Top-Line Growth Can Be Dangerous!

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About the Author

V. N. Bhattacharya is a management consultant on strategy—business strategy, sales and marketing strategy. He helps companies achieve profitable growth by developing and sustaining their competitive advantage. Bhattacharya started his career with Hindustan Unilever (Unilever, India) as a management trainee. He executed national responsibilities in sales, marketing and customer service in other firms. He worked as the Chief Executive of BPL Telecom Ltd., a telecom engineering, manufacturing and networking company, before setting up his consulting practice.

Bhattacharya is a seasoned business leader and strategist, and blends rich experience with brilliant academic credentials. He teaches strategy at Mudra Institute of Communication Ahmedabad (MICA)—a premier business school in India with focus on communication management. He is a guest faculty at the Indian Institute of Management (IIM), Bangalore—one of the top three Indian business schools.

Introduction

Working with a number of mid-sized as well as large companies as a management consultant, I have come to the unhappy conclusion that managers have an unwise preference for size. They believe revenue growth automatically improves profitability. Their focus on the top line is probably explained by the business world's emphasis on economics, win-lose rationality and bigness. Self-interest – salaries are better in large firms – is a potent factor, too. Single-minded attention to sales growth without sufficient thought to creating competitive edge is risky and often leads to unhappy consequences.

Highly successful companies like Asian Paints (India) and Sigma Aldrich (USA) concentrate on building competitive edge rather than blind pursuit of top-line growth. They focus on a few customer segments and avoid doing business with others. By doing so, they develop capabilities that enable them to serve target customers better than competitors. It enables them to gain leadership and achieve superior profitability. By presenting contrasting examples of unsuccessful and successful companies, I hope to encourage managers to build strategies that enable their firms to become great rather than big. Bigness is a product of greatness, not the other way around.

Revenue Growth Not a Panacea

Managers assume that revenue growth is a natural and automatic panacea for most corporate ills. It is not. In fact, chasing growth can be bad for a firm's health. It leads to mindless pursuit of revenue growth. It is a slippery slope. A single-minded quest for competitive advantage, on the other hand, is not only good for the top line, it fattens the bottom line as well.

Excessive focus on top-line growth drives the strategy of many companies and propels them to fight for market share. Expensive promotions, sharp pricing and a large sales force produce short-term gains. Managers begin to believe their steps are in the right direction. Soon, competitors counter with lower prices, improved features or attractive offers and neutralize the effect.

Corporate initiatives that mistakenly aim for revenue growth without addressing the fundamental issue of competitiveness assume greater effort alone will win customer preference. For a time, higher levels of activity raise customers' awareness of the company and create temporary advantage. Raising market profile without improving customer value can, however, hasten decline. More customers try the product or service, find it does not meet their requirements and are disappointed. Word spreads and ill repute grows. The company tries harder still. Expenses mount and margins shrink.

Too much attention to revenue growth gives rise to an opportunistic mindset. When leaders drive people to capture market share, they often turn a blind eye to where new business is coming from. Customers are acquired under relentless pressure from within, often at discount prices or promise of higher levels of service. The higher cost of acquiring customers from outside target segments erodes margins and strains existing resources. In time, these customers discover the company's offerings are not of great value and exit.

Opportunistic Mindset Encourages Grasshopper Behavior

Sales managers exhort their teams to go after low hanging fruit in new markets. Sales people constantly seek new leads, never mind where they came from. Jumping from one opportunity to another forces the organization to use resources sub-optimally. It weakens the ability to develop customer insights and new capabilities. Existing ones are eroded and the firm loses its competitive advantage gradually. When bigness is attempted at the cost of greatness, neither is achieved.

In its early years a mid-sized Indian software company grew rapidly by repeatedly entering new markets. Good, but unexceptional products had brought in substantial revenue growth from countries that were relatively unsophisticated. Growing presence and efforts of new channel partners had fuelled their success. At a certain stage, the company's leadership re-assessed their strategy. They decided market presence and aggressive selling methods would not be enough to succeed in mature and highly competitive markets. A unique sales methodology, they felt, would distinguish them from the competition. Customers would also gain from the shorter sales and implementation cycles. They defined precisely how the new sales process would be carried out and adopted it as their key strategy.

Opportunism and a hunter mindset were, however, deeply ingrained in the psyche of the management. As they expanded their presence to over twenty countries, they forgot their strategy and continued to scout for large opportunities. They entered new countries before consolidating old ones. Stretched thin, top management had little time to implement the new sales process. Instead of recruiting and training more sales people, they appointed senior people to manage relationships in distant markets. They effectively abandoned the strategy that would have made them unique and effective. Not surprisingly their, growth rate dropped by half in a single year!

Asian Paints (see box), the leading Indian paint company, has consistently adopted a different approach. They have focused on painters and household consumers. These customers prefer to buy a product that is readily available, other things being equal. The painter hates to lose a day's wages and the householder does not like the inconvenience of a half painted home because a small quantity was not available to finish the job. The competitive advantage of decorative paints, Asian Paints figured, flowed from improved availability of product, shade and pack. They reorganized their supply chain and improved production and distribution to ensure their products enjoyed the highest availability of any brand.

They chose not to focus on the painting contractor market. That segment is characterized by few shades, bulk packs, low prices and larger volume orders. All their competitors operated aggressively in this segment; some even formulated products especially for contractors.

Deliberate avoidance of a sizable market would not have gone unchallenged in the Board Room. It must have been raised repeatedly and debated hard and long. The strategy to focus on the retail customer and avoid the contractor has not weakened the company; it has strengthened it. They have extended the philosophy to the industrial paints market. Asian Paints has stayed away from custom-made stoving paints, electing to serve customers with standard formulations where they can leverage the supply chain better. To Asian Paints the choice of serving one segment went hand in hand with the decision to say "No" to the other.

The sales team of Asian Paints is expected to deliver bigger numbers each year. But they do not lose sight of what maintains their competitive edge. Focus enables them to serve one segment better than others. It raises their capabilities and hones business processes. It has helped them build a larger network of retailers than any other paint company in India. And they have remained the undisputed leader among paint companies in sales as well as profitability for four decades.

Why the Bias for Bigness?

Managers have developed a compelling attraction for size. In the 1960s and '70s, most developed economies enjoyed steady demand and low inflation. To improve profits, firms needed to keep increasing sales while ensuring they operated efficiently. In the '80s and '90s rising energy costs and growing competition in international trade brought home the need to factor in the dynamics of the external environment. But in management education the emphasis on economics, win-lose rationality and growth has been overwhelming.

Size has a primal attraction. Bigger is usually more powerful in the natural world. In business, too, size creates certain advantages. A big firm usually wields considerable influence over its stakeholders, even in the community it operates. Large numbers of customers, employees and suppliers diminish the power of each player in its dealing with the firm. Society and the political system also tend to be wary of the large corporation, preferring to leave it alone unless necessary. Size provides a company a degree of immunity. Enron was an apt example.

That is probably why public corporations are more enamored by size than family owned businesses. Private ownership imbues a successful firm with the values of the founder. Whether led by economic tenets such as shareholder value, or ethical principles, they appear less susceptible to bigness. Publicly owned firms are more likely to be attracted to bigness. Perhaps it is because public ownership, especially when it is fragmented, gives managers considerable power over the destiny of the firm. A big firm usually pays more than a small one.

It is assumed that big companies live longer. It is a myth, but myths persist. It seems more attractive to work for a giant. The sinister aspect of size, however, is vanity. It lends swagger to senior managers. Arrogance seems justified.

Board members are known to drive managers to pursue growth relentlessly. War chests are funded for aggressive acquisitions. Heavily laden and unwilling to jettison ballast, the firm slows down and weakens. Customer value and competitive advantage are treated as irrelevant and the firm sets off to become something to everyone. In doing so, managers at the helm forget that markets sub-divide as they grow bigger; new segments emerge. Customers no longer feel satisfied with vanilla offerings and demand to be served in special ways. In maturing markets, the opportunistic mindset that chased every lead grows steadily dysfunctional.

The Virtues of Focus

Savvy firms look for customers they can over serve and say no to those that perceive a weak value proposition. In his article 'What is Strategy?', Michael Porter describes the plight of Maytag, the iconic American brand of washers, dryers and dishwashers. Maytag products were known for their reliability and durability. In the 1980s, growth of the home durables industry in the US had begun to slow. Competition from companies marketing a full line of products had increased. Maytag decided to become bigger. In 1986, The Maytag Company christened itself Maytag Corporation and acquired Magic Chef. In the next fifteen years they acquired a series of companies and brands, some of them with disparate positions. They attempted to compete on the basis of a full range of durables and appliances instead of the strength for which they were known.

Between 1985 and 1994 Maytag grew in sales from $ 684 million to $ 3.4 billion, but return on sales dropped from 8-12 percent in the 1970s to less than 1 percent between 1989 and 1995 (Porter, HBR Nov-Dec 1996). On 31 March 2006, Whirlpool Corporation completed its acquisition of the $ 4.7 billion company.

Sigma Aldrich has not made the same mistake. The US specialty biochemical company has, for over fifty years, concentrated on doing business with research organizations worldwide. They produce over 200,000 different chemicals and supply them in small quantities, sometimes as little as 5 grams. They discourage, indeed avoid, large volume orders from the manufacturing sector. This focus has seen them grow to US $1.8 billion in sales.

Both Sigma Aldrich and Asian Paints have grown big by becoming specialists, by turning out to be great at what they do, by over serving selected customers and saying "No" to others. That is why they have achieved high profitability consistently and grown at the same time. Since 1999, Sigma Aldrich has delivered profit before tax (PBT) above 14.6 percent of sales. In the last seven years Asian Paints' PBT have stayed over 13 percent of sales. And they have grown bigger each year.

Growth is a consequence, not strategy. Being the best in the business makes a company bigger, gives it long life and puts money in the bank. Bigger is not better than greater. Being great can make you bigger and better.

Asian Paints: Focus Pays

Asian Paints, with $893 million in 2007 sales, is ranked 24th worldwide in the paint industry and is the No. 1 paint company in India (http://www.coatingsworld.com/articles/2007/07/2007-top-companies-report.php).

Akzo Nobel, on the other hand, is ranked No. 1 in the world paint industry (Coatings World) with a turnover of $7.8 billion in the same year. It is a highly profitable company but on profit before tax to sales ratio it doesn't hold a candle to Asian Paints. Between 2004 to 2007 Akzo's hovered between 10 and 11 percent, whereas Asian Paints ranged between 14 and 15 percent.

The company humbly began in a garage in Mumbai in 1942, when four friends got together to start the business. By 1968, Asian Paints became market leader in India. Since then its No. 1 position has not been challenged. With the No. 2 company half its size, Asian Paints is increasing the gap.

From the beginning, the company focused on household consumers and individual painters who served them. It avoided institutional business led by the painting contractor.

The household customer and the painter both valued ready availability of colors in various packs. The company streamlined its supply chain, production and distribution to ensure they had the highest availability of colors in consumer packs of up to 4 liters. No other company has managed to better their record. Other things being equal, Asian Paints has ensured that painters recommend their products to customers. Household customers have benefited from avoiding inconvenient delays and escalation of costs. In the last few years the company has successfully strengthened the brand by investing in advertising and promotions aimed directly at consumers.

The result has been remarkable. For more than three decades, Asian Paints has been the unchallenged No. 1 paint company in India on sales as well as profitability. Together with subsidiaries and associate companies, they manufacture decorative paints, industrial, automotive and powder coatings. They have successfully remained the cost leader, as well, in the Indian paint industry. In order to strengthen this position, they have vertically integrated. They now produce key raw materials like pthalic anhydride and pentaerythritol.

From 29 plants in 21 countries Asian Paints serves consumers and institutional customers in more than 65 countries.

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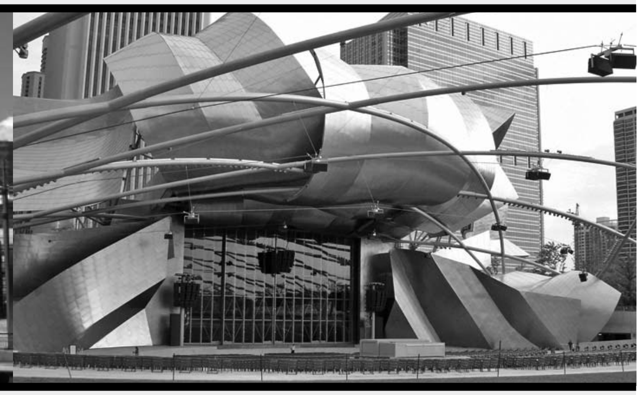

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