GROWTH THAT COMPOUNDS

What is sustainable growth rate? Growth has a financing boundary

Sustainable growth rate is a conditional financing identity, commonly ROE times retention. State capital, payout, leverage, and assumptions before use.

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MANAGEMENT SUMMARY

Sustainable growth rate (SGR) is a conditional financing identity that commonly multiplies return on equity by the retention ratio. It is not a promise, a demand forecast, an ESG score, or a universal growth target. This article defines the equity base, earnings period, payout, retention, leverage, asset-productivity, and financing assumptions that make the identity interpretable. A synthetic scenario chart shows how 12% ROE with 70% retention implies 8.4% under the declared identity, while different payout and ROE assumptions produce different boundaries. Robinson supplies planning-context caveats about treating portfolio formulas as decisions, and Hulten and Hao reinforce the capital-base boundary. The formula, scenarios, and review card are author synthesis, not current-company advice.

Keywords: Sustainable Growth Rate · Return on Equity · Retention Ratio · Payout Ratio · Growth Financing · Capital Allocation · Return on Investment

A growth plan can show a market opportunity and still omit the financing boundary. The company may retain profits, issue debt, issue equity, improve asset productivity, or reduce the payout. Those choices change how much growth the stated capital base can support.

Sustainable growth rate is a conditional identity for growth financed under stated return and retention assumptions. A common form is return on equity multiplied by the retention ratio. The identity is a boundary for a model, not a promise about what a company will grow.

The growth-share matrix article owns portfolio allocation caveats. The contribution-margin article owns the operating contribution boundary. This page owns the financing identity between earnings, payout, equity, and growth.

What does sustainable growth rate mean?

Define the terms before multiplying:

Table 1 What does sustainable growth rate mean?

Term	Declaration	Failure when it is hidden
Return on equity	Net income divided by a named average equity base	Leverage, goodwill, or period changes move the ratio
Retention ratio	Share of earnings retained rather than paid out	A payout assumption is mistaken for operating growth
Payout ratio	Share of earnings distributed under the declared policy	Buybacks, special dividends, or loss periods change the numerator
Sustainable growth rate	ROE multiplied by retention under the identity	A conditional capacity becomes a forecast or target
Financing boundary	Debt, equity, cash, asset productivity, and leverage assumptions	External financing is hidden when the target exceeds the identity

Table from this essay. Sources and interpretation are given in the article.

The accounting identity becomes meaningful only after the capital base and earnings period are stated. Average equity and ending equity are different denominators. A high ROE can arise from leverage or a small equity base rather than from a change in customer demand or operating quality.

What is the sustainable growth rate formula?

The common identity is:

SGR = return on equity × retention ratio

and:

retention ratio = 1 - payout ratio

If ROE is 12% and the retention ratio is 70%, the synthetic SGR is 12% × 70% = 8.4%. This is the output of the declared identity. It is not evidence that the company will grow at 8.4% or that growth above it is impossible.

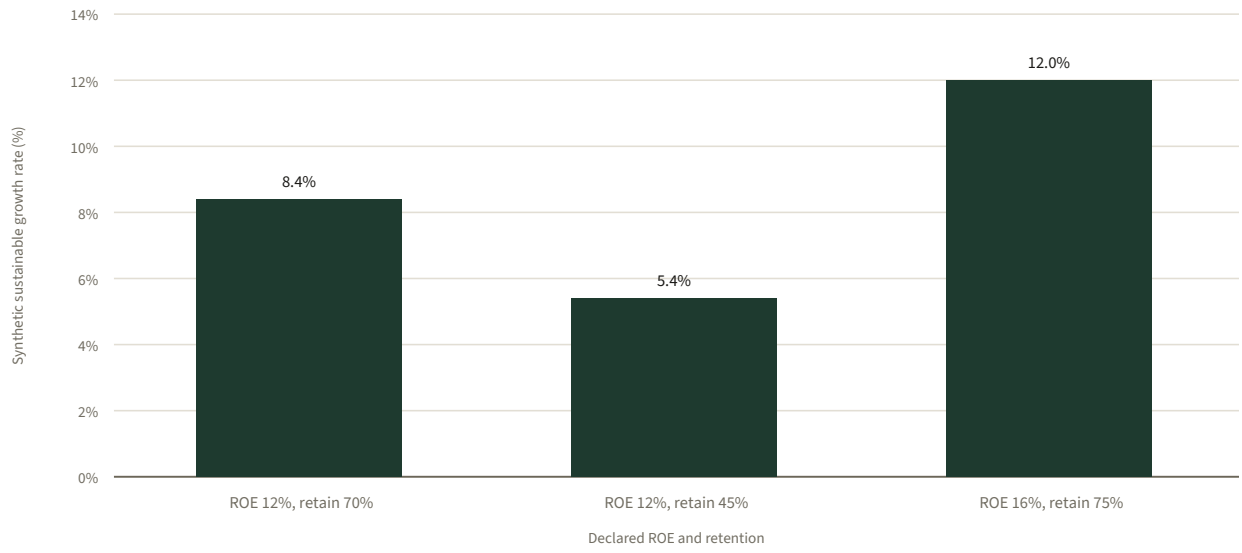
Robinson's planning-oriented critique of the growth-share matrix is useful as a historical caution: a formula or portfolio display can simplify a capital-allocation decision while hiding boundaries such as market definition, cost, capacity, and organization. Robinson does not provide a universal SGR target.

Hulten and Hao show why the interpretation of company value changes when intangible capital and the capital base are measured differently. Their working-paper setting is not an SGR benchmark. It reinforces the narrower rule that a return ratio must preserve its capital and output definitions.

What do synthetic financing scenarios show?

The chart uses three illustrative combinations of ROE and retention. It contains no current company figures, forecast, investment recommendation, or market benchmark.

Figure 1 Synthetic sustainable-growth-rate scenarios



Author's synthetic SGR scenario model grounded in Robinson (1986) and Hulten and Hao (2008). The identity, assumptions, and values are illustrative; they are not current-company figures, a forecast, or financial advice.

Table 2 What do synthetic financing scenarios show?

Scenario	ROE	Retention ratio	Synthetic SGR	If target exceeds identity
Base retention	12%	70%	8.4%	Name external financing or changed assumptions
Higher payout	12%	45%	5.4%	Retained earnings support less growth under the identity
Higher ROE and retention	16%	75%	12.0%	Verify whether capital base and earnings definition remain comparable

Table from this essay. Sources and interpretation are given in the article.

The final column is a review prompt, not a recommendation. A target above the identity can be financed with external equity or debt, lower payout, higher ROE, greater asset productivity, or a changed capital boundary. Each route introduces assumptions that the SGR identity does not resolve.

Is sustainable growth rate a forecast?

No. SGR is a conditional output of a financing model. A forecast needs a demand, price, volume, margin, capacity, competitive, and timing model, among other declared objects. SGR does not provide those observations. It can be used as a constraint or scenario input when its assumptions are explicit, but it should not be labeled as the expected growth path without additional evidence.

The same caution applies to the word sustainable. In this article it describes a financing identity. It does not assess environmental impact, social outcomes, governance quality, or long-run competitive durability.

What does sustainable growth rate not measure?

SGR does not measure market demand, product quality, customer retention, profitability in every sense, cash available for investment, or the causal effect of reinvestment. It does not tell a manager which financing instrument to use and it is not personal or company-specific financial advice.

The defensible conclusion is narrower: under the declared ROE, retention, payout, capital, and period assumptions, the identity returns a conditional growth boundary. The decision to fund growth requires a separate capital and risk review.

How should a team review an SGR calculation?

1. Name the earnings period and the average or ending equity denominator.
2. Reconcile net income, payout, buybacks, and retained earnings.
3. State leverage, asset-productivity, currency, and extraordinary-item treatment.

4 Calculate ROE and retention separately before multiplying.

5 Compare the target with the identity and name any external financing gap.

6 Keep SGR separate from demand forecasts, operating margins, and ESG assessments.

7 Recalculate when capital base, payout, or accounting boundary changes.

Sustainable growth rate is useful when it is treated as a conditional identity. It becomes misleading when the boundary disappears and the output is promoted to a promise.

Hulten, C. R., & Hao, X. (2008). What is a company really worth? Intangible capital and the “market to book value” puzzle (Working Paper No. 14548). National Bureau of Economic Research. https://doi.org/10.3386/w14548

Robinson, C. G. (1986). The growth share matrix as a planning tool: caveats and practical problems. South African Journal of Business Management, 17(1), 31-37. https://doi.org/10.4102/sajbm.v17i1.1031

END OF ESSAY

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