

The Price of Ambition

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Dear Investors,

A common maxim in the business world is that every company plans to grow. In most cases, this objective is well justified: it brings economies of scale, improves competitive positioning, makes it easier to attract talented people at all levels, and creates value for shareholders. On this last point, the relationship is direct not only with a company's historical growth, but also with expectations for future growth, since the estimated value of a business depends fundamentally on its expected growth rate and profitability. But does this expansionary ambition always make sense?

According to an ancient Greek myth, King Minos of Crete commissioned the inventor Daedalus to build a labyrinth to imprison the Minotaur, a mythical creature half man and half bull. To ensure that the secret of the labyrinth would never be revealed, King Minos imprisoned Daedalus and his son, Icarus, in a heavily guarded tower once construction was completed. Determined to escape, Daedalus built wings made of bird feathers and wax so that he and Icarus could flee.

Before departing, Daedalus instructed Icarus not to fly too high, as the heat of the sun could melt the wax and destroy the wings. At first, everything went according to plan, and both escaped the tower through the air. However, the euphoria of being able to fly led Icarus to rise higher and higher, ignoring his father's warnings about the danger. Once he had flown too high, the wax holding the feathers together began to melt, and Icarus's wings came apart, causing him to fall from the sky into the Aegean Sea, where he drowned.

This metaphor for the risks of becoming dazzled by one's own success, being guided by ambition, and abandoning prudence—thereby making the mistake of trying to exceed the limits imposed by reality itself—was as valid in ancient Greece as it is today. We will discuss this theme in the context of business and investing.

Why Business Growth Is Limited

A company's revenue growth within a given industry comes from two main sources: an increase in demand—either through higher volumes or pricing—or gains in market share. The latter is always a temporary driver of growth, as it is not possible to gain market share indefinitely. In the extreme case, growth would cease once the company captured the entire market and became a pure monopoly. In practice, this limit is reached much earlier, due to competition and antitrust regulation, which prevent monopolies and promote competitive dynamics. Demand, on the other hand, can grow indefinitely—but not at a rapid pace.

Demand growth can also be broken down into a few key components: population growth, increases in per capita income, and a higher share of wallet for the product or service. Since demographic growth and per capita income tend to evolve slowly, periods of rapid growth are typically associated with increased adoption by consumers of the product or service offered—either directly by the company or by the end of the value chain in which it operates. This type of fast growth can persist for extended periods in early-stage industries, but it is rarely observed in more mature sectors that have already reached a relatively stable equilibrium between supply and demand.

At the risk of stating the obvious: no company can grow rapidly forever within the same economic activity, as gains in market share and share of wallet are inherently limited, while population and income growth are

gradual. The expectation of sustaining high growth rates indefinitely by simply doing “more of the same” is unrealistic. Once a company reaches the point where there is no longer room to grow rapidly within its core segment, its shareholders are at risk.

What Happens When a Business Reaches Its Limit

There are a few alternatives available to a business that can no longer grow efficiently. The first is to fail to recognize that its market has become saturated and continue searching for ways to accelerate growth. This often leads to capital being wasted on investments aimed at increasing the quality or volume of supply without sufficient demand to absorb it. In a simple example, imagine if the food industry insisted on selling more than humanity is capable of consuming, or tried to convince people to allocate an ever-increasing share of their budgets to food. The challenge is not so straightforward in practice, as the point at which growth becomes inefficient is not clearly defined. It is usually identified empirically, when continued efforts to grow stop generating results. At that stage, it depends on the judgment of shareholders and executives whether to attribute the slowdown to strategic or execution failures—problems that are, in principle, solvable—or to the more intractable issue of market saturation.

The second alternative is to expand the business into new industries or segments where there is still room for rapid growth. When these are adjacent to the company’s core activities and leverage its existing market position and capabilities, this strategy can have a good chance of success. However, there are also many cases of companies expanding into entirely unrelated sectors, forming conglomerates with little to no operational synergies. Most business groups that have followed this path have not delivered strong returns for their shareholders.

The third option is to acknowledge that expansion is no longer efficient and instead distribute the cash generated by the business to shareholders, either through dividends or share buybacks. This is the most prudent course of action from the standpoint of maintaining high returns on invested capital, but it is also the least commonly chosen—both by executives and, in many cases, by shareholders themselves.

The Difficulty of Not Pursuing Growth

Abandoning the goal of rapid growth is not an easy choice for individuals with a track record of success leading their businesses. Professional executives naturally want to be involved in large companies with sophisticated and ambitious business plans, where successful execution has the potential to significantly advance their careers. Moreover, their compensation is not necessarily closely aligned with returns on invested capital, meaning it can be objectively more attractive for them if the company continues to grow—even if profitability deteriorates in the process.

Shareholders are in a somewhat different position, as they are directly affected by the lower returns that an inefficient expansion plan can generate, but the ambition to grow the business to its full potential is equally present. In the case of controlling shareholders who founded the business—and who may even have their personal identity closely tied to it—the drive for growth can be even stronger. Highly successful individuals in the business world tend to be extremely competitive, ambitious, and confident. While these traits are desirable most of the time, they also increase the risk of falling into the trap illustrated by the myth of Icarus: becoming dazzled by one’s own success, being driven by ambition, and neglecting prudence.

The market further exacerbates this dilemma. Most equity analysts prefer to hear growth narratives—stories about talented leaders driving expansion strategies where the sky is the limit. In a culture that prioritizes growth above all else, sometimes even above profitability, stating that the plan is to grow at modest rates—even if it is to preserve high returns—can sound almost like an admission of failure.

The Case of See's Candies

To illustrate how non-trivial this topic is, even Warren Buffett and Charlie Munger had their own learning curve. In 1972, they acquired See's Candies, a traditional manufacturer of premium chocolates and confectionery on the U.S. West Coast. Founded in 1921, the company has maintained a reputation for high quality across all its products to this day, making See's one of the preferred brands in the region for gifts and special occasions. This quality premium also translates into a pricing premium, making the business highly profitable.

With a simple and highly profitable business in hand, the legendary duo pursued a nationwide expansion plan for See's Candies, opening stores across multiple U.S. states. Despite preserving the same attributes that made the brand so successful in California, See's never achieved the same level of penetration outside the West Coast. While California today has around 230 stores, neighboring states (Washington, Oregon, Nevada, and Arizona) have approximately 55 stores combined, and the rest of the United States accounts for only about 40 stores.

The exact reasons why See's Candies failed to scale more meaningfully in other states are not clearly determined. Whether due to the lack of brand tradition in other regions, stronger competition, different consumer habits, or other factors, the reality is that the business—exceptional in California—proved to be less replicable than initially expected. After several unsuccessful expansion attempts, Buffett and Munger abandoned the ambition of growing See's further and instead began distributing all the cash generated by the business as dividends, reallocating it to other investment opportunities. The company became an emblematic case, frequently discussed at Berkshire Hathaway's annual shareholder meetings, as an example of both the benefits of holding a high-quality business over long periods and the inherent limits to growth.

The Case of Sears, Roebuck and Co.

Despite the similar name, the outcome of Sears' story was very different from the one we just described. In the 1950s, Sears was the largest retailer in the world. Despite its already dominant position, the company continued to pursue aggressive growth over the following decades, opening a large number of stores across the United States and diversifying into several other businesses, including insurance, real estate brokerage, shopping mall development, and financial services.

In the 1990s, Sears entered a period of decline. While the company continued its strategy of investing in diversified businesses, competitors such as Walmart and Target focused their efforts on optimizing their retail operations. This allowed them to achieve greater efficiency and offer lower prices to consumers, steadily gaining market share.

In 2005, Sears was acquired by Kmart—another struggling retailer—and their operations were merged in an attempt to rescue both companies. Following the merger, the new entity sought to restore profitability by closing underperforming stores, selling real estate and other assets, and engaging in financial maneuvers aimed at generating cash. However, the focus on financial engineering became so pronounced that the quality of the retail operations was neglected. Stores became increasingly outdated, with inventory issues and deteriorating service levels.

The 2000s also marked the rise of e-commerce, with companies such as Amazon capturing market share from traditional retailers. Sears attempted to compete in online retail but was unsuccessful, continuing to report losses until it filed for bankruptcy in 2018, after 126 years of operation.

This case clearly illustrates how even a market leader can fall from its peak to complete failure due to excessive ambition and overconfidence. We intentionally chose a retail example. The sector is filled with

aggressive expansion plans based on the assumption that accelerating the pace of new store openings will simply replicate the average profitability of existing operations. In practice, this rarely unfolds as expected. When companies expand too quickly, site selection tends to be less disciplined, teams are less prepared, and management loses attention to detail that is so critical in retail. In trying to grow too fast, the business ultimately sacrifices quality, profitability, and customers.

How to Deal with Growth Risk in Investing

Although business expansion is always desirable for investors, any initiative aimed at accelerating growth or entering segments outside a company's core business introduces additional risk. The required investments are within the company's control and will almost certainly be deployed, whereas the expected incremental revenues and profits depend on demand dynamics and the competitive environment—factors that are uncertain and beyond the company's control. This does not mean that ambitious plans make an investment thesis unattractive, but rather that they require caution.

The first question—one that never has a definitive answer—is assessing the likelihood of success. A starting point is to evaluate the nature of the planned expansion. The closer it is to the company's core business—leveraging the knowledge and experience of its management team, the assets it already owns, and the capabilities in which its employees are already proficient—the higher the probability of success. The challenge of venturing into new areas lies in the many unknowns, where failure may stem from risks that were not even identified in advance.

A second angle is to assess the planned change in the growth rate. The more abrupt the intended acceleration—for example, a company growing at 5% annually seeking to grow at 30% in the following period—the higher the risk. The execution required to sustain rapid expansion is non-trivial. People take time to become proficient in their roles, processes take time to be implemented efficiently, and compressing the timeline to achieve these targets makes everything more difficult.

The outlook is more favorable when accelerated growth is driven by a clear and genuine increase in demand that the company is capable of meeting. Even then, the competitive environment must be carefully assessed. When a growth opportunity is large and obvious, the number of competitors seeking to capture it can be equally large, potentially leading to destructive competitive dynamics. Typically, the sum of revenue growth plans across all market participants implies an aggregate revenue level far exceeding what is realistically achievable, even under optimistic scenarios. In other words, most players will be disappointed, and it is difficult to identify the eventual winners in advance.

When such demand expansion is not underway and a company attempts to accelerate growth by stimulating consumption or gaining market share, the risks are substantial. Customers and competitors do not always behave as expected, and plans that appear sound on paper can fail entirely in practice.

Finally, it is essential to assess how much one should be willing to pay for the prospect of growth. Since these initiatives are considerably riskier than maintaining a business at a steady-state level, the potential return implied by the share price must be sufficient to compensate for the additional risk. While this concept is basic and widely understood, it is common to find market valuations that effectively assume non-obvious growth as a near certainty—especially when supported by articulate executives presenting compelling narratives to analysts.

Why We Are Discussing This Now

It may seem unusual to talk about the risks of growth while monetary policy remains restrictive, but a more challenging environment is precisely the situation in which there is no expectation of major demand surges on the horizon—making excessive ambition especially risky. In an effort to appeal to a market that remains only marginally interested in equities, despite the attractive valuations of many stocks, some companies have become creative and have begun pursuing less obvious growth plans.

When demand is uncertain, we prefer companies that choose to focus on operational optimization and on preparing for the next wave of opportunities, rather than those that embark on attempts to generate incremental revenue precisely when doing so is most difficult. To give a simple example, it is not efficient to intensify marketing investments during economic recessions, as it is harder to generate incremental sales when consumers have less money to spend. In addition to the lower probability of success, the incremental sales tend to be of lower value, and the return on marketing capital tends to be unsatisfactory.

Against this backdrop, we have recently passed on several investment opportunities in otherwise good businesses because of growth plans that we considered misguided. We therefore take this opportunity both to share a warning about risks of this nature and to let our investors know that, even though we remain optimistic about the low valuations in the Brazilian equity market, we continue to stay disciplined and avoid flying too close to the sun.