



GROWTH THAT COMPOUNDS

Why growth compounds – and activity doesn't.

The quiet difference between moves that make the next move easier and work that resets when the quarter ends – and why the second is so much easier to fund.

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MANAGEMENT SUMMARY

Growth compounds when the output of one cycle becomes an input to the next; activity produces output that is consumed on the way out. Working from Dierickx and Cool's 1989 distinction between stocks and flows, this essay argues that the operative quantity is not the growth rate but the growth rate net of decay, and that organisations fund the second kind of work for structural rather than ignorant reasons: the reporting period is shorter than the payback period. It sets out a retrospective test, names the prospective question that test cannot answer, and takes seriously the counter-case that accumulated stock is also commitment, and commitment is expensive to reverse.

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Two commercial teams hit the same number this quarter. One starts next quarter from a higher floor; the other starts from exactly where it started this time. The number alone does not tell you which is which.

Growth compounds when the output of one cycle becomes an input to the next. Activity produces output that is consumed on the way out. That is the distinction. A campaign that fills a quarter's pipeline is mostly spent by that quarter; a pricing architecture the sales team can defend without escalation is still standing the quarter after, making the negotiations that follow cheaper. Both are legitimate work. Only one accumulates. In the commercial organisations I have worked in, the error has run in one direction — toward activity — and the reason is structural: the reporting period is shorter than the payback period.

The distinction is stock and flow

One of the clearest accounts of this predates the growth-team job title. In 1989, Ingemar Dierickx and Karel Cool published a short paper in *Management Science* arguing that the assets which sustain competitive advantage are the ones that cannot be bought outright — nontradeable, and, they add, non-imitable and non-substitutable — and so have to be accumulated instead. Their central distinction is between flows and stocks:

A crucial point illustrated by the bathtub metaphor is that while flows can be adjusted instantaneously, stocks cannot. It takes a consistent pattern of resource flows to accumulate a desired change in strategic asset stocks.

Spend is a flow; it can be doubled or halved inside a single budget cycle. Pricing power, a market's understanding of what you are for, a sales team's shared judgement about which deals to walk away from — these behave like stocks. They respond mainly to a pattern held over time. Which is why a quarterly push moves a flow far more reliably than it moves a stock.

One caveat the paper insists on, and one worth carrying: "Note that it is not implied here that all asset accumulation processes exhibit the properties described below. In fact, many do not." Read what follows as a diagnostic.

You cannot buy back the time

They give the mechanism a name — time compression diseconomies — and locate it in the production function rather than in sequencing: it expresses, in their words, "the 'law of diminishing returns' when one input, viz. time, is held constant." In R&D, they argue, this implies that "maintaining a given rate of R&D spending over a particular time interval produces a larger increment to the stock of R&D know-how than maintaining twice this rate of R&D spending over half the time interval."

Read that against a familiar response to a bad half-year. Discount authority drops a level. The pipeline review goes from monthly to weekly. The brand line is an early candidate for cutting, because it is the hardest to defend with a number inside the window. Most of those moves buy flow at the expense of stock.

Why compression bites is my own extension, not theirs. Some work is serially dependent: the second experiment needs the first one's result, and parallel funding does not change that. Work that requires the market to learn has a version of the same constraint — you can buy more reach at once, but you cannot make one person's second exposure arrive before their first. It fails where the change is carried by product, price or distribution rather than by message: a retailer that changes its assortment and prices overnight has repositioned in one cycle.

Compounding is what survives decay

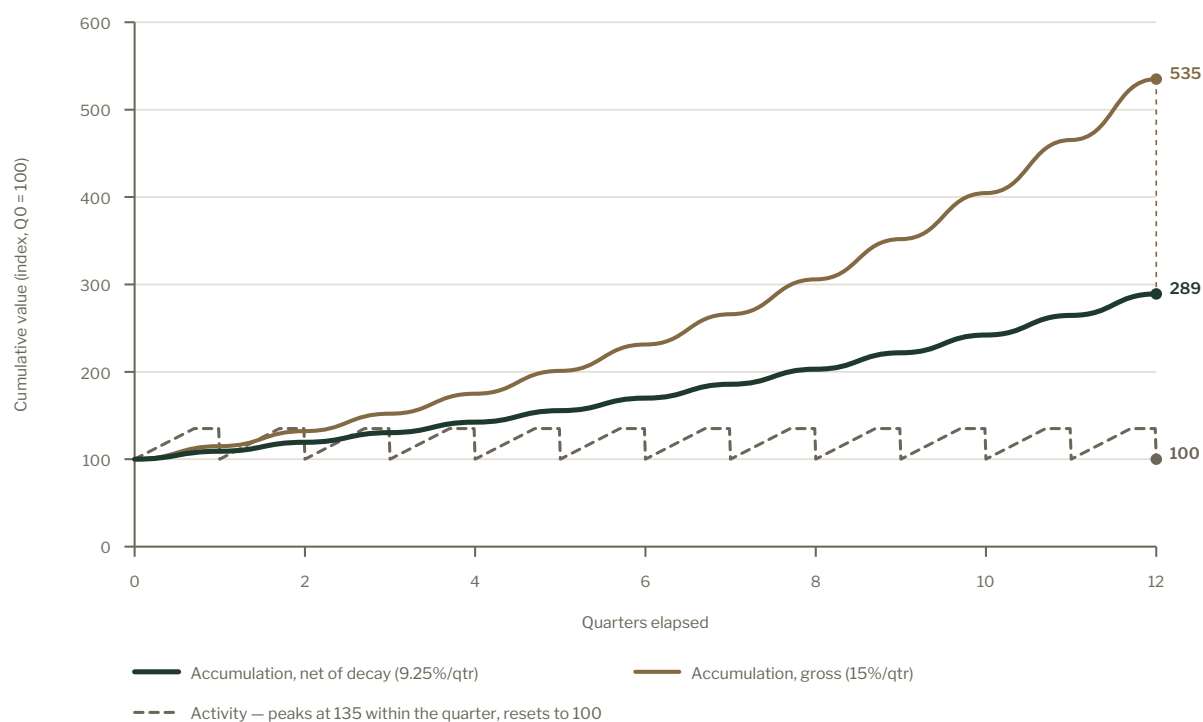
Here the compound-interest analogy misleads. Interest compounds on an undiminished base; most commercial assets do not. Dierickx and Cool are blunt about it:

As is the case with physical plant and equipment, all asset stocks “decay” in the absence of adequate “maintenance” expenditures. R&D know-how depreciates over time because of technological obsolescence; brand awareness erodes because the consumer population is not stationary (existing consumers leave the market, while new consumers enter), consumers forget, etc.

So the quantity that matters is not the growth rate but the growth rate net of decay. People leave, and some of the judgement leaves with them. Say a positioning that was sharp two years ago now describes much of the category, because competitors adopted the same sentence. An asset that looks like it has stopped compounding may simply be compounding slower than it erodes. Which shifts the practical question: less “what should we build” and more “what are we already carrying that is depreciating, and what maintains it?”

Running the other way is the mechanism they call asset mass efficiencies — their term for the pattern where an existing stock makes the next increment easier to add, on the principle they summarise as “success breeds success”. Where no stock exists, more of the cost is paid again every cycle. That is what the reset to zero costs.

Figure 1 Accumulation versus activity, indexed over twelve quarters



Modelled illustration. Parameters: gross accumulation 15%/quarter; decay 5%/quarter (net 9.25%); activity peaks at index 135 within each quarter and returns to 100 at every boundary. Not measured data.

The same work, in two forms

Little commercial activity is inherently one or the other. The same effort, differently designed, can accumulate or evaporate.

Table 1 The same work, in two forms

The work	As activity — spent when it ends	As an asset — still there next cycle
Demand generation	A campaign that books meetings this quarter	A positioning the market can repeat back to you
Pricing	A discount that closes the deal in front of you	An architecture a seller defends without escalation
Sales process	A seller who is unusually good at qualifying	A qualification standard the whole team applies
Measurement	A report explaining what happened last quarter	A model that gets corrected every cycle

Author’s own classification.

The right-hand column is as ordinary as the left, and can cost the same. It carries one additional requirement — that something survives the end of the cycle in a form the next cycle can start from — and it usually pays later, which is the whole problem.

Three questions — and the one they cannot answer

For any piece of commercial work, three questions:

- 1 Does it persist? When the work stops, does the output remain, or stop with it?
- 2 Does the next cycle start from it — or reproduce it from zero?
- 3 Does it lower the cost of what follows? Not its own cost. The next one's.

Three noes is activity. A quarter that needs pipeline needs pipeline; the error is running only activity for a decade and calling the aggregate a growth strategy.

But this test is retrospective, and that limitation is the interesting part. It sorts last year's work into two columns; it does not tell you which of two proposals in front of you today will still be standing in three years — and in the pitch, a failed brand programme and a compounding one look identical. The honest prospective version is narrower and less satisfying: an asset is only demonstrably a stock once it has survived the people who built it. A related test is whether it can be taught to someone who was not there. If it lives in one person's judgement, it is a flow wearing a stock's clothes — which is part of why I keep teaching alongside the work.

Why the short one is easier to fund

Five reasons, none of them stupidity, which is why the pattern persists.

The measurement window is usually shorter than the effect. An accumulating asset often spends its early life in a J-curve, costing before it pays. In a quarterly review, a J-curve is hard to tell apart from a mistake.

Nobody is arguing the mechanism. The growth-loop literature — Brian Balfour, Casey Winters, Kevin Kwok and Andrew Chen at Reforge — described it clearly enough that it is now the standard frame: funnels “operate in one direction... no concept of how to reinvest what comes out at the bottom,” and so, in their words, “no compounding effect.” That is the same observation. What it does not carry is a price for the erosion, which is where the interesting part of the problem lives: a loop that leaks faster than it fills is still a loop.

Activity is easier to attribute than an asset is. A campaign has an owner. A qualification standard that raises win rates across several teams over several years has no owner the review can point at. Nobody has ever been promoted for a win-rate improvement that arrived two years late with four names on it.

And the incentive is documented. John Graham, Campbell Harvey and Shiva Rajgopal surveyed 401 financial executives and found that a majority would take a real economic cost to protect a reported number: most would decline a positive-NPV project rather than miss an earnings target. The pressure described above is not a story about short-sighted managers. It is a documented preference, held by the people who approve budgets, for a smooth reported series over an accumulating asset.

The evidence for the other path is slow and aggregate. The best-known case is Les Binet and Peter Field's analysis of the IPA Databank — 996 campaigns entered into the biennial IPA Effectiveness Awards from 1980 to 2010 — which found that splitting the budget roughly 60% to brand building and 40% to sales activation coincided with peak effectiveness and efficiency across the sample. The authors put it no more strongly than that — their text says the data “tentatively supports this hypothesis,” and they note it may vary by category without being able to show how. It is a finding about averages across three decades: no single quarter contains it, so no single quarter feels like the one to act on it.

The argument against all of this

There is a serious counter-case, and it grants the whole argument: stock is commitment, and commitment is expensive to reverse.

Dierickx and Cool supply the mechanism without drawing this conclusion from it. In their account a stock deters entry precisely because, unlike a flow, it cannot be adjusted at will — “in general, only variables that have the nature of a stock, as opposed to a flow, can carry a credible threat.” They read that as an advantage. It is also a cost. The same immobility that stops a competitor copying you is what stops you moving. An entrenched pricing architecture is what makes responding to a new entrant expensive; a qualification standard the whole team applies can encode last cycle's ideal customer into this cycle's behaviour. Asset stocks are barriers, and barriers have an inside.

Which means an asset can also stop paying by becoming wrong — still intact, still maintained, still pointed at a market that has moved. Dierickx and Cool anticipate this under substitution, which “threatens to render the original asset stocks obsolete, typically because they no longer create value to the buyer” — Canon designing service out of the product, leaving Xerox's service network partly obsolete without it having decayed at all.

That is the question underneath my doctoral research at EM Normandie, on cross-border M&A and sales–marketing integration. A border is a useful place to ask it, because it forces a distinction a single market can more easily avoid: which part of a commercial asset was ever portable, and which part was local all along. It is a live question.

What this changes

“Invest for the long term” rarely survives contact with a budget cycle. The narrower version: hold the compounding question and the activity question on separate lines, funded separately, with different definitions of success. Where they share a line item, the quarterly one wins, because it can show its work.

The obvious objection is that a line for unattributable work is an early candidate for cutting in a bad quarter — separating it isolates it rather than protecting it. That is right, and it points at the answer. Whoever owns the second line has to be measured on asset condition rather than asset creation: whether what was built three years ago still works. Without that it becomes a slush fund, and deserves to be cut.

Which makes maintenance the load-bearing item. If stocks erode without it, maintenance spend is what keeps net compounding above zero. In the budgets I have seen, it does not sit anywhere — and

the rate you would need in order to price it turns out never to have been measured for the assets a commercial team actually owns.

One version of this fits inside a single meeting. Take the four things the team was proudest of last year and ask, of each, whether it still works if the person who built it leaves tomorrow. What survives is stock. What doesn't was flow — worth funding and worth defending, but on flow's terms, and with nobody surprised when next year starts from the same place.

Figure 2 The stock-or-flow test

WHAT WE BUILT	WHO BUILT IT	WORKS IF THEY LEAVE?	WHO KEEPS IT WORKING
The four the team was proudest of.	A person, not a department.	Yes, no, or not without a rebuild.	Named owner, and which budget line.

What survives goes on the line funded for condition. What does not is flow — fund it as flow, and let nobody be surprised when next year starts from the same place.

Author's own worksheet.

Much of what a commercial team builds in a quarter is not meant to survive it. That is fine. It becomes a problem when nobody decided in advance which part was supposed to stay.

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END OF ESSAY

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