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Not all elephants can dance: Investors must identify the exceptions

Devina Mehra | 6 Nov 2024

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SUMMARY

Very few large businesses remain both agile and dominant for decades on end. Think of Kodak, Nokia and Research in Motion. Investors must not only watch out for disruptions, but also track how competitively big players are placed.

As the first page of any book on corporate law tells you, a corporation has an infinite life. But how long do companies actually last?

A global study shows that very few companies cross 50 or 70 years. Interestingly, the longest extant organizations are almost all 'non-commercial,' mostly educational and faith-based institutions. Even the longest running commercial company is a Japanese one in the business of constructing temples. Maybe there is a lesson in that!

Yet, we are all often told that the simplest investing mantra is: "Buy old and large businesses. Buy the largest company in the sector with the strongest brand."

But does success last? The average age of a company in the S&P 500 was 32 years in 1965, it's 20 years now and had even dipped to below 15. (Source: Statista).

Look at the original BSE Sensex list from the 1980s. The stocks there were not just large companies, they had mostly been around for many decades, with the sole

exception of Indian Hotels. But the majority of those companies have disappeared or become irrelevant.

Globally, remember Nokia, Kodak and BlackBerry (Research in Motion)? All dominant players at a time when magazine covers used to be about whether anyone could ever catch up with them. Where are they now?

And this is not just about being in a fast-moving technology business. In any case, when Kodak was running its film-based business, nobody thought it was a fast-moving high-tech area. The issue is far more fundamental than that.

One, if the industry's scenario changes for whatever reason, some companies adapt and some can't. Bajaj Auto, for example, was a winner in the liberalized India as well, whereas Premier Automobiles and Hindustan Motors fell by the wayside.

Other Sensex constituents disappeared because industries like textiles, paper and shipping became less important to the economy, or because family businesses were not run properly—that is how entire 'blue chip' groups like Mafatlal, JK, Thapar, etc, are no longer so.

Two, when a company is a dominant player, even if it does nothing wrong at all, any new player in the business will end up taking share and sales away from it.

For the largest player in the market, it is nearly impossible to grow faster than the market, whereas for a smaller player, taking away 1%, 2% or 5% share of the market is not such a big deal.

When Tata Motors acquired Jaguar Land Rover, my bet on the company's performance was predicated on the fact that with a couple of great new Jaguar models, it would be able to grow sales far faster than its competitors, as it then had only a 4-5% market share in the global luxury car market.

Three, a new player can target niches. In India, we have seen time and again that in consumer products like tea, hair oil, detergent or confectionery, small players can target certain states or areas and even tailor their products according to the preferences of that particular region.

Or a smaller player can use a 'thin edge of the wedge' strategy. For example, start with only exterior paints, rather than offer the full paint range as the incumbent must.

The net result is that these more nimble players nibble away at market shares. At times, larger players then have to acquire their competitors at a premium, as Hindustan Unilever, Marico and Dabur have had to do more than once.

Often, a new player cuts prices, offers discounts or gives freebies like free service on vehicles or appliances. It also happens that smaller and later entrants often have lower cost structures and overheads compared to old established companies, which tend to accumulate costs over time.

If the biggies try to match them, they take a huge hit on margins and profits, given their much bigger revenue base. If they don't, they lose share.

Four, it is also mostly true that the big disruptions in a field of business come from new entrants or smaller players. It is very hard for a giant to do this, especially if it eats into its current cash-generating business.

Kodak had digital-camera technology but could never scale it up, as it would have destroyed its existing business. Of course, we know how that story played out, with Kodak getting disrupted anyway and the company going out of business.

Plus, there is also some inertia when you have a substantial profitable business and an emerging new area is too small to get the top management's focus.

Microsoft, with its cash-cow businesses, missed out on opportunity after opportunity in the global markets for internet browsers, search, cloud computing and more. It has caught up only recently in some of these under Satya Nadella's leadership.

Five, sometimes companies move away from the very thing that had made them big. The recent push by Starbucks towards more online ordering and on-the-go coffee reminded me that the chain was set up because its founder was enamoured of European style cafes which served as community hang-outs.

Similarly, Yahoo dominated the internet even after the tech crash of the early 2000s. Google made space for itself because Yahoo tried to keep people on its own website, rather than redirect them to other internet addresses.

And now Google is precisely in that same space, where it gives search results in such a fashion that the user does not click through to any other site. It is this kind of behaviour that creates room for the next new company meeting similar needs.

Of course, an attractive business also tends to attract competition and even a good business can be bought at the wrong price. But those are topics for another day.

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