“Two Different Growth Routes”

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Last quarter,a Paint company had weak results.The signs were there, as many extensions didn't make sense. Would doubling down on paints make better sense?

I think Indian businesses are at the cross roads and have a choice to make.

There are two growth models-The Redwood Tree model where the business is solid in one area. This is true in the USA, Western countries.

The second is the Banyan tree model where a company grows, and then some branches droop to become roots in different businesses. This model exists in the East and India.

The first model works in a pure capitalist system .The CEO and the board are incentivised to create value in one core area. There is no patience for weak entries.

The second model has its roots in government licenses and regulatory protection. We see this in China, India, South Korea, Japan.

In India, early industry was set up by industrialists with capital and government license blessings. Over time, these conglomerates manufactured everything from Cycles ,TVs , Cars, Radios, Steel and Aluminium. Their competitor in most cases was an unprofitable public sector and hence they looked better in comparison.

The reason this Banyan tree model worked in India is because every family has a few brothers, a few uncles, a few children and everyone wanted to run an independent business. These branches then grew and established anchor, sometimes good, sometimes bad.

These conglomerates worked on 'TRUST" as the basic reason for their unrelated diversification and it worked for many years.

Conglomerates are not in fashion in the West. It is a fact that conglomerates get a 20 % discount on the stock market. GE , the last of the celebrated conglomerates went bust. The first big US conglomerate was ITT and Hal Geneen the CEO justified the diverse portfolio on business cycle theory.

Growth happens first with the CORE, then entry into adjacencies and then with new categories. Indian conglomerates moved into new categories via licenses.

That is changing now as capital can be raised for a good idea and capability for the CORE can be sourced. We are seeing stand alone Redwood trees in India.

Rarely do conglomerates succeed in diverse areas, they do so if they have government help. The conglomerates then end up hanging around with these new companies, many times No 4 or No 5 in that segment justifying the presence by saying " that the business is EBITDA positive and doesn't Hurt us"

Managerial time and reputation loss in market are not something conglomerates think about. Employees who work in these ' less focus' businesses feel like second class citizens in the conglomerate.

I think India is moving more to a redwood tree model with capital, capability and licensing being freer now. Because Uber does Uber eats doesn't mean Swiggy should do Swiggy rides!!!

Owners, CEOs , Boards need to rethink the growth model- Redwood or deadwood?

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