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Forbes India: How ITC chief kicked the butt
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Bureau

By the time you read this, the 15-member board of directors of ITC would have swiftly concluded its meeting scheduled for the morning of June 18. The mood inside the board room in Virginia House, the headquarters of India's largest tobacco company, would have been understandably buoyant. This is ITC's centenary year. And the main agenda for the board meeting -- to discuss the proposal for a special 1:1 bonus share issue -- would have been expeditiously cleared.

For Yogesh Chander Deveshwar -- Yogi to his colleagues on the board -- this would mark the perfect beginning of the end. By the time he steps down in April 2012, he would have spent more than 15 years as chairman, easily the longest serving in ITC's history. But that's not a sobriquet that Deveshwar really cares about.

Y C Deveshwar, chairman of ITC, transformed the tobacco company into FMCG giant.

He's already made it amply clear in media interviews, including one to this magazine, that he's looking for a longer innings.

On the face of it, Deveshwar may have a legitimate reason: He's in the throes of transforming ITC from a cigarette maker to a fast moving consumer goods (FMCG) company for the past decade or so. In the last three years, he's really upped the ante -- and taken on a plethora of global and local rivals including Unilever, Procter & Gamble, Pepsi Foods, Britannia, Nestle and Parle Agro, all at one go.

So far, ITC's non-tobacco FMCG business is just about Rs. 3,700 crore. In this year's five year rolling plan -- a ritual that all ITC chairmen have religiously stuck to -- Deveshwar says he's banking on the FMCG business growing to nearly four times that size (Rs. 12,000 crore) during this period, even as ITC aims for a turnover of Rs. 55,000 crore. (Put simply, the FMCG target is a bit like adding four times Marico's current turnover.) And quitting in the middle of the surge would seem rather tame.

Clearly, while Deveshwar is preparing the ground for an extension, most insiders reckon the final nod from the board may not come till the last moment. There's also the seemingly small matter of convincing its erstwhile owners British American Tobacco (BAT) to support his candidature. BAT has about 32 percent stake and two board seats. And the two folks it has picked for the job, Hugo Powell and Anthony Rhys, are both former FMCG veterans from Unilever. And while BAT hasn't interfered with ITC's management in the last decade and a half after a failed attempt to take majority stake, it isn't likely to give in to Deveshwar's campaign now without driving a hard bargain. Want to know why? We'll come to that in a bit.

Meanwhile, most rivals who've witnessed Deveshwar's bare-knuckled assault from close quarters are keeping their eyes peeled on the succession issue. For, a change in leadership will invariably affect how the future plans of ITC are carried out. Already, Deveshwar's aggressive expansion of market share has raised eyebrows both inside ITC and outside. The CEO of a leading Indian FMCG firm, who wishes to remain unnamed, says he is astounded at the kind of money ITC is putting up to buy market share in the personal care business. Soaps and shampoos are among the biggest categories in the personal care space. And in trying to build a Rs. 500 crore business, ITC is said to have lost about Rs. 250-odd crore this year alone.

Where's the end game?

A well-known columnist in a leading business newspaper claims she received a call from Deveshwar after she referred to some "illogical" players in the FMCG industry in one of her recent columns. He gently enquired in his avuncular manner whether she was indeed referring to ITC. "What is his real end game? Do you really know?" she enquires, puzzled.

It is a question that holds the key to ITC's future. Ideally, Deveshwar would want nothing better than to be remembered as the man who helped build India's largest consumer product firm. After all, reducing the dependence on the not-so-desirable core tobacco business has proven to be no mean task. For four decades, ever since ITC's first Indian chairman A.N. Haksar took charge from BAT in 1969, every leader has tried his best to diversify beyond tobacco, but without much success.

In Deveshwar's era, however, ITC has clearly achieved more than a measure of progress. Today, about half of its net revenues of Rs. 18,000 crore comes from cigarettes, and the other half from hotels, paper boards, infotech, agri-business and now increasingly, foods and personal care. Of these, Deveshwar inherited hotels and paper board, the only two other businesses of any real scale, from his predecessors. In the early part of his era, he did discover and nurture e-Choupal, the concept of a rural trading platform using a digital technology backbone. It fired the imagination of the business community and academia, winning a plethora of awards and even providing material for a Harvard Business School case study. At one point, ITC was opening six e-Choupals a day across the rural hinterland. In the end, hobbled partly by tight regulations and its own inherent complexities, the business never quite grew into a sustainable growth engine and remained only a visible symbol of ITC's corporate social responsibility.

Today, his big bet is on foods and personal care. He's already totted up losses of more than Rs. 2,035 crore on the FMCG business (insiders say that actual losses are far bigger if one considers the initial incubation costs that may have been absorbed by the tobacco division's hefty profits). His colleagues say that Deveshwar would like more time to personally handhold the new businesses, put them on a stronger footing and demonstrate success, before leaving.

And to be fair to him, not too many CEOs in contemporary India can claim to stay focussed on their end goal in the teeth of such heavy losses. But then, hardly any of them would have perhaps made it to the board of a company the size of ITC at the age of 37 like he did back in 1984, a time when board seats were reserved for those in their 50s.

A career in audacity

Clearly, Deveshwar knew how to take bold decisions. A former ITC senior executive remembers the time when he returned from Air India to confront a complex situation. Godfrey Philips had launched Four Square Specials, a mini version of Four Square Kings. It was making deep inroads into ITC territory. One option was to introduce a similar variant of Gold Flake and stop the intruder. But it ran the risk of downgrading the Gold Flake franchise. And the entire marketing team inside ITC baulked at the prospect of tinkering with a mega brand. Deveshwar, who was then the head of the tobacco division, went against the advice of his entire team and singlehandedly went ahead with the launch of Gold Flake Filter. He focussed on promoting Gold Flake Kings to manage the possibility of any brand dilution. It worked splendidly. Volumes grew several-fold. And Gold Flake became a veritable cash machine for ITC.

But nothing could have possibly prepared him for the challenges of leading ITC when his turn finally came in 1996. BAT and ITC had just fallen out. In a bid to wrest control of the company, BAT had ended up dividing the organisation into two camps: Those that favoured the re-entry of BAT. And those that didn't. It was a bloody, no-holds-barred battle. K.L. Chugh, his predecessor, had chosen to aggressively lead the company into financial services, international commodity trading and edible oils. He had even contemplated an entry into power.

None of them proved effective -- and ITC lost lots of money. This provided the perfect launch-pad for BAT to mount its offensive against Chugh. BAT wanted ITC to stick to the knitting. That's exactly what it had done in the UK starting in 1989, dismantling and unbundling a set of diversifications that were remarkably similar to that of ITC. See graphic on the .

In January 1996, Deveshwar inherited a fractured organisation. Morale was low, and a number of top leaders soon went to jail on charges of foreign exchange violations. He formed an interim management committee to manage the affairs of the company, created a separate legal team to deal with all the Enforcement Directorate cases piled up against the company and began to tone up the governance system inside the company. He created a three-tiered system: The board of directors to focus on strategic supervision, a corporate management committee to dealwith strategic management and a divisional management committee with operational responsibility.

After the Enforcement Directorate fiasco, when incriminating documents had been found in the chairman's office, Deveshwar completely sanitised it. So you'll rarely find a piece of paper lying around in his room. Instead, his room is choc-a-bloc with ITC products!

He also made a few quick calls on the portfolio and the structure of the company. The paper board business was bleeding, almost on the verge of bankruptcy. Not many folks inside the company were in the mood for another bout of adventurism.

They wanted ITC to get rid of it, just like it had done with the financial services business. But Deveshwar stuck to his guns. He brought back the hotels and paper board business inside an integrated structure -- so that they could receive adequate support from ITC's cash flows. "The earlier diversifications did not receive full-blooded support in terms of investments to help them grow," says the chairman. He also put in place a system of checks and balances to ensure that businesses did not take undue risks.

By all accounts, Deveshwar did a commendable job of bringing the company back on the rails. The hotels and paperboard business gradually began to turn around. His colleague and executive director, Anup Singh, describes him as a "master strategist". For the first five years, Deveshwar did little else but put in place strong systems. He also made sure that BAT officials did not interfere in the day-to-day management of the company. "Typically, a BAT official would sit in for the initial interim committee meetings. Deveshwar made sure that they didn't and were only privy to what was discussed at the board by virtue of their two board seats," says a senior corporate executive.

Consolidation and growth

Gradually, the company began to rediscover its moorings. And so, by 2002, he had begun the search for new growth pastures. During a visit to the World Economic Forum at Davos, Deveshwar and his group human resources chief Anand Nayak ran into Harvard University professor Krishna Palepu. Palepu's work on the relevance of diversification to growth in emerging markets struck a chord with ITC's big boss. So from 1998, Palepu began to advise ITC on its corporate strategy.

One of the issues that Palepu dwelt on was how to leverage ITC's distribution strengths. That, in turn, prompted Deveshwar to start looking at a large FMCG play. His reasoning: ITC already had the relevant brand management skills. Sure, the large distribution system needed tweaking, but there was little doubt that it was a formidable strength -- and above all, it had a huge cash hoard (at current estimates, close to Rs. 12,000 crore) to fund the expansion. There was another reason: Compared to the high gestation hotels and paper board business, the FMCG business was relatively a low gestation one.

It started with the lifestyle retailing business. Initially, the plan was to diversify the Wills trademark from cigarettes to the lifestyle retailing category. With the ban on tobacco advertising, ITC realised that it would have to look for alternate ways to keep alive its trademarks. Simultaneously, it had to withdraw the Wills brand from the cigarette business, so that it did not constitute surrogate advertising.

ITC's entry into retail shook up the market: It rented out properties at astronomical rates in prime locations. Its merchandising standards were world-class and in the initial period, there were rumours that it even burnt the unsold stock rather than sell the mark-downs. But so far, ITC has struggled to find its feet in the retailing business, despite reworking rentals and getting out of a spate of bad

property deals.

The big foods foray was next. And the learning curve was pretty steep there. Take Bingo, its first product in the branded snacks category. First of all, Bingo was manufactured in a central location in north India and transported all over the country. That resulted in the cost of freight being very high. It also severely tested the distribution system that was skewed towards convenience stores.

ITC had to expand its reach and invest significantly in new infrastructure to achieve the width of distribution to take on PepsiCo's Lay's. Its media muscle was formidable, in keeping with Deveshwar's philosophy of spending like the market leader. Yet Pepsi played its cards smartly.

Like all ITC products, Bingo too passed through several quality tests in a bid to ensure that the product was superior than Lay's. In normal trade practice, these products enjoy a shelf life of four months. As a strategy, ITC decided to stick to a six month shelf life, according to insiders. Pepsi used this to its advantage by promising the trade fresh stocks from its regionally distributed manufacturing locations.

Somewhere along the line, in their quest for turnover, the top brass in the food division allowed the demand forecasting plan go haywire. And there was a huge pile-up of unsold stock at the distributor level. Finally, faced with an overstocking situation, the company was forced to write off nearly Rs. 25 crore worth of stocks over a period of two years. Ravi Naware, CEO of the foods division, was forced to take premature retirement after the setback. Despite this, Bingo finger snacks -- Mad Angles -- did reasonably well.

For biscuits too, ITC is said to have used a deep discounting strategy to push stocks into the trade. Seventy percent of its portfolio consists of glucose biscuits, where margins tend to be very tight. With Parle being the reference brand in the category, ITC has no option of raising prices without losing share. By ITC's own admissions, Parle is also considered one of the best working capital managers and has a formidable distribution model.

On Aashirwad atta, ITC did achieve success. And it derived some advantage from the sourcing strengths of its e-Choupal network to reduce costs and improve the level of localisation. With a 52 percent share of the branded atta market, ITC will have to patiently look to convert unbranded users. Unbranded atta accounts for 90 percent share of the market.

The foods debacle peaking in 2009 was a grim reminder of the cash-on-tap syndrome. If a cash-rich company like ITC decides to chase turnover, it could end up blowing up a lot of it without too much gain. "We allocate capital with a venture capitalist's mindset. We've made it known that cash is always available for businesses that are performing," says K. Vaidyanath, executive director.

Lessons learnt

So ITC was careful with its next major foray: Personal care. Reports suggest that the business plan was scrutinised thoroughly to ensure that the growth was profitable.

Till date, ITC has rolled out four brands in the soaps and shampoo market in a tiered manner: Wills Essenza in the super premium category, Fiama di Wills in the premium category, Vivel for the mass market and Superia for the popular segment.The product quality is impeccable -- and ITC has signed up a bevy of stars -- from Deepika Padukone to Kareena Kapoor to Hrithik Roshan -- to endorse the different brands. Yet market share gains have been much slower to come through. ITC has a 5 percent share each in soap and shampoo categories.

So what does Deveshwar plan to do now? "In the consumer business, you need scale to build a franchise. It is a chicken-and-egg problem. We will infuse life into these businesses so that they can stand on their own legs," says Deveshwar.

Now, here's his dilemma: Unless he pushes for scale, his chances of reducing ITC's dependence on tobacco will be slim. And in foods and personal care, Deveshwar reckons he has the best opportunity to build share and volumes. But both businesses are also the grazing ground of the smartest multinationals in the world, including Unilever, P&G and Nestle and some of the best-run local firms like

Britannia and Parle.

In the next few years, the pressure will mount inside ITC to push for scale. And that pressure will come from the corner office. According to senior executives, Deveshwar has increasingly been driving the strategy himself in a bid to ratchet up the growth rates at ITC. Many of the key decisions -- on which product category to attack, how to position and even pack sizes -- nowadays emanate from him. It was his decision to enter the snackfoods business and even branded atta. He even visits the market on a regular basis, moving from shop to shop, assessing the company's performance. In effect, Deveshwar is now emotionally committed to the FMCG business.

Having developed a beachhead, Deveshwar says the next phase of growth will be about launching sharply differentiated products. In its Bangalore research and development centre, a team of scientists led by former GE scientist C.C. Lakshmanan is hard at work to address the convergence of health and well-being across agri-produce, functional foods and personal care, says Deveshwar.

The tall leader

Thanks to his long stint at the helm, Deveshwar virtually towers over the other leaders in the company. The fact that he earns close to three times more than the next senior most director also adds to the "power distance".

Besides, other than the four executive directors who get permanent seats at the corporate management committee, all the other members are deemed as "invitees". That somewhat reduces their ability to challenge decisions -- and cuts out any possible dissent. In the last few months, insiders say that there have been some reports of dissent from within on the larger FMCG strategy being put down with an iron hand.

It is his mastery of the brief that helps Deveshwar do this. He prepares intensively before every corporate management committee, often working till 4 a.m. Even now, he makes detailed notes on every single page that is sent to him before coming in for a meeting.

A larger-than-life chairman does ensure that decisions get pushed through quickly. But it also heightens the chances of failure, especially if there is heavy centralisation of decision-making. Technically, the businesses may be run by CEOs, who in turn report to a director. But in a lot of the cases, the chairman directly signs off on most key decisions. It ends up making the system somewhat dependent on him.

Since 2000, ITC has not had any new director on the board, except for Kurush Grant, who was elevated to the board in March this year. Grant is now the point person in charge of FMCG.

Considered a whiz in the tobacco business, his elevation to the board was perhaps long overdue. But for two consecutive years, the nominations committee, headed by the chairman himself, did not find any occasion to meet.

Grant is also the only person who is seen as a possible successor to Deveshwar, if he chooses to step down in 2012. But by then, Grant would have spent only two years as executive director.

Will they bat for him?

By all accounts, the task of turning around and profitably growing the FMCG business will take a lot more time than Deveshwar's current tenure allows. And almost the entire board, consisting mostly of retired bureaucrats and finance professionals, is likely to push for continuity, rather than plump for a new leader.

Deveshwar will, of course, need the support of BAT. The issue is: What does he offer them? The London-headquartered BAT is still keen on gaining control of ITC. But Deveshwar has so far ensured that BAT is kept at bay.

He's actively canvassed support from the government to keep ITC an independent, professionally managed firm, much like Larsen & Toubro. ITC is today viewed as a company that looks after the interest of Indian farmers. And the support from the financial institutions has ensured that BAT is unable to increase its stake. And earlier this year, the government's decision to ban FDI in tobacco may have been the final spoke in the wheel for BAT.

In the recent past, ITC has increased its dividend payout ratios from 35 percent to 50 percent to keep shareholders like BAT happy. With Philip Morris looking to make strong inroads in India with Marlboro, Deveshwar may want to fight the new challenger by allowing BAT to bring in a brand like Kent into India. Or he could promise to make the government see reason and reverse the FDI ban on tobacco and/or take on local manufacture of BAT brands to service Asia-Pacific.

But the big threat for Deveshwar is to ensure that at no time does his big FMCG foray severely dent ITC's financial performance. So far, none of this has affected the performance of the company. Partly because the tobacco business is so strongly placed that it continues to sustain consistent price hikes.

ITC has generated a total shareholder return of 24 percent since 1996, which would be among the highest in its peer group, says Vaidyanath.

As a diversified conglomerate, as long as its enterprise value is higher than the sum of parts valuation, ITC may not face any perceptible threat.

In 1989, in UK, BAT faced a sudden hostile bid from James Goldsmith (Jemima's father) and was finally forced to jettison all its new businesses and stick to the knitting.

Today, that's the last thing on Deveshwar's mind.