified pursuit of more sales, assets, or revenues to gain market dominance. Certain issues relating to managing growth are more pronounced in emerging markets because increased size alone can also lead to greater need for coordination and management control problems (Kimberly, 1979). Firms that overemphasize growth at the expense of profitability are ultimately blindsided by ensuing management control problems, if not by smaller and more nimble competitors. The lack of control is exacerbated in emerging markets, where there is still a lack of professional managers and talent to adequately address this problem. Specifically, excessive growth in a relatively short time can be dysfunctional if corollary resources and capabilities, such as manufacturing facilities and managerial competencies, are absent or cannot be developed. Moreover, unless economies of scale are achieved with growth, expenses will exceed revenues and smaller profits (if not losses) will occur. Thus, the key to achieving sustainable growth is not growth per se, but profitable growth over time.

3. Managing sustainable growth

In this article, we advance the case for profitable growth, or the simultaneity of both high profits and high sales growth as the condition of sustainability. This favorable condition is born from the successful experiences of firms operating in emerging markets that differ significantly from developed economies. Accordingly, we argue that emerging markets can sustain high growth only to the extent they are able to produce a continuing stream of high-performing firms over time. But the path of sustained high performance for firms depends in large part on their ability to effectively manage both sales growth and profitability.

In emerging markets, how should firms achieve profitable growth? Based on secondary information and further informed by interviews, we ascertained that firms make their initial decisions based on growth strategy: to be sales growth-oriented or profit-oriented. Typically, such decisions are formulated in terms of a trade-off. With a focus on sales growth, a firm might initially sacrifice profits, particularly in maturing markets, in order to attain higher market share, hoping that profits will catch up later. By limiting its expenses in order to maintain a desired level of profits, a profit-oriented firm might forego opportunities to expand its market share (for other differences, see Table 1).

Although both growth-oriented and profit-oriented strategies could lead to profitable growth, they require different resources and capabilities. Growth-oriented strategies require firms to be able to sense and seize opportunities in the external environment, while profit-oriented strategies require firms to be more internally focused and exploit existing resources and capabilities. Given the fact that firms in emerging markets are generally young and have limited resources and capabilities, there is a trade-off between growth- and profit-oriented
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