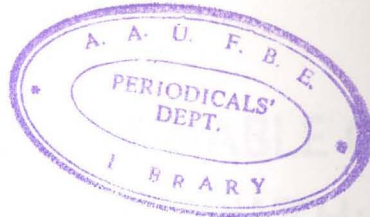
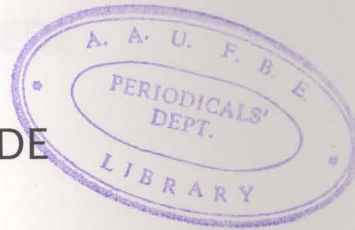


MBA 93



USING THE SUSTAINABLE GROWTH RATE FOR MANAGING GROWTH: THE CASE OF META ABO BREWERY

BY: MERON KEBEDE



Advisor: MR. P. LAXMIKANTHAM



ADDIS ABABA UNIVERSITY
FACULTY OF BUSINESS AND ECONOMICS
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*IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR
MASTERS OF BUSINESS ADMINISTRATION*

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ABSTRACT

This paper addresses the financial aspect of managing growth in Meta Abo Brewery. The period taken into consideration is from 1987 to 1998 and it is divided into the pre and post public enterprises reform periods.

The findings reveal that the actual growth rate of the enterprise was not in harmony with the sustainable growth rate that should have been attained for the period considered. The company was rapidly growing before the reform. After the reform it was growing slowly. Therefore, the researcher recommends that management closely examine the company's growth plans using the sustainable growth rate.

The alternative of reducing the dividend payout or giving out elevated sum of dividend is not in the domain of the company's decision making, and hence it is suggested that the government should take a policy decision regarding dividend payment. The enterprise should be able to decide upon its dividend payment in line with its growth plan and its fund requirement. In addition, the researcher also recommends improvement in the asset turnover to avoid problems that may arise from rapid growth.

1. INTRODUCTION

The management of growth requires careful balancing of sales objectives of the firm with its operating efficiency and financial resources. Many companies overreach themselves financially at the alter of growth. The trick is to determine what sales growth is consistent with the realities of the company and of the financial marketplace¹. Rapid growth as well as slow growth has got their own implications and consequences. Rapid growth puts a stress on the financial resources of a business, because sales growth requires increased assets in the form of accounts receivables, inventory, fixed plant, etc which must be paid for. As a company's sales expand, as growth takes place, somehow the firm expects it's financing to be easier. With high profitability the company expects no problem in financing growth². Nevertheless, as growth continues with high profitability, the firm requires more finance.

On the other hand, slowly growing companies are also faced with growth problem. If such companies are not aware of the financial implications of slow growth, they might become targets for takeover by more perceptive raiders. In both cases, companies must put a limit to their growth so as to conserve their financial strength. Uncontrolled/unmanaged growth can be devastating for a company's future. In order to find out if a company is growing rapidly or slowly we compare the sustainable growth rate with the actual growth rate.

1.1 COMPANY BACKGROUND

Meta Abo Brewery Share Company (S.C) is a publicly owned enterprise that was established in May 1967 G.C as a share company by two

¹ Van Horne, James C. and Wachowicz Jr. John M.: **Fundamentals of Financial Management**, 10th Ed., Prentice-Hall, New Delhi, 1999:pp. 187

² Weston, J. Fred, **Financial Implications Of Growth** in Readings In Finance, 1966: pp.357

foreigners and two Ethiopians. In 1975 G.C the company was nationalized and its name was changed to Meta Abo Beer Factory. The regulatory body of the company was Ministry of National Resources Development. Later on, the supervising body was changed to Ethiopian Beverage Corporation that was established under proclamation no. 11/75.

The company was reformed by the council of Ministers regulation no. 64/1992 as of 10 November 1992 with an authorized capital of Birr 9,253,000 of which 9,076,000 is paid. It is now governed by public enterprises (reform) proclamation no. 25/92. The supervising authority, the Ethiopian Beverage Corporation was dissolved from 10 November 1992 by the council of Ministers Regulation no. 5/92.

1.2 WORKING DEFINITIONS

The definitions of some terms as it is used in the study include the followings:

Growth: increase in the size and activities of a firm over the long run.

Actual growth rate: is the rate at which a company's actual sales increase on a yearly basis.

Sustainable growth rate: is the maximum growth rate a firm can achieve without external equity financing while maintaining a constant debt-equity ratio. It is the maximum rate of growth a firm can maintain without increasing its financial leverage.

Rapidly growing companies: companies whose actual growth rate exceeds the sustainable growth rate.

Slowly growing companies: those whose sustainable growth rate exceeds the actual growth rate.

1.3 STATEMENT OF THE PROBLEM

The public enterprises proclamation lays down provisions for formation and operation of the enterprises so as to enable them operate profitably³.

In light of this:

- The study has tried to examine the practice of Meta Abo Brewery towards growth management with the focus on financial decisions.
- The study has justified whether Meta Abo Brewery was growing rapidly or slowly before the reform and whether there is any change after the reform.
- The study has tried to show if there is any improvement in managing of growth in the company after the public enterprises (reform) proclamation no. 25/92.
- Examined the variables of sustainable growth rate to understand the company's decision (financial strategy) to manage its growth.

1.4 OBJECTIVES OF THE STUDY

The main purpose of the study is to assess the practice of Meta Abo Brewery in managing growth by addressing some questions like:

- What is the sustainable growth of Meta Abo Brewery?
- Was Meta Abo Brewery growing rapidly or slowly before the reform and is there any change afterwards?
- What are the consequences of Meta Abo Brewery's growth (positive or negative) after the reform?
- How is growth managed in Meta Abo Brewery? What are the possible actions taken by the company to balance its growth i.e. did Meta Abo Brewery try to alter any one of the variables of the

³ Transitional Government of Ethiopia: 'Public Enterprise (Reform) Proclamation no.25/92', Negarit Gazette, No.21, Addis Ababa, 1992

sustainable growth to align the sustainable growth rate with the actual growth rate?

- Is the financial aspect of growth properly managed in Meta Abo Brewery?

1.5 SIGNIFICANCE OF THE STUDY

Growth and its management present special problems in financial planning. The result of the study is believed to provide information that can be used by different groups.

- i.* The company, as a guideline for its future activities, can use the information.
- ii.* The company can inspect its financial policies (its dividend and leverage policy) related to managing growth and change it accordingly if necessary.
- iii.* Creditors can use the information to analyze the credit worthiness of the company.
- iv.* Investors can understand where the company stands; whether they should invest or not.
- v.* The study can also be additional source of information for other studies in related area.

1.6 METHODOLOGY

The study is a case study approach in which the practice (experience) of Meta Abo Brewery towards growth management is examined during the pre and post-public enterprises (reform) proclamation no. 25/92.

Data for the study are gathered mainly from secondary sources. Related literatures, journals, periodicals, websites, company publications, and financial statements of the company are reviewed. The financial

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Data for the study are gathered mainly from secondary sources. Related literatures, journals, periodicals, websites, company publications, and financial statements of the company are reviewed. The financial

statements that are used for the study include the company's income statement and balance sheet for the period 1987 to 1998 i.e. twelve years financial statements of the company are used. The period from 1987 to 1992 is considered as the pre-reform period and the rest; i.e. 1993 to 1998, is regarded as the post-reform period.

The statements are used to calculate the actual and sustainable growth rates of the company for the referred periods. The calculated sustainable growth rate is compared with the actual one to find out if the company is growing rapidly or slowly. The data that are analyzed are presented in graphs and tables as per their appropriateness. The financial decisions taken by the company are also grown from the financial statements by comparing important ratios (variables of sustainable growth) for the periods under consideration. The results of the comparison are used to value the aptness or otherwise of the decisions.

1.7 SCOPE OF THE STUDY

The scope of study is delimited to the description of Meta Abo Brewery's growth experience during the pre and post reform period and its management from financial standpoint. The company's financial statements are analyzed to find out the company's sustainable growth rate and to see the company's ability to align the actual growth rate with this rate. The company's financial decisions are also analyzed by evaluating some important ratios. The study did not consider other aspects of growth management other than the financial aspect.

1.8 TIMETABLE OF THE STUDY

Collection of reference materials	6 weeks
Collection of financial statements	3 weeks
Data encoding	2 weeks
Data analysis and interpretation	2 weeks
Preliminary draft	3 days
Final draft, duplication and binding	4 days
Total time	14 weeks

1.9 ORGANIZATION OF THE STUDY

The report is composed of four chapters. The first chapter is introduction. Literature review is included in the second chapter and data analysis and interpretation is dealt with in the third chapter. The last chapter contains conclusions and recommendations.

2. LITERATURE REVIEW

2.1 OVERVIEW

Commonly cited reason for financial distress and failure is lack of effective long-range planning. Long-range planning is a means of systematically thinking about the future and anticipating possible problems before they arrive. Financial planning formulates the way in which financial goals are to be achieved and also establishes guidelines for change and growth in a firm. In other words, financial planning is concerned with the financial and investments policies of a firm. And hence, the linkage between the investment proposals for the different activities of the firm and the financing choices available for the firm should be clear in the financial plan.

The financial plan provides the opportunity for the firm to develop, analyze, and compare many different scenarios in a consistent way. Various investment and financing options can be explored, and their impact on the firm's shareholders can be evaluated. Questions concerning the firm's future lines of business and questions of what financing arrangements are optimal are addressed.

According to Rose et al, basic policy elements of financial planning are⁴:

1. The firm's needed investment in new assets. This will arise from the investment opportunities the firm chooses to undertake, and it is the result of the firm's capital budgeting decisions.
2. The degree of financial leverage the firm chooses to employ. This will determine the amount of borrowing the firm will use to finance its investments in real assets. This is the firm's capital structure policy.
3. The amount of cash the firm thinks is necessary and appropriate to pay shareholders. This is the firm's dividend policy.

⁴ Ross, Stephen A. et al: **Fundamentals of corporate finance**, 4th Ed, Irwin McGraw-Hill, Illinois, 1998: pp.83

4. The amount of liquidity and working capital the firm needs on an on going basis. This is the firm's net working capital decision.

The decisions a firm makes in these four areas will directly affect its future profitability, need for external financing, and opportunity for growth. External financing and growth are related. The growth a company can achieve has a direct relation with the financial policy of the company. Thus, 'Growth and its management present special problems in financial planning in part because many executives see growth as something to be maximized.'⁵

According to Hampton, three measures of corporate growth are commonly used⁶:

- i. Increase in sales: is a direct indicator of growth in a firm's operating areas.
- ii. Increase in profit: is normally measured through increase in the firm's earnings per share.
- iii. Increases in assets: steady increases in a firm's operating resources may also be viewed as an indicator of growth.

Firms can experience internal or external growth. A firm is said to be growing internally when it increases sales and profits by expanding its own operations. The growth rate the company can achieve without additional external funds is known as the internal growth rate. Internal growth may be funded from sources inside or outside the firm. Internal sources include retained earnings and the funds shielded by depreciation and other noncash expenses. If outside funds are sought, the firm may offer debt or equity securities to raise money. Even then, the firm is experiencing internal

⁵ Higgins, Robert C.: *Analysis Of Financial Management*, 5th Ed, Irwin McGraw-Hill, Boston, 1998: pp.119

⁶ Hampton, John J.: *Financial decision making, concepts, problems, and cases*, 4th Ed, Prentice-Hall, New Delhi, 1994: pp.391

growth. External growth occurs when a firm takes over the operations of another firm. The acquiring firm may purchase the assets or stock or may combine with the second firm.

Different reasons can be cited as to why a firm wants to grow like:

1. Diversification: most firms recognize that diversifying their operations reduces the risk of failure. If a firm is operating in a variety of markets with many products, it can cope better with a cutback in a single product or market.
2. Stability: when a firm is able to achieve a large volume of sales, it becomes more stable than firms with smaller volumes of sales. The high sales level allows a deep penetration of most of the firm's markets. If a firm dominates a market, it is better able to withstand pressures and problems in the market.
3. Profits from turnaround situations: when a firm is operating below its potential profit levels, a new management could remove inefficiencies and solve problems, resulting in a dramatic rise in profits. Such a firm offers a turnaround situation.

2.2 SUSTAINABLE GROWTH RATE

In order to express the dependence of growth on financial resources, we need to make the following assumptions:

- ☞ The company wants to grow as rapidly as market conditions permit.
- ☞ Management is unable or unwilling to sell new equity.
- ☞ The company has a target capital structure and a target dividend policy that it wants to maintain.

If we want to increase sales, we must also increase assets. Increase in assets must come from either retained earnings or increase in liabilities. As equity grows, liabilities can increase proportionally without altering capital structure. The growth of liabilities and equity determine the rate at which assets expands. And, in turn the rate at which assets expands limit the growth rate in sales. Thus, what limits the growth rate in sales is the rate at which owners' equity expands. A company's sustainable growth rate therefore is nothing more than its growth rate in equity. Hence, sustainable growth rate can be calculated as follows:

$$g^* = \frac{\text{Change in Equity}}{\text{Beginning of period equity}}$$

Or, $g^* = PRA\check{T}$ Where: P= Profit margin

R= Retention rate

A=Asset turnover

\check{T} = Asset to equity (where equity is beginning of period equity)

Sustainable growth can also be thought of in another way. Return on assets (ROA) can be expressed as the product of profit margin and asset turnover. Accordingly, the sustainable growth equation can be rewritten as:

$$g^* = R\check{T} \times ROA$$

P and A or ROA, summarize the operating performance of the business, while R and \check{T} describe the firm's principal financial policies. R captures management's attitude toward the distribution of dividend, and \check{T} reflects its policies regarding financial leverage.

According to Rose et al, a firm's ability to sustain growth depends explicitly on the following four factors⁷:

- i. Profit margin: an increase in profit margin will increase the firm's ability to generate funds internally and thereby increase its sustainable growth.
- ii. Dividend policy: a decrease in the percentage of net income paid out as dividends will increase the retention ratio. This increases internally generated equity and thus increases sustainable growth.
- iii. Financial policy: an increase in the debt-equity ratio increases the firm's financial leverage. Because this makes additional debt financing available, it increases the sustainable growth rate.
- iv. Total asset turnover: an increase in the firm's total asset turnover increases the sales generated for each Birr in assets. This decreases the firm's need for new assets as sales grow and thereby increases the sustainable growth rate. Notice that increasing total asset turnover is the same thing as decreasing capital intensity.

The sustainable growth rate illustrates the relationship between the firm's four major areas of concern: its operating efficiency as measured by profit margin, its asset use efficiency as measured by total asset turnover, its dividend policy as measured by the retention ratio, and its financial policy as measured by the debt-equity ratio.

2.3 TOO MUCH GROWTH

When a company's actual growth (g) exceeds its sustainable growth (g^*), the company will face the problem of growing rapidly. Companies should realize that they couldn't sustain such activity without funding that growth. When a company grows at a rate in excess of its sustainable growth rate, it can

⁷ Ross, Stephen A. et al: **Fundamentals of corporate finance**, 4th Ed, Irwin McGraw-Hill, Illinois, 1998: pp.99

either improve operation (increase in profit margin or asset turnover, ROA) or alter its financial policies (increase in retention ratio or financial leverage). 'Increasing operating efficiency is not always possible and altering financial policies is not always wise.'⁸ The additional cash required can be met by increasing leverage for the time being until the company reaches its debt capacity thereby leading the company to financing problem. Lenders will refuse additional credit requested and the company will find itself without the cash to pay its bills and can go bankrupt. Therefore, management should be aware that growth above the sustainable growth rate creates financial problems that have to be anticipated and solved. If it is not anticipated and solved, the company will face shortage of cash.

In order to manage the problem of rapid growth, the company can solve the problem by borrowing if the company's growth is likely to decline in the near future as the firm reaches maturity; i.e. if the problem is transitory. Otherwise, if the problem is long-term, then management must formulate a financial strategy from among the following options: selling new equity, increase leverage, reduce the payout ratio (cut dividend payout ratio), prune away marginal activities, outsource some or all of production, increase prices, or merge with a cash cow.

1. Sell new equity

If a company is willing to raise new equity capital by selling shares, the increased equity plus whatever added borrowing it makes possible will be sources of cash with which to finance future growth.

However, in countries where equity markets are poorly developed or nonexistent, companies must go through the difficult and costly task of

⁸ Higgins, Robert C.: 'Analysis Of Financial Management', 5th Ed, Irwin McGraw-Hill, Boston, 1998:pp.124

seeking out investors one by one to buy new shares. Therefore, this strategy cannot be used in Ethiopia as a means to deal with rapid growth.

2. Increase leverage

Increasing leverage raises the amount of debt the company can add for each Birr of retained profits. However, there are limits to the use of debt financing. All companies have a creditor imposed debt capacity that restricts the amount of leverage they can employ. Moreover, as leverage increase, the risks borne by owners and creditors rise, as do the costs of securing additional capital.

3. Reduce the payout ratio

A cut in the payout ratio raises sustainable growth by increasing the proportion of earnings retained in the business. Though, as there is limit to leverage, there is a lower zero limit to a company's dividend payout ratio. Owners' interest in dividend payments varies inversely with their perceptions of the company's investment opportunities. If owners believe the retained profits can be put to productive use earning attractive rates of return, they will happily forgo current dividends in favor of higher future ones. On the other hand, if company investment opportunities do not promise attractive returns, a dividend cut will anger shareholders, prompting a decline in stock price.

4. Profitable pruning

This strategy recognizes that when a company spreads its resources across to many products, it may be unable to compete effectively in any. Better to sell off marginal operations and plow the money back into remaining businesses. Profitable pruning reduces sustainable growth problems in two ways: it generates cash directly through the sell of marginal businesses, and

it reduces actual sales growth by eliminating some of the sources of the growth.

This strategy can also be used for a single-product company. Here the idea is to prune out slow-paying customers or slow-turning inventory. This lessens the sustainable growth in three ways: it frees up cash, which can be used to support new growth; it increases asset turnover, and it reduces sales. Sales declines because tightening credit terms and reducing inventory selection drive away some customers.

5. Sourcing

Sourcing involves the decision of whether to perform an activity in-house or purchase it from outside vendor. A company can increase its sustainable growth rate by sourcing more and doing less in-house. When a company sources, it releases assets that would otherwise be tied up in performing the activity, and it increases its asset turnover.

6. Pricing

When sales growth is too high relative to a company's financing capabilities, it may be necessary to raise prices to reduce growth. If higher prices increase the profit margin, the price increase will also raise the sustainable growth rate.

2.4 TOO LITTLE GROWTH

A company faces too little growth when its sustainable growth exceeds its actual growth, and is said to grow slowly. Such companies face the problem of how to productively spend (employ) the excess profit that is above their need (find productive use for the cash flows) that leads to deteriorating asset turnover which result in build-up of under used (idle) resources, and

declining financial leverage. If the problem is temporary, management can continue accumulating resources in anticipation of future growth. But, if the problem is long-term, then management should return the money to shareholders by increasing dividend or repurchasing shares, or should buy growth, reduce liabilities, or increase assets.

1. Ignore the problem

Management can continue investing in its core businesses despite the lack of attractive returns, or it can simply hold back an ever-larger pile of idle resources. However, poorly utilized resources depress a company's stock price and make the firm a feasible and attractive target for a rider. A rider can redeploy the target firm's resources more productively and earn a substantial profit in the process.

2. Return the money to shareholders

The most direct solution to the problem of idle resources is to simply return the money to owners by increasing dividend or repurchasing shares. Nevertheless, many executives appear to have a bias in favor of growth rather than paying large dividends even when the growth creates little or no value for shareholders. This is so because, shareholders entrust managers with the task of profitably investing their capital, and for management to return the money suggests an inability to perform a basic managerial function. In other words, dividends reduce the size of management's empire.

3. Buy Growth

Motivated by pride in their ability as managers, concern for retaining key employees, and fear of raiders, managers often respond to excess cash flow by attempting to diversify into other business.

In general, rapidly growing companies face the problem of additional fund to finance their growth while slow growing firms seek productive use for their excess cash. Therefore, it is natural for high-and-low growing companies to solve their respective growth problems by merging so that the excess cash generated by one organization can finance the rapid growth of the other.

1993-1998, as the first
 used as a support for
 or rapidly and if the
 the company's
 growth rate

(of period equity)
 actual sales growth rate
 the sustainable growth
 compute the ratios and the

Key Ratios

	1993	1995	1998	1999	2000
1	10.50	20.2	16.1	12.38	16.45
2	0.34	0.24	0.27	0.21	0.19
3	1.51	1.11	1.82	1.38	1.54
4	1.37	4.85	3.85	3.8	2.13
5	11.6	27.3	6.17	6.52	21.26
6	14.38	33.8	11.48	12.23	16.71

3. DATA ANALYSIS AND INTERPRETATION

In light of the theoretical background this chapter provides a comprehensive analysis and interpretation of the actual financial data of Meta Abo Brewery for the years 1987-1998 is presented. As it was mentioned in the previous chapter, the years from 1987-1992 are considered as the pre-reform period and from 1993-1998, as the post-reform period. This analysis and interpretation is used as a support for judging whether the company is growing slowly or rapidly and if the financial aspect of growth is properly managed in the company.

3.1 DATA ANALYSIS

As it was discussed in the earlier chapter, the sustainable growth rate can be calculated as follows:

$$g^* = PRA\bar{T}$$

Where: P= Profit margin

R= Retention rate

A= Asset turnover

\bar{T} = Asset to equity (where equity is beginning of period equity)

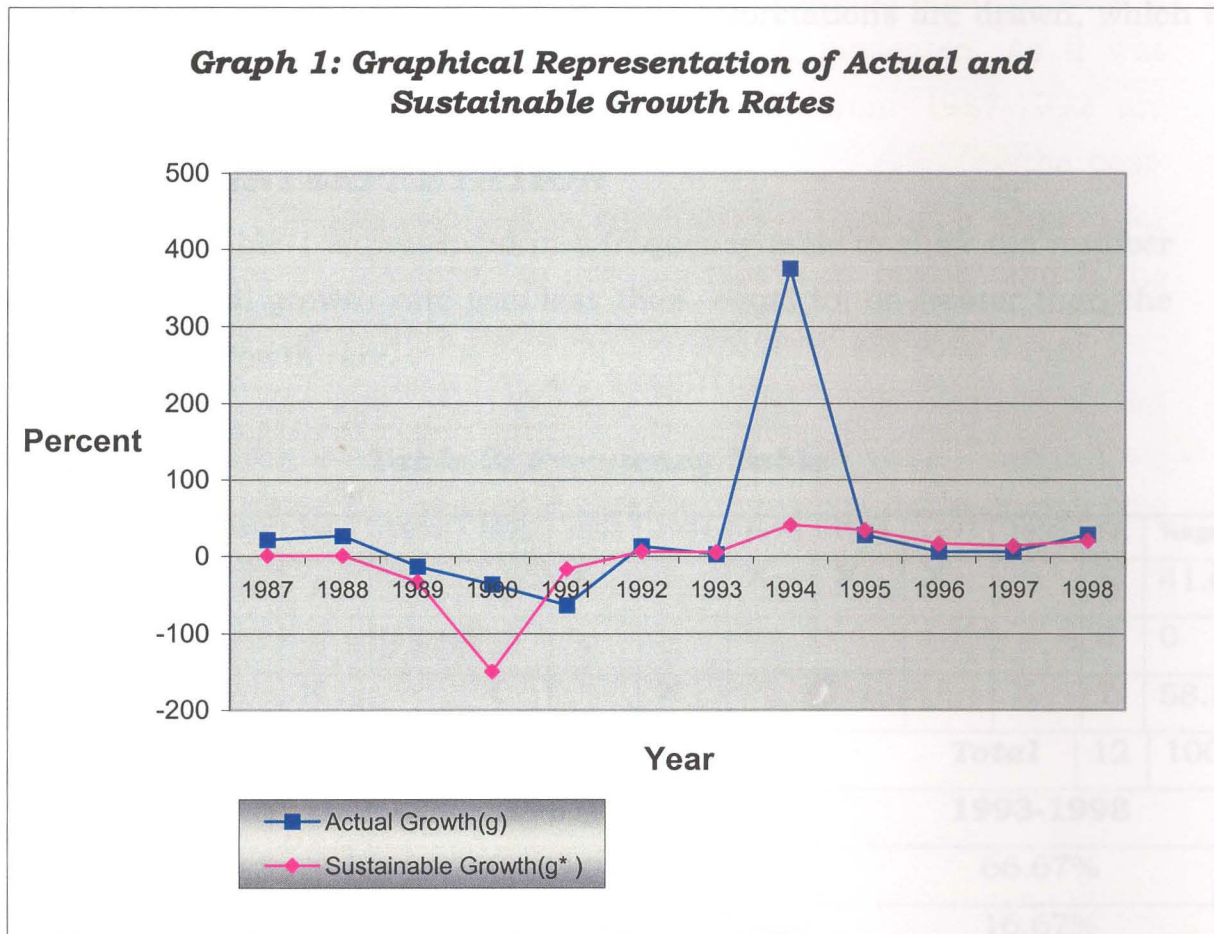
The sustainable growth rate is compared with the actual sales growth rate achieved. The following table shows the actual and the sustainable growth rates for Meta Abo Brewery. The data used to compute the ratios and the growth rates are given in the annex.

Table 1: Growth Rates and Important Ratios

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Profit Margin(P)%	0.97	0.23	-0.92	-9.07	-7.1	2.35	5.83	15.56	20.2	14.1	12.86	16.45
Retention Ratio (R)	0.1	0.2	1	1	1	1	0.33	0.34	0.24	0.21	0.21	0.21
Assets Turnover(A)	2.75	3.39	2.72	1.55	0.59	0.63	0.42	1.61	1.41	1.52	1.39	1.37
Assets/Equity(\bar{T})	2.53	2.62	13.37	10.6	4.07	4.19	6.48	4.74	4.95	3.65	3.6	4.15
Actual Growth(g)%	21.32	26.41	-13.3	-36.6	-63.4	13.1	2.48	374.6	27.5	6.17	5.82	28.24
Sustainable Growth(g*)%	0.67	0.41	-33.5	-150	-17	6.17	5.21	40.39	33.9	16.44	13.55	19.71

Note: All numbers are rounded to the nearest two decimal place.

The actual and the sustainable growth rates are also presented in graphical form as follows:



As can be seen from the above graph, there is an immense gap between the actual growth rate and the sustainable growth rate. This could have happened because of not taking the proper financial actions to align the two rates. Before the reform, the actual growth rate was greater than the sustainable growth rate and this could be the result of the company's inability to balance the profitability of the operation with the funds required to support the growth or lack of capability by the company to acquire the additional cash required. And after the reform, the sustainable growth rate was greater than the actual growth rate. This could be due to the failure of

Meta Abo to find productive use of the cash flows (profit) generated in excess of the company's need.

Based on table-1 and graph-1, different interpretations are drawn, which is dealt with in the next section.

3.2 DATA INTERPRETATION

The data in table-1 is presented in a frequency table to show the number of times actual growth rate was less than, equal to, or greater than the sustainable growth rate.

Table 2: Frequency Table

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	Fr.	%age
$g < g^*$					X		X		X	X	X		5	41.67
$g = g^*$													0	0
$g > g^*$	X	X	X	X		X		X				X	7	58.33
Total												12	100	
1987-1992						1993-1998								
$g < g^*$	33.33%						66.67%							
$g > g^*$	83.33%						16.67%							

Fr. =Frequency and %age= Percentage

From the above table, it is evident that the actual growth rate of the brewery is greater than the sustainable growth rate for 7 years (approximately 58.33%) out of the 12 years. During these years the company was a cash absorber leading to the requirement of funding to finance the operations. What the brewery was generating in the form of additional resources from retained profits was not growing concomitantly with that of the extra cash required to back up increased sales. Hence, the company was strained by shortage of funds to finance its increased sales and should raise fund either from internal or external sources.

The reverse, i.e. actual growth rate was less than the sustainable growth rate, was true for the remaining 5 years (41.67%) of the time. In these years, the company was a cash generator and could have been faced with the dilemma of what to do with the profits in excess of company needs. The company was not utilizing its resources to their capacity, i.e. there was under-utilization of resources.

The actual growth rate came into harmony with the sustainable growth rate in none of the years considered.

It can also be observed from table-2 the number of times the actual growth rate was greater or less than the sustainable growth rate during the pre and post-reform period. This growth rate was greater than the sustainable growth rate 83.33 percent of the time; i.e. for 5 years out of 6, prior to the reform. The opposite case was true; i.e. sustainable growth rate was greater than that of the actual 66.67 percent of the time (4 years out of 6) following the reform.

The following points can be drawn from the observation of table 1 and 2:

- The actual growth rate has been greater than the sustainable growth rate in most of the years taken into consideration. It has shown such a trend for 7 years out of the 12 years considered. For the remaining 5 years the sustainable growth rate was greater than the actual growth. Therefore, for the overall performance of the company intended for the period taken into consideration, Meta Abo tends to be a rapidly growing company with the actual growth rate being greater than the sustainable one 58.33 percent of the time out of the 12 years.
- Meta Abo was growing rapidly (being a cash absorber) during the pre-reform period and then changed to be a cash generator after the reform (became a slow growing company).

o There is much variability in the actual growth rates than in the sustainable growth rates. The actual growth rate during the period considered ranged from -63.40 percent (in 1991) to 374.60 percent (in 1994); while the sustainable growth rates range from -150 percent (in 1990) to 40.39 percent (in 1994). This can also be referred from graph-1. The company has the highest actual as well as sustainable growth rates in the year 1994.

The following table shows a comparison between the two periods (before and after the reform). The actual and sustainable growth rates and the variables of the sustainable growth rate are given with their averages and their overall average for the two periods.

Table 3: Comparison of the two periods

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Profit Margin(P)%	0.97	0.23	-0.92	-9.07	-7.1	2.35	5.83	15.56	20.16	14.1	12.86	16.45
Retention Ratio(R)%	10.00	20.00	100.00	100.00	100.00	100.00	33.00	34.00	24.00	21.00	21.00	21.00
Assets Turnover(A)	2.75	3.39	2.72	1.55	0.59	0.63	0.42	1.61	1.41	1.52	1.39	1.37
Assets/Equity(\bar{T})	2.53	2.62	13.37	10.63	4.07	4.19	6.48	4.74	4.95	3.65	3.6	4.15
Debt/Assets (%)	60.74	108.1	110.43	123.79	125.29	123.79	73.99	70.67	72.96	67.95	68.71	71.4
Return on Assets (ROA) %	2.68	0.78	-2.51	-14.09	-4.17	1.47	2.44	25.05	28.49	21.42	17.9	22.59
Actual Growth(g)%	21.32	26.41	-13.31	-36.6	-63.41	13.13	2.48	374.6	27.48	6.17	5.82	28.24
Sustainable Growth(g*)%	0.67	0.41	-33.51	-149.77	-16.96	6.17	5.21	40.39	33.85	16.44	13.55	19.71

	Average 1987-1992	Average 1993-1998	Overall Average 1987-1998
Profit Margin (P)%	-2.26	14.16	5.95
Retention Ratio (R) %	71.65	25.67	48.66
Assets Turnover (A)	1.94	1.29	1.61
Assets/Equity (\bar{T})	6.24	4.60	5.42
Return on Assets (ROA)	-2.64	19.65	8.50
Debt/Assets (%)	108.68	70.95	89.82
Actual Growth (g) %	-8.74	74.14	32.70
Sustainable Growth (g*) %	-32.17	21.53	-5.32

The profit margin and return on assets on the average increased after the reform. The negative values before the reform resulted from the loss that

was incurred by the company for three consecutive years. On the other hand, retention ration, asset turnover, and leverage ratio declined after the reform.

On average, the actual growth rate has increased after the reform, it increased from a negative value of 8.74 percent in the pre-reform period to 74.14 percent in the post-reform period, with an overall average of 32.70 percent. This could have been contributed by the tremendous increase in the sales volume (374%) of the company within one year (from 1993 to 1994).

The sustainable growth rate also showed the same trend as that of the actual growth rate. It increased from an average of -32.17 percent during the pre-reform period to 21.53 percent in the post-reform period, with an overall average of -5.32 percent.

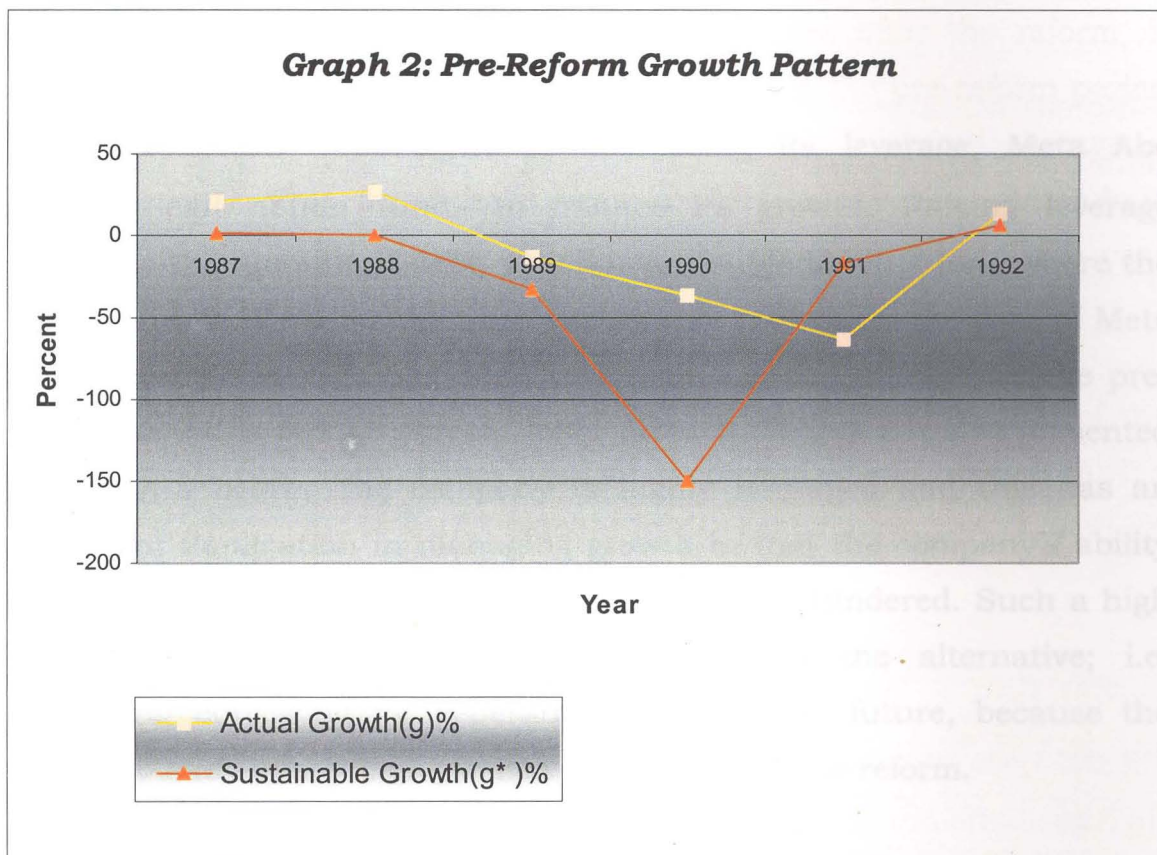
Referring back to table-3, on the average, the actual growth rate is greater than the sustainable growth rate for the two periods, though the actual growth rate was negative during the pre-reform period because of declining sales volume it still was better than that of the negative sustainable growth rate. Thus, we can say that Meta Abo Brewery is a rapidly growing business.

3.3 ASSESSING DECISION VARIABLES

3.3.1 Pre-Reform Period

If a growing company is not conscious about the extra financing needed to sustain the growth, the rapid growth will create a financial problem for the company. Rapid growth can strain a company's resources and lead to bankruptcy. The financial problem encountered is known as overtrading: the phenomenon of being unable to pay liabilities as they fall due because of shortage of funds that emanates from unbalanced growth.

Meta Abo Brewery was a victim of rapid growth before the reform as it was evident in table-2 and graph-2 below; actual growth was higher than sustainable growth 83.33 percent of the six years before the reform.

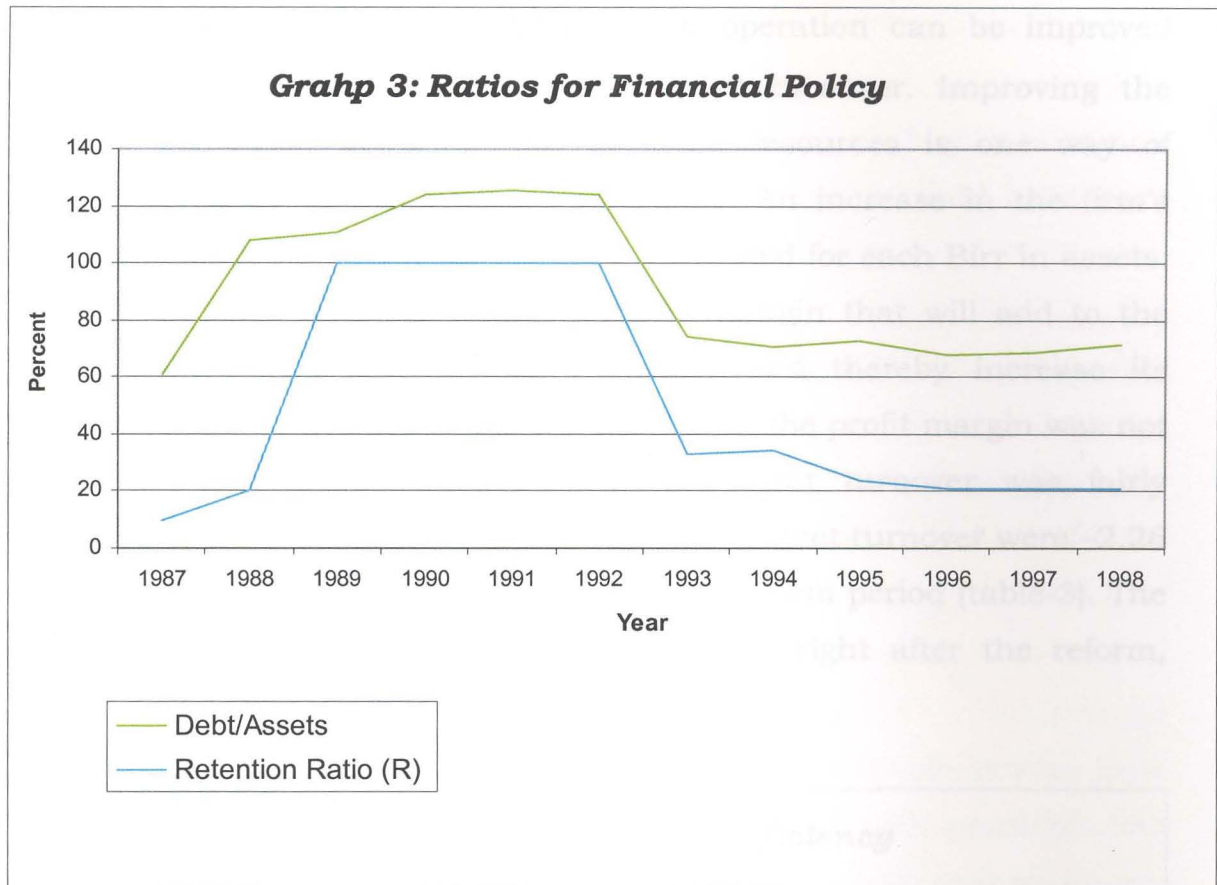


One of the measures of a company's growth is increase in sales. Increase in sales leads to the need to increase assets. The additional assets needed must come either from internal or external sources. The following strategies can be used as a remedy to deal with the problem of rapid growth, either separately or in combination.

1. **Sell new equity:** as it is apparent for public enterprises, there is limited, if any, possibility of generating external funds in the form of equity. Since there is no option to raise equity finance by issuing share, Meta Abo Brewery has little chance of obtaining funds from the owner;

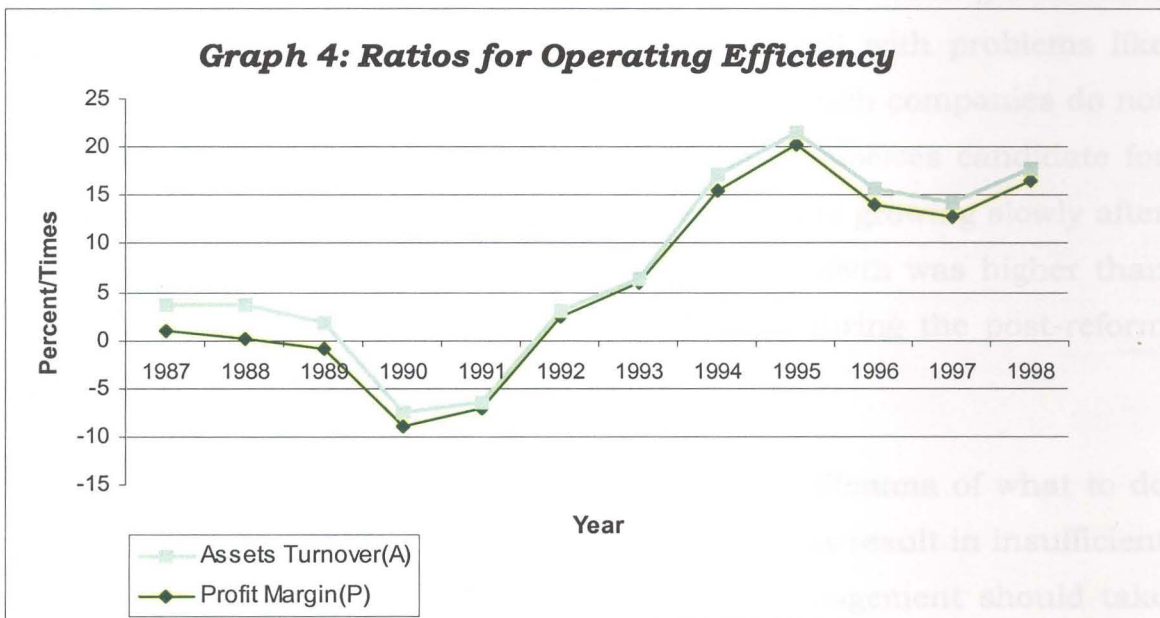
i.e. the government, every time it wants to grow. Thus, the brewery cannot adopt this alternative. Had there been active stock market trading of shares in our country and Meta Abo had the opportunity to raise new equity capital by selling shares, the increased equity could have been source of cash to finance future growth.

2. Increase leverage: by increasing its leverage, Meta Abo Brewery can obtain funds to finance its growth. Raising leverage increases the amount of debt, which is advisable in situations where the actual growth is higher than the sustainable growth. In the case of Meta Abo Brewery, leverage has been very high; i.e. the average for the pre-reform period is 108.68 percent (refer table-3). This fact is also presented on graph-3 below. The company is highly leveraged and this has an important implication in managing growth in that the company's ability to raise funds in the future by borrowing will be hindered. Such a high leverage ratio will reduce the significance of the alternative; i.e. increasing borrowing for generating funds in the future, because the company has already highly relied on debt before the reform.



3. Reduce payout ratio: reducing the dividend payout ratio will increase the amount of earning that will be retained in the business. This also means that the retention ratio will increase thereby raising the sustainable growth rate. However, this financial option might not be feasible because it is not under the full authority of the brewery to decide upon dividend payment. The amount of state dividend to be paid to the government is determined by the supervising authority. Yet, the company has shown an increase in its retention ratio before the reform, on the average 71.65 percent (table-3). This could have been contributed to the loss incurred by the company and since the company didn't pay out dividend at that time, the payout ratio declined. Graph-3 shows that the retention ratio was almost constant for most of the time prior to the reform.

4. Increase operating efficiency: operation can be improved either by increasing profit margin or asset turnover. Improving the revenue generated by using the available resources is one way of generating funds to the business internally. An increase in the firm's total asset turnover increases the sales generated for each Birr in assets. Increase in sales leads to improved profit margin that will add to the firm's ability to generate funds internally and thereby increase its sustainable growth. With the case of Meta Abo, the profit margin was not satisfactory before the reform, while the asset turnover was fairly enough. On the average, the profit margin and asset turnover were -2.26 and 1.94 percent respectively during the pre-reform period (table-3). The profit margin has shown a dramatic increase right after the reform, which can be seen in graph-4 below.



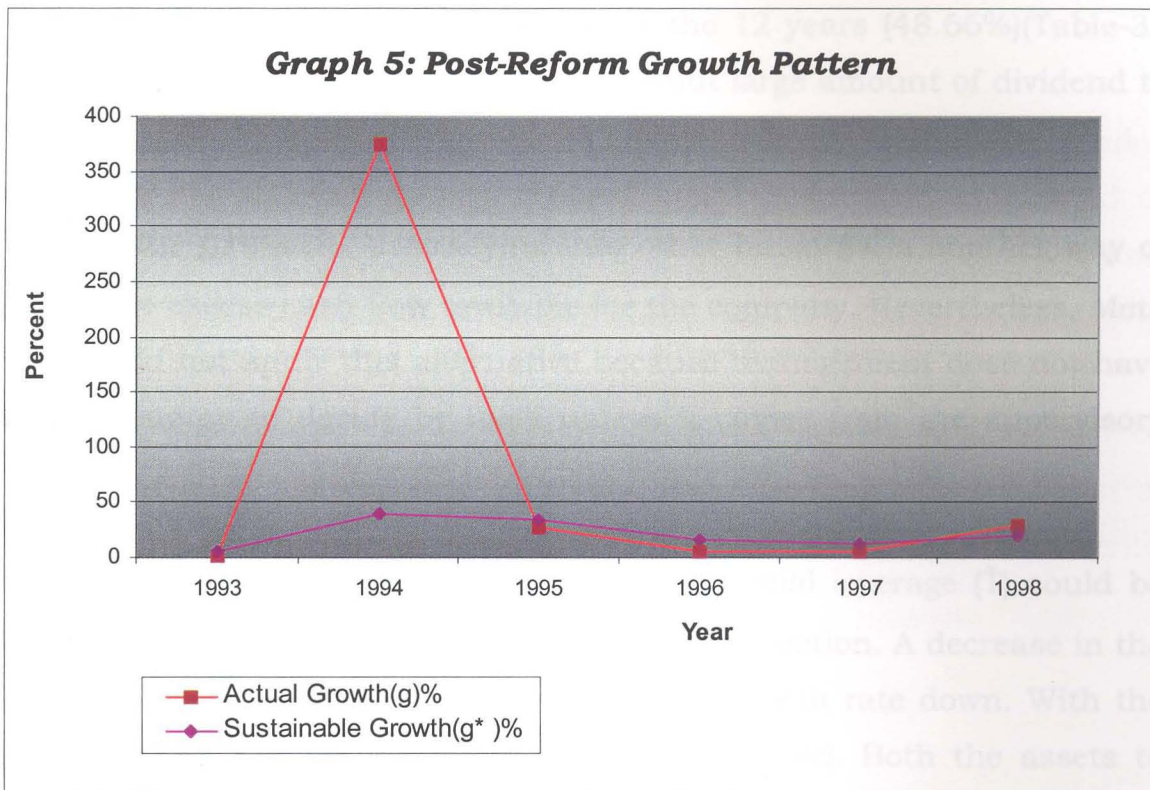
5. Other decisions: other than the above-mentioned strategies in situations where the actual growth is greater than the sustainable growth rate the company can:

- Prune out slow-paying customers or slow-turning inventories to decrease sales and increase the assets turnover.
- Source out some of the activities of the company to another vendor like for example getting a distributor for the product instead of distributing it by the company itself. This will free some assets and increase the asset turnover ratio in so doing raising the sustainable growth rate.
- Lift prices high so as to reduce sales, which will bring the actual growth rate down. Nonetheless, prices should not be too high not to lose customers eventually; if prices are too high, this alternative should be avoided as much as possible.

3.3.2 Post-Reform Period

Companies growing slowly, those with their sustainable growth rate higher than the actual growth rate, are also faced with problems like those that grow rapidly, but of a different type. If such companies do not take the appropriate measure, they will make themselves candidate for takeover by potential buyers. Meta Abo Brewery was growing slowly after the reform. Table-2 shows that the sustainable growth was higher than the actual growth for 66.67 percent of the time during the post-reform period, which can also be seen in graph-5

Slowly growing companies will be faced with the dilemma of what to do with the profit in excess of the company's need. This result in insufficient growth and under-used resources. Therefore, management should take the following actions accordingly.



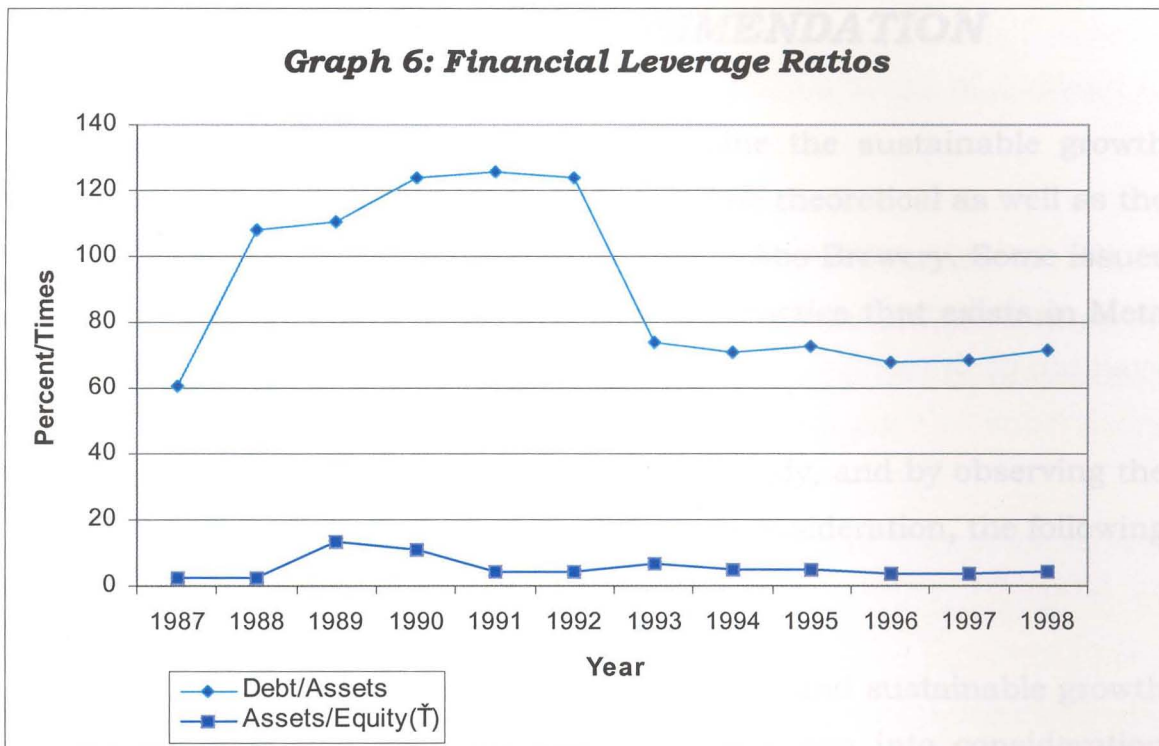
1. Ignore problem: excess profit leads to deteriorating asset turnover that result in accumulation of idle resources and declining financial leverage. If management believes that this problem is temporary, then it can continue to accumulate the resources with the hope for future growth. The problem with this alternative is that the underutilized resources can attract unwanted attention for possible takeovers.

2. Return the money to owners: in situations where the company is generating excess profit above the company's need, it is better to return the money to owners in the form of large dividends. Meta Abo seems to be using this strategy cause its retention ratio shows a declining trend during the post-reform period. This can also be seen from graph-3. On average, the retention ratio decreased from an amount of 71.65 percent before the reform to 25.67 percent after the reform, which

is even less than the overall average for the 12 years (48.66%)(Table-3). This could imply that the company gives out large amount of dividend to its owner.

3. Buy growth: diversifying into other business is another way of using the excess cash flow available for the company. Nevertheless, Meta Abo could not apply this alternative because management dose not have full autonomy to decide by itself unless it comes from the supervisory body.

4. Other decision: decreasing the financial leverage (\bar{T}) could be devoting some excess operating cash to debt reduction. A decrease in the financial leverage will push the sustainable growth rate down. With the case of Meta Abo, this strategy seems to be used. Both the assets to equity and debt to assets ratios declined in the post-reform period. On average the asset to equity ratio declined from 6.24 to 4.60 and the debt to assets ratio from 108.68 percent to 70.95 percent after the reform (table-3). This effect can also be seen in the following graph. The two ratios follow more or less the same pattern of rising or declining.



3.3.3. Overall Assessment

Referring back to table-2, it can be said that Meta Abo is a rapidly growing company because its actual growth was higher than the sustainable growth for 7 years out of the 12 years considered (58.33%). This is also shown in graph-1. Table-3 also revealed that the overall average for the two periods show that the actual growth and the sustainable growth were 32.70 and -5.32 percent respectively. How did Meta Abo cope with actual growth above sustainable levels? By looking at the four ratios, it is revealed that the company increased its profit margin after the reform. Increasing profit margin was vital because it enabled the company to finance its accelerating growth. At the same time, it allowed its asset turnover to decline, which worsened the problem. In addition to increasing the profit margin, the company should also use the different strategies mentioned in item 3.3.1, either separately or in combination.

4. CONCLUSION AND RECOMMENDATION

4.1 CONCLUSION

This paper has tried to discuss and examine the sustainable growth model as a means of managing growth from the theoretical as well as the practical viewpoint by taking the case of Meta Abo Brewery. Some issues that need consideration with regards to the practice that exists in Meta Abo Brewery are presented in this chapter.

Taking the outcome from the findings of the study, and by observing the financial performance of the enterprise under consideration, the following conclusions are drawn:

- © There is high discrepancy between the actual and sustainable growth rates of Meta Abo Brewery for the period taken into consideration (1987-1998). This could imply that the company did not properly manage the financial dimension of growth.
- © Sustainable growth rate has been different from the actual growth rate for both the periods considered separately (pre-reform and post-reform periods). Before the reform, the actual growth was greater than the sustainable growth and hence the company was growing rapidly. The opposite situation was true during the post-reform period. There was no improvement made after the reform to make better the difference between the two growth rates.
- © The overall average for the two periods reveals that the actual growth rate is higher than the sustainable growth and hence the company is growing rapidly. In which case, growth was not properly managed from the financial aspects in both periods.

- © The option of reducing the dividend payout (increase the retention rate) or giving out high amount of dividend is not in the domain of the company's decision making.
- © Meta Abo Brewery highly relied on debt for its financing especially before the reform. This will hinder the company's ability to generate funds through further borrowing or will affect the future profitability of the company due to an inevitable interest payment.
- © The company's asset turnover shows a declining tendency, which will worsen the situation of rapid growth.
- © The profit margin has an increasing pattern, on average, which is vital because it will enable the company to finance its accelerating growth without restoring to major addition in financial leverage.

4.2 RECOMMENDATION

In light of the above-concluded actuality with regard to growth management in Meta Abo Brewery, the subsequent recommendations can follow:

- ① It is advisable for the management of the brewery to closely monitor its growth plans using the sustainable growth model in order to achieve the sustainable growth rate, the rate at which the financial resources won't be depleted and at the same time sales can increase. In so doing, the company will be able to formulate the financial strategies that will help it fine-tune the actual growth rate with the sustainable growth rate.
- ② A policy decision is necessary to enable the management of the brewery to determine its dividend payout and retention rate according to the company's growth plan. This will enable the company not to rely on debt financing.
- ③ Meta Abo has to find productive use of its resources (assets) and increase efficiency of its asset utilization thereby improving the operation of the company.
- ④ The brewery might have to consider price increment so as to reduce growth and raise sustainable growth. This strategy will lessen actual growth by eliminating some of the sources of the growth. However, the price should not be too high to drive away customers.

The above recommendations could be of great use for all concerned parties in the brewery to fine-tune their decisions dealing with financial aspect of growth and hence put the company on strong financial basis. Therefore, the management of Meta Abo Brewery should consider these recommendations for future decisions

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ANNEX 1: Data used to calculate actual and sustainable growth rates

	1987	1988	1989	1990	1991	1992
Net Income	656,525.00	196,350.00	(683,979.00)	(4,262,167.00)	(1,220,082.00)	456,226.00
Sales	67,601,703.00	85,457,979.00	74,084,182.00	46,971,137.00	17,186,734.00	19,443,596.00
Total Assests	24,538,206.00	25,210,105.00	27,286,123.00	30,247,235.00	29,252,252.00	30,989,603.00
Beginning Equity	9,708,110.00	9,633,477.00	2,041,138.00	2,845,794.00	7,195,246.00	7,398,783.00
Profit Margin(P)%	0.97	0.23	-0.92	-9.07	-7.10	2.35
Retention Ratio(R)	0.10	0.20	1.00	1.00	1.00	1.00
Assets Turnover(A)	2.75	3.39	2.72	1.55	0.59	0.63
Assets/Equity(\bar{T})	2.53	2.62	13.37	10.63	4.07	4.19
	1993	1994	1995	1996	1997	1998
Net Income	1,161,215.00	14,717,915.00	24,301,875.00	18,051,783.00	17,422,734.00	28,573,922.00
Sales	19,926,769.00	94,576,882.00	120,568,977.00	128,012,372.00	135,460,478.00	173,709,248.00
Total Assests	47,645,351.00	58,753,675.00	85,284,954.00	84,278,421.00	97,308,026.00	126,477,175.00
Beginning Equity	7,356,193.00	12,390,643.00	17,231,280.00	23,059,559.00	27,009,077.00	30,451,624.00
Profit Margin(P)%	5.83	15.56	20.16	14.10	12.86	16.45
Retention Ratio(R)	0.33	0.34	0.24	0.21	0.21	0.21
Assets Turnover(A)	0.42	1.61	1.41	1.52	1.39	1.37
Assets/Equity(\bar{T})	6.48	4.74	4.95	3.65	3.60	4.15

Source: Audited Financial Statements of Meta Abo Brewery for the years 1987-1998