12 Deadly Sins That Bedevil Incumbents

Weekly Learnings 18 / 2023

Here's a pattern that I've observed throughout my career: incumbents mostly lose; they somehow survive but don't thrive. An incumbent growing faster than the market over a decade is more an exception, rather than the rule.

https://www.foundingfuel.com/article/12-deadly-sins-that-bedevil-incumbents/

I am an ardent fan of the Harvard Business Review and I read every issue. In its latest May-June 2023 edition, HBR announced a prize for its award-winning article in 2022: How Incumbents Survive and Thrive, authored by Julian Birkinshaw, a well-known professor of strategy and entrepreneurship and vice dean at the London Business School.

I have spent more than four decades in top leadership roles at Unilever, Philips, Nokia, PepsiCo, and more recently, the Aditya Birla Group. I am intimately aware of the dilemmas and challenges incumbents face. After all, it formed an integral part of my work as a business leader. That's why I found it hard to agree with the basic thrust of the HBR article.

My column attempts to present my perspective not just based on personal learnings over the years, but also relevant performance data from India and the world. I argue that there is enough evidence for the so-called "excellence" companies from 1984 till now to show that the best companies do not continue to succeed.

On the other hand, the HBR article argues that 40% of companies have remained a part of the Fortune Global Top 500 list even after 25 years. For Prof Birkinshaw, the data point is proof that digital disruption hasn't had the same effect on incumbents. For me, it is a measure of longevity, not of competitiveness or thriving. I'll explain why in just a bit.

First, let's consider some examples from the world of sport.

If you take a long view of sport over the last 30 years, no incumbent country has dominated the arena, be it rugby where New Zealand is considered the top dog, or in cricket, the mighty West Indian side led by Clive Lloyd in the 1970s, followed by the sledging Australians.

This phenomenon is also true for football, where Brazil and Argentina have been repeatedly challenged by the European sides. India dominated hockey for a long period after Independence but has been struggling to get back to the top for more than two decades now. In every case, technology came in, the rules changed, new capabilities were needed, and the incumbents could not adapt.

On the other hand, individual sport is often intrinsically linked to age. Once age catches up, reflexes go down, and invariably, a new wave of players comes in. However, over the last 15 years, the manner in which the top three have dominated is a great example of how incumbents can adapt and thrive. Federer, Nadal, and Djokovic have, amongst them, won 64 Grand Slams. No other sport is dominated by the top 3 for a decade in the way that this trio has done. This is a true exception.

What's true for sports applies to business as well.

But first, let's stay with the HBR article. Since the article is behind a paywall, we've attempted to distill the key takeaways below.

A 3-MIN SYNOPSIS

[Click here to read the synopsis.]

Now, let's move ahead. On January 21, 2023, I was invited to speak at the Procter & Gamble India annual conference. The theme I chose: 'Why MNCs are uncompetitive in today's world'. I looked at data related to the top 100 MNCs globally and the top 50 Indian MNCs as part of this study. The study period was for a decade, from 2010 to 2021.

Here are the key data points from that research:

Global Data 2010-2021 CAGR	Growth 2010-2021
1. World GDP growth in $ terms	3.4%
2. Top 100 MNCs growth in $ terms	4.2%

Of which Top 8 tech MNCs growth in $ terms	8.6%
Of which top 92 non-tech MNCs growth in $ terms	3.9%
3. Top 100 MNCs profit growth in $ terms	8.1%
Of which Top 8 tech MNCs growth in $ terms	12.5%
Of which Top 92 non-tech MNCs growth in $ terms	7.4%
4. Market cap growth of Top 92 non-tech MNCs in $	8%
5. Market cap growth of Top 8 tech companies in $	19%
6. S&P 500 market cap growth in $ terms	20%

Let's now look at the data for Indian MNCs for the same period (Indian companies headquartered in India).

Indian data 2010-2021 CAGR	**Growth 2010-2021**
1. India GDP growth in $ terms	5.1%
2. Top 50 Indian MNCs growth in $ terms	4.0%
3. Top 50 Indian MNCs contribution to India GDP in 2010	26%
4. Top 50 Indian MNCs contribution to India GDP in 2021	22%
5. Sensex growth in $ terms	10.4%
6. Market cap growth of top 50 Indian MNCs in $ terms	4.1%
7. Profit growth of top 50 Indian MNCs in $ terms	2%

Indian companies have a dollar depreciation impact on their results, but still, the performance is average to mediocre.

The inference I tend to draw from this data set is that incumbents—both top global and Indian companies—have survived, but not thrived.

The first measure of competitiveness is market share, the second measure is profitable share growth and the third is market cap growth. Most incumbents continue to have size but have lost significant share over the last decade or two.

So, that brings us to the question: why do incumbents survive but not thrive? I feel there are several qualitative reasons for this. Let's look at 12 reasons, with a few companies as examples, locally and globally:

1. **A regulated industry:** One could argue that ITC has survived and thrived because the tobacco industry is declining and regulated, and a rival is unable to build a new brand due to the advertising ban on cigarettes. Besides, unlike other MNCs, it also doesn't have to deal with a global parent breathing down its neck. Now, that is a rare combination.

2. **Arrogance:** Soon after it started in 1994, Maruti swiftly took over the Indian market largely because the incumbents, Fiat and Ambassador, refused to innovate. However, as the top dog, Maruti made its first mistake in not having sports utility vehicles (SUVs) in its line-up. In no time, the SUV segment became the fastest-growing segment and now accounts for 43% of total car sales in the country. Maruti lost its share and was eventually able to regain some of it, only after it added its own line of SUVs. Its share is now at 42%, a lot less than when it controlled more than half the market.

   The second mistake Maruti is making is not entering the electric vehicle (EV) segment. It continues to argue that it will enter when the market is right! This is no different than Henry Ford's arrogance: 'Have a car as long as it's black'. This same arrogance is a hallmark of many MNCs operating across the world.

3. **Not seeing the future:** The incumbent telecom operators Airtel, Vodafone, and Idea lost to Jio because they were focused on voice and rural, and not video. This is a case of not being able to see the future or seeing it through a limited lens.

   The renowned HBR professor, the late Clayton Christensen, and his co-authors Scott D Anthony and Erik Roth argued in their book Seeing What's Next that individuals take action based on how they believe innovation will change industries. Yet these beliefs are largely based on guesswork and incomplete data and lead to costly errors in judgement. It isn't clear if any elegant predictive model or framework was used to spot the signals of industry change for the Jio foray, but the fact is that Reliance did end up outsmarting the incumbents, starting in 2016. Globally, telecom operators in protected markets have stayed where they are but are much less profitable. The valuation of most telecom companies is down.

4. **History doesn't repeat itself:** All FMCG companies have lost share hand over fist in the last twenty years in India and globally. In India, they saw their share dip, because of the shifting distribution power. The FMCG firms believed that their pricing power and distribution clout would continue undiminished and refused to partner effectively with organised trade and e-commerce. They paid for their sins of omission and commission. There is one exception though: Colgate India has managed to hold on to its market share of above 50% and margins above 65%. It is possibly the only FMCG brand to lose the least share in India. However, it faces considerable headwinds in maintaining its growth.

5. **Value migration:** In the mobile phone space, Nokia, Motorola, and Blackberry were the incumbents in 2006. Today, all three have been unceremoniously nudged aside. Nokia failed to pick the right operating system in a world that migrated to apps and

lost out. Blackberry had its messenger, BBM, which was the WhatsApp of that era. While Blackberry overestimated the power of email, Motorola made strategic mistakes with low-cost handsets. Nokia knew very well that the ground beneath was shifting, but it had the twin challenges of a delayed new operating system Meego and a new leadership team that didn't understand Nokia's strengths in branding and emerging markets. A reason for incumbents to lose is that innovation always comes from outside the traditional industry boundaries and incumbents who do not react fast or wish the new innovation away would decline slowly.

6. **Inability to fight off lower-priced rivals:** Some innovator incumbents like Sony and Philips in consumer electronics saw themselves as premium players. They failed to see the bigger opportunity at lower price points and lost out to LG, TCL, and Samsung. Sony stayed at a premium price point and bled there, while Phillips was scared to fight the Koreans and sold its consumer electronics business and franchised its brand. This is true in FMCG too, whether it is Unilever or P&G.

7. **Lack of a stable business model:** In India, we have lost 27 airlines in the last 30 years. All 27 have gone out of business, the latest on the edge being GoAir. There was a time when Air India, Jet, and Kingfisher were the incumbents. Two are in the grave and I am sure even a die-hard Air India manager will not describe Air India as thriving. Air India survived because of government support.

   In aircraft manufacturing, it is a two-player race. Boeing was the incumbent, till it lost badly to Airbus and in the last quarter Boeing overtook Airbus, but by selling its new 737 Max at hugely discounted prices. Boeing's challenges were to do with product safety and lack of innovation.

8. **Overestimating brand strength:** Another reason incumbents lose is that they lose focus and think their brand is stretchable in every category from A to Z. Companies tend to explain away this phenomenon with a lot of jargon. Asian Paints is going through that phase right now, introducing tools, putty, bath fittings, sanitaryware, kitchen and wardrobe, furniture, furnishing, lighting, etc. Brooke Bond went into motorcycles at the peak of its tea and coffee dominance! Amazon made this mistake and is now involved in a clean-up exercise in a bid to be profitable in India. It has exited ed tech, the food delivery business, and the wholesale business. Both Coca-Cola and PepsiCo overestimated the Indian market and built capacities way beyond even today's sales. Both were unprofitable for the first 20 years. P&G continues to have a high conditioner shampoo in India, a market where taking out oil from hair is important. There are numerous other examples of incumbents failing to read emerging markets and overplaying their hand: Hero, Kellogg's, Hershey's, Heinz, and Tang. The list is long.

9. **Not seeing the full market potential:** In the FMCG market in India we see the following types of brands:
   - National brands
   - Regional brands
   - Unorganised brands
   - Retailer brands and

- The unbranded, unorganised sector, which is the fountain for upgradation.

Only a smart company and a smart management team will see the opportunity this way and not remain focused on companies like themselves. Many MNCs measure their share against like-minded competition. To my mind, that's a survival proposition, not a thriving proposition in the long term.

10. **Emperor's new clothes:** The reason Indian incumbents lose is because they are unable to hold on to or retain their legacy advantages, fail to respond to price competition, and aren't able to spot the forces of disruption. In the case of Indian companies, no one is willing to tell the owner the truth, owners are not market connected and still carry the license advantages in their minds. Also, with an honorable exception like Amul, Indian owners rarely invest in brands that are crucial for success in a changing world. Then again, being a cooperative, even Amul did not have to focus on delivering consistent profitable growth. For the most part, Indian owners value loyalty, ahead of new capability, and that pulls the organisation back all the time. The legacy family companies of the 1950s are a pale shadow of what they were in their prime and more will follow.
11. **Structure and tenure:** Country heads in MNCs generally tend to have short tenures. MNCs keep changing the concept of core and structure every few years. This game of musical chairs forces managers to keep the focus on alignment. Nokia used to restructure every 18 to 24 months. In 2010, I remember a post by an engineer on the internal company blog in Helsinki describing the reshuffles as "reorganising the chairs on the Titanic." At least, the old Nokia was honest enough to take criticism and nothing happened to that engineer.

12. **The rise of nationalism:** This is a double-edged sword. Consumers across the world are imbued with a strong nationalist feeling over the last 6 years. So, an MNC has to prove that it is aligned with the country's interests. A local company is expected to show alacrity in being first in the queue to serve the national agenda. Also, technology is freely available now, the product difference in most categories has diminished and that hurts incumbent MNCs. I predict this is here to stay.

    Another way to think about this is to look at whether the top 3 players in every industry have remained unchanged over a decade or two. Have the shares of the top 3 continued to grow from their start point? I'd argue, unlike Nadal, Federer, and Djokovic in the world of tennis, the share of the top 3, i.e. the incumbents, has declined in a majority of industries.

What should incumbents do?

In the world of sports, elite athletes adapt or retire. On the other hand, corporate incumbents need to consistently demonstrate the drive and hunger to succeed, and the willingness and openness to try out new things. They also need to display resilience and agility.

Charles Darwin said it best when he said it is not the strongest, but the ones who can adapt that survive and thrive. That's just as true for corporations in India and globally.

Being an incumbent is seldom easy. You are on everybody's radar. Everyone seems to know your weak spots.

In most industries today, incumbents have higher legacy costs and newcomers have a lower cost structure. Realigning costs consistently is key.

Incumbents survive and thrive when they are willing to challenge their own portfolio and place considered innovation bets ahead of time.

Incumbents need to infuse speed in their work practices. Inertia is a big enemy and breaking the company down into nimble operating units is the only way to stay ahead. In the last 20 years, no big company has beaten a small company. However, a fast company has beaten a slow one.

In an interconnected world, most companies tend to pick bureaucratic centralisation over decentralised empowerment. That, over anything else, is the key reason they lose.

Dig deeper

- Shivakumar's keynote at the Procter & Gamble India annual conference, January 2023 (.pdf): https://app.box.com/s/nbhg3xru1l12lvfeyp6e499r345upsh9
- How tech innovation shapes business, by Prof Julian Birkinshaw, TEDxLondonBusinessSchool: https://youtu.be/cKY4xY4J4dw

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08 May 2023