

CAPITAL ABSORPTION

The underlying physics of how businesses actually compound.

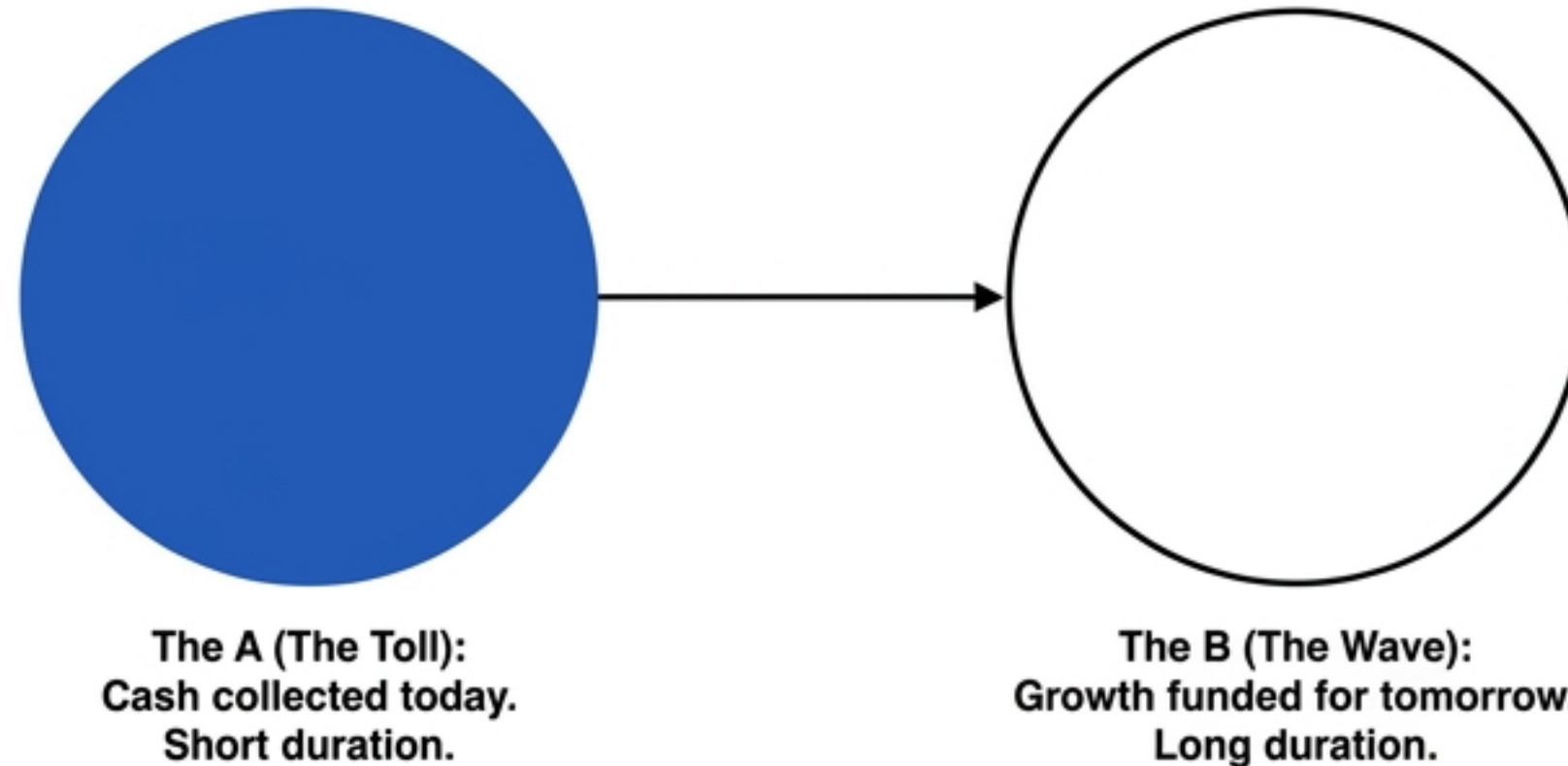
“A compounder is a business that reinvests
~~its earnings at a high rate of return.~~”

**Compounding is not a property
a business possesses.**

It is a consequence of capital flow.

The Toll and The Wave

Every business is a flow of capital between two reservoirs:



Compounding acts only on the B.

The Open System

"What an organism feeds upon is negative entropy."

— Erwin Schrödinger, 1944

An open system maintains and builds order only so long as it draws in more order than it dissipates.

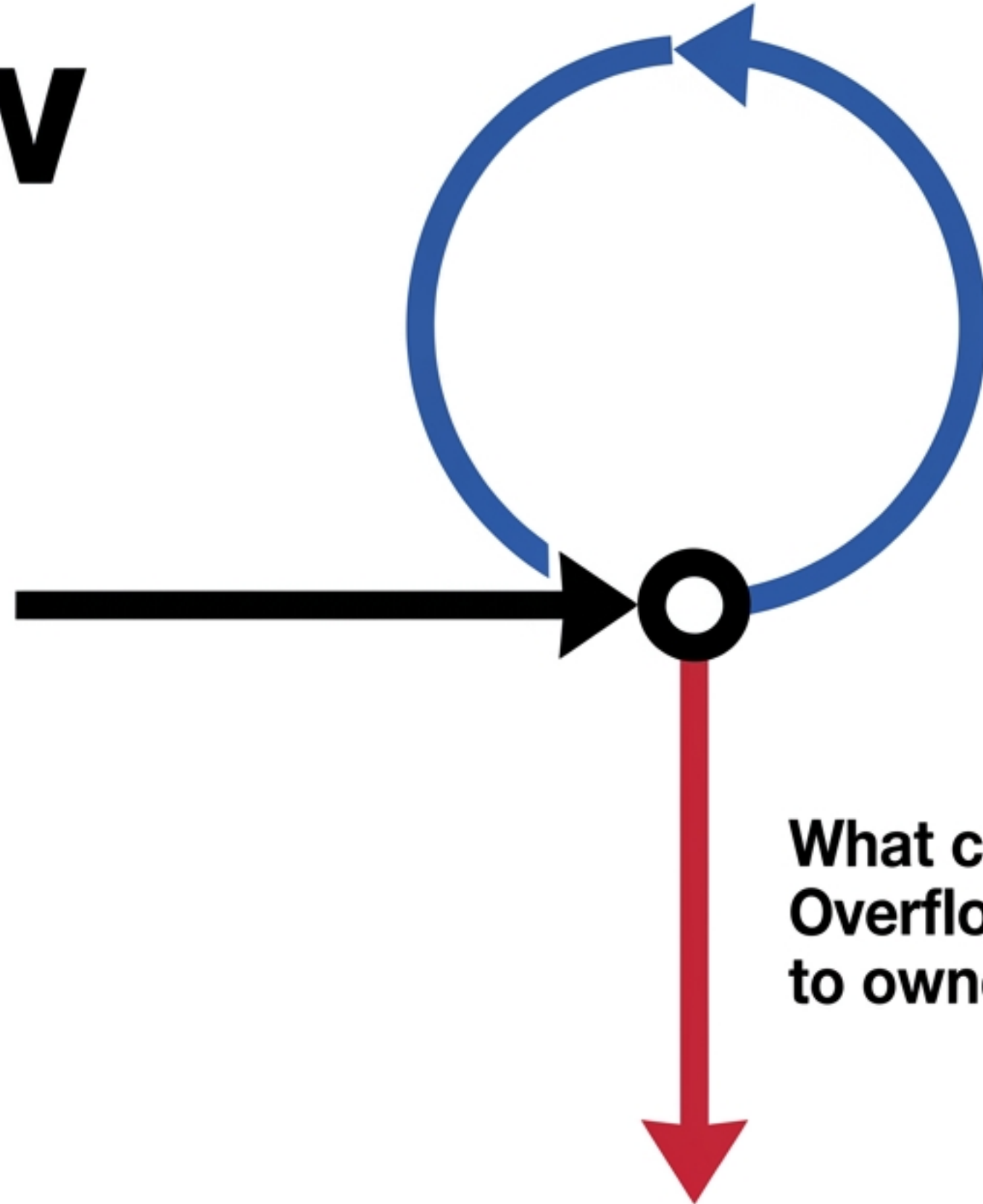
— Ilya Prigogine

The Business Translation:

A business is an open system. **It must absorb the flow and organize**, or lose it and **dissolve.**

The Flow

Absorption is incorporation. The toll takes in the growth and converts it into a larger toll tomorrow.



**What is absorbed:
Reinvested and
compounded.**

**What cannot be absorbed:
Overflows and returns
to owners.**

The Axis of Compounding

Absorption and overflow are opposite halves of one flow.

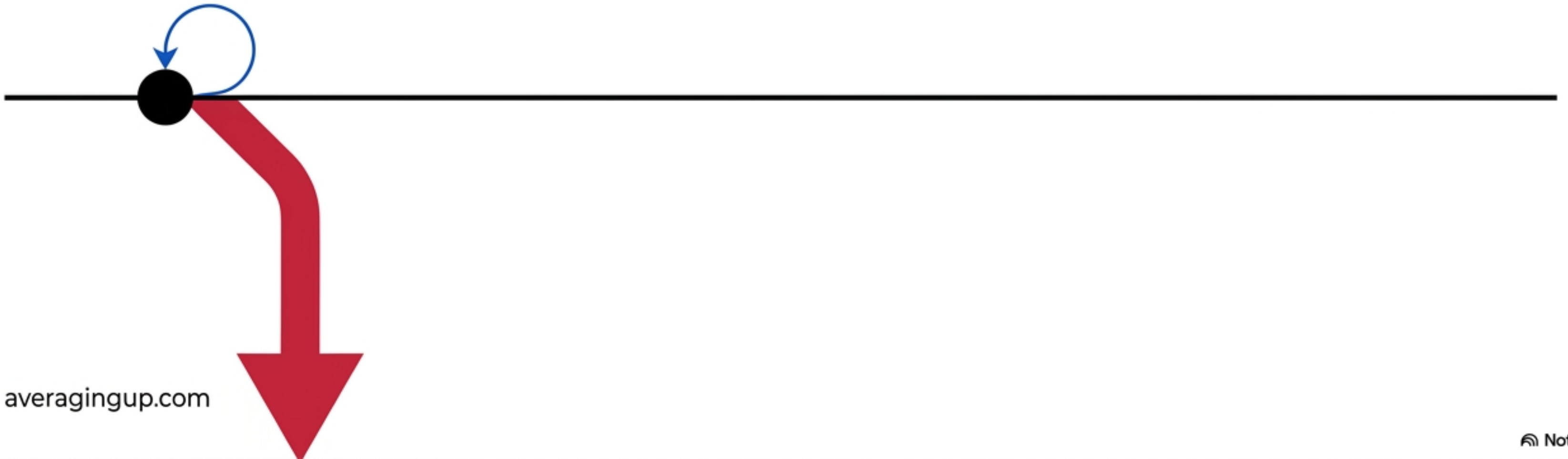
The direction and intensity of this flow decide everything.

Walk the spectrum.

Weak Absorption

Archetype: See's Candies

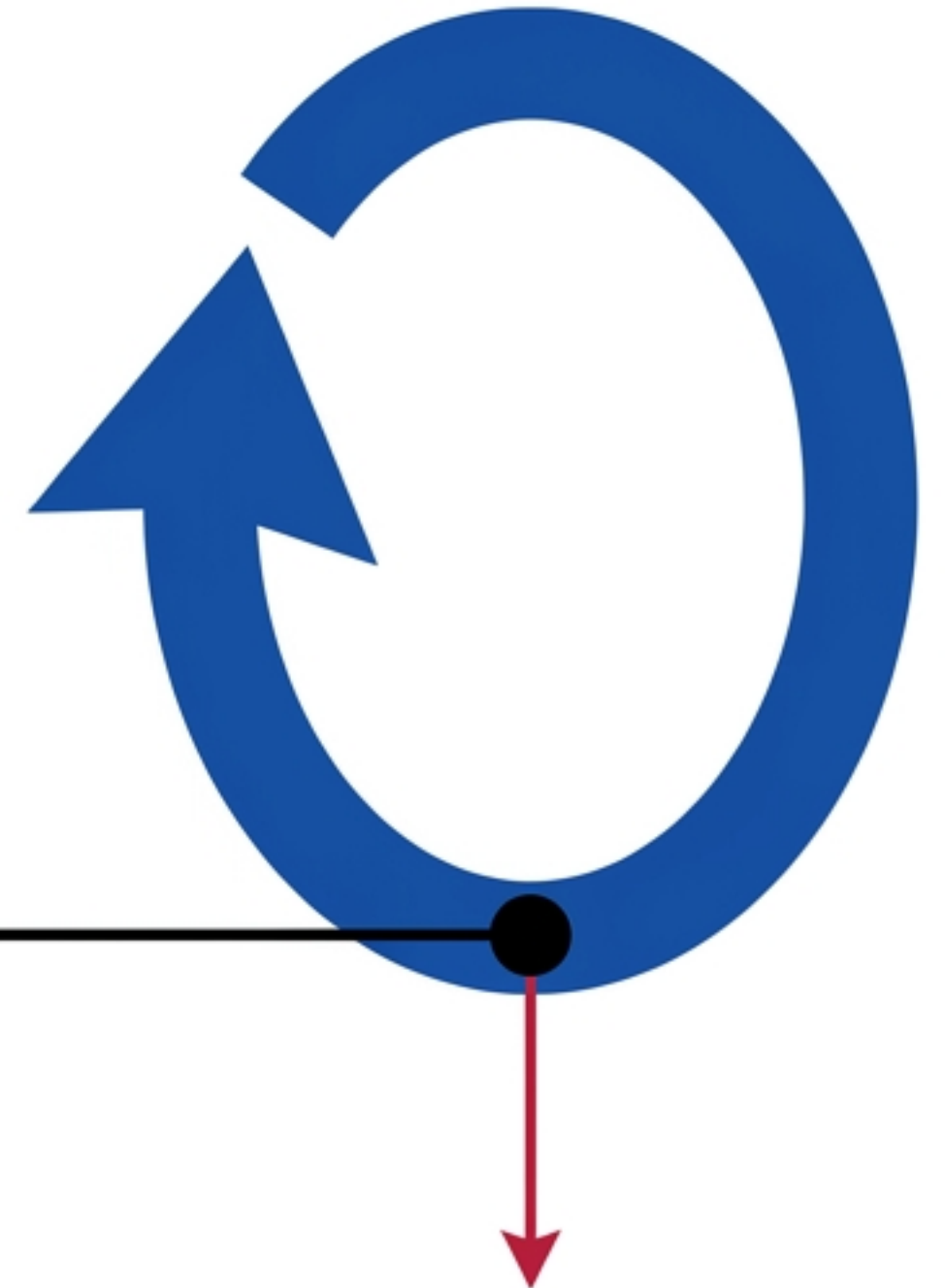
- Internal growth is exhausted. Almost nothing left to reinvest.
- Result: Bare absorption. Massive overflow.
- Compounding: Slow (mechanical, via buybacks).



Strong Absorption

Archetype: The Capital-Heavy Railway

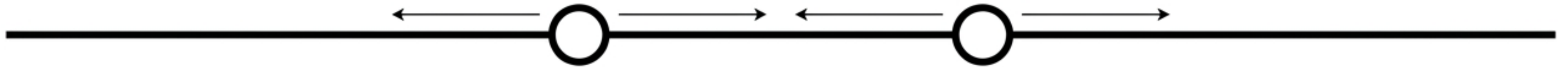
- Toll covers growth; plows nearly all cash back into an expanding base.
- Result: Intense absorption. Thin overflow.
- Compounding: Fast (exponential base-building).



Dual Duration in Motion

Archetypes: Berkshire Hathaway, Alphabet

The vast middle is not a category, but a passage.



Established tolls fund the build-out of new franchises.
As growth matures into a toll, the business drifts toward overflow.
As it opens new growth, it shifts back toward reinvestment.

The Wager

Archetype: Early Amazon

The flow reverses: The B absorbs the A.

Reinvestment consumes more than the business earns.

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This is the direction of ruin—unless it is a deliberate wager that the toll will eventually reverse the flow.



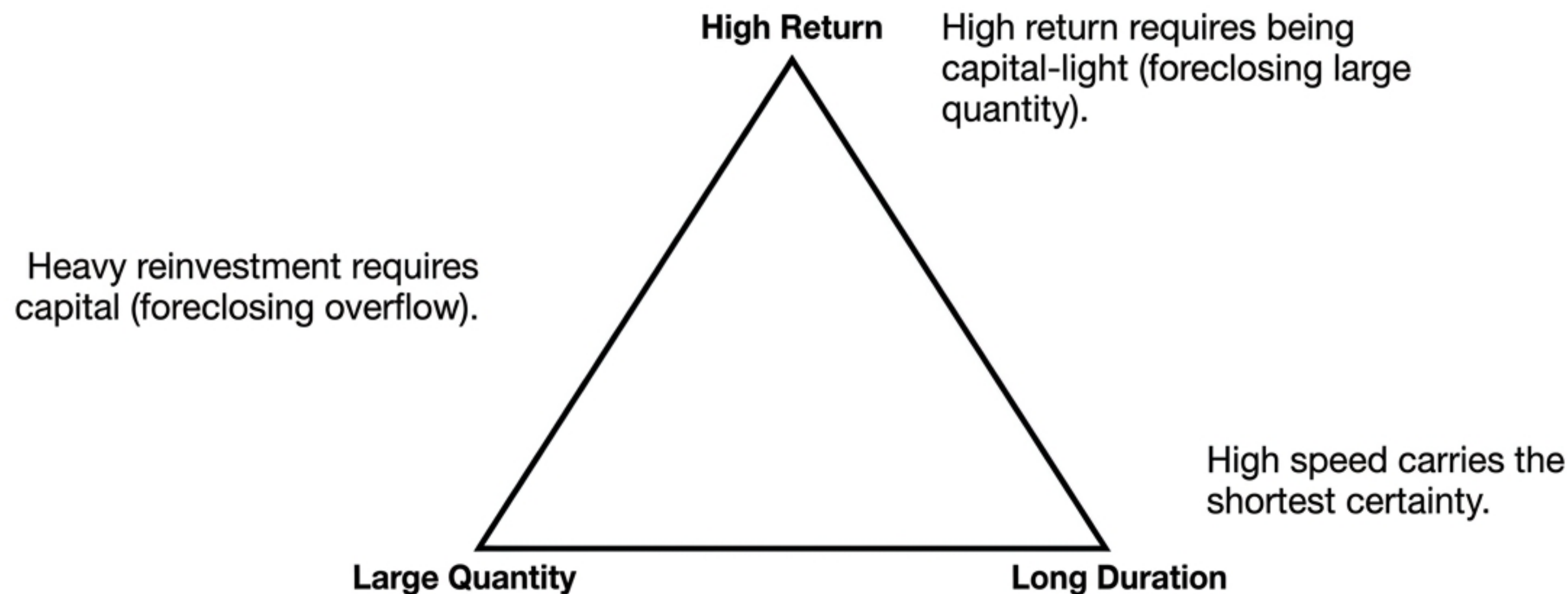
The Dollar Test

Speed is not a function of absorption alone.

$$\begin{array}{ccc} \text{Quantity} & \times & \text{Incremental} \\ \text{Reinvested} & & \text{Return} \\ \text{(Dictated by Absorption)} & & \text{(What that quantity earns)} \end{array} = \text{The Speed of Compounding}$$

The Structural Tension

The perfect compounder requires all three.
But the flow that gives with one hand takes with the other.



The Geometry of Compounding

Weak Absorption
(See's Candies)

Strong Absorption
(The Railway)



Slow Compounding

Fast Compounding

Massive Overflow

Thin Overflow

**Do not ask whether
a business compounds.**

**Ask in which direction its
capital flows, and how fast.**

This content is educational and does not constitute investment advice.