



Institutional dilemma

Painting a BIG picture

The economic slowdown, which has affected the venture capital market, is threatening to wipe out smaller firms. This, in turn, may speed up consolidation activity, once the global economy rebounds. In the paints & coatings sector, the giants that controlled almost 50 per cent of the industry seemed to be poised for more consolidation. This situation has forced the market players to stop and ponder over the business strategies and goals to be adopted in the long run.



Courtesy: Getty Images Inc



Courtesy: www.openphoto.net

Dr Mosongo Moukwa

The motto of 'too big to fail' went bust with the recent global slowdown as governments rushed to the rescue of failing financial institutions. With all the reorganisation of big companies that recently took place, it seemed as though the world has rediscovered the age old wisdom about hubris and excess.

Managing 'bigness' has always been a challenge. Generally, big organisations narrow down the individual initiatives of those who belong to them. This thought was echoed more than a hundred years ago by thinkers like Montesquieu, Tolstoy and Louis Brandeis. But the thinker whose name is most often linked to these matters is probably EF Schumacher, who published the classic work on the size of institutions, 'Small is beautiful' in 1973.

Small is beautiful

Schumacher, formerly the head of planning at the British Coal Board, understood the basic political dualism in human beings. The need for freedom and the need for order create two contradictory imperatives when it comes to creating institutions. "We need the freedom of lots of small autonomous units," he wrote, "and at the same time, the orderliness of large scale, possibly global unity and coordination. When it comes to action, we obviously need small units, because action is a highly personal affair, and one cannot be in touch with more than a limited number of persons at any one time. But, when it comes to the world of ideas, to principles or to ethics, to the indivisibility of peace and also of ecology, we need to recognise the unity of mankind, and base our actions on this recognition."

Small vs big

The way big institutions have handled this dualism, Schumacher noted, was through 'a strenuous attempt to attain smallness within bigness'. This was usually disingenuous. Schumacher's favourite example was General Motors under Alfred Sloan, which was structured in a number of distinctive sub-companies. But, no matter how strenuously Buick insisted on itself as a brand distinct from Chevrolet, it was a ventriloquist's act. The essence of the trick was to create companies that behaved like large ones but looked like small ones.

This trick is easier to pass off than it used to be. Increasingly, big institutions do not look the same institutions at all. Vast corporations with global reach, in most industries, present themselves as non-hierarchical. In the case of IT industry, computerisation has made it possible to mass produce a wide range of products. For others, including paints & coatings industry, technology has been used to expand communication and leverage knowledge across faraway units. However, the problem of bigness is now different from that faced by Schumacher.

In the 1990s, some of the organisations that defined capitalism for much of the 20th century were on retreat, attacked by corporate raiders, harassed by shareholders and outfoxed by entrepreneurs. Those days, everyone agreed that the future belonged to entrepreneurial startups such as Yahoo, which in 1998, had the same market capitalisation with 637 employees as Boeing with 30,000.

Painting new possibilities

The entrepreneurial boom in IT was supercharged by two developments: Deregulation and opening of protected markets. AT&T, for example, was broken up. The arrival of personal computer in the 1970s and the Internet in 1990s created an array of start ups. While the IT and telecommunication industry was reshaping smaller companies, the pace of change in the paints & coatings industry was much slower.

Table 1: Top paint companies

Company	Country	Rankings '09	Sales '08 (in \$ billion)
AkzoNobel Coatings	The Netherlands	1	14.124
PPG Industries	USA	2	10.935
Henkel KGaA	Germany	3	9.849
The Sherwin-Williams Co	USA	4	6.521
DuPont Performance Coatings	USA	5	4.3
BASF Coatings	Germany	6	3.729
RPM Inc	USA	7	3.643
The Valspar Corporation	USA	8	3.168
Sika Finanz AG	Switzerland	9	2.356
Kansai Paint	Japan	10	2.299
Nippon Paint	Japan	11	2.276
3M Company	USA	12	2.2
Jotun A/S	Norway	13	1.87
Daw	Germany	14	1.471
Masco Corp	USA	15	1.44
COMEX	Mexico	16	1.4
H B Fuller	USA	17	1.391
Hempel's Marine Paints A/S	Denmark	18	1.347
Beckers	Sweden	19	1.316
Asian Paints	India	20	1.062

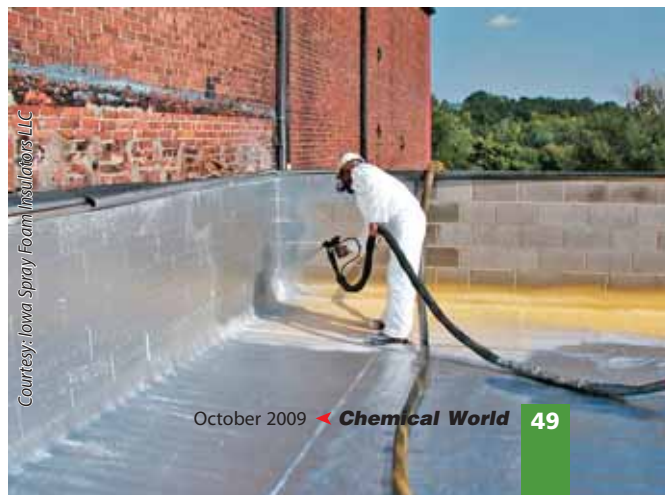
Source: Coatings World

Although universities encouraged polymers and materials science departments to spin out technologies usable for the coatings industry, many of the entrepreneurial polymers-based companies never became big, nor did they threaten major players. However, they gave a new impetus to the industry. With big chemical companies cutting back R&D programmes and laying off thousands of workers, small chemical businesses represented a significant portion of the chemical-related invention pipeline, particularly in the US and Germany.

Unlike the IT industry, the paints & coatings industry has continually experienced major consolidation since the 1990s, driven primarily by the search for strategic positioning in the industry. In fact, it has been much friendlier to big companies than the IT industry.

Shades of difference

Indeed, the trajectory of the paints & coatings industry has been different. Those organisations that weathered the difficult times have bolstered their operations with smaller, strategic bolt-on acquisitions. Private equity firms have acquired larger downstream businesses that have been on the block. In the coatings industry, 3-5 per cent of firms are typically involved in mergers and acquisitions (M&A) activity. Thus, companies have restructured, reorganised and divested themselves into non-core businesses.



Courtesy: Iowa Spray Foam Insulators LLC



COATINGS CORNER

'Giant' leaps

Companies need to have a certain size to fully leverage distribution channels and gain control over the costs of raw materials. There is also an awareness of the risk of subcontracting. PPG, for example is captive in many aspects of its operations. Sherwin Williams, like Asian Paints and Benjamin Moore, is semi-captive in emulsions used in the manufacturing of paints. Indeed, big companies have learned that their production cycles can be disrupted if contractors are not up to the mark. And, in highly profitable segments, they want to ensure that all proprietary processes are fully kept in check.

However, many of the giants have discovered long ago that it is better to be entrepreneurial as well as big. The giants are getting better at minimising the costs of size (such as longer, more complex chains of managerial command), while exploiting its advantages such as the presence in several markets and access to a larger talent pool. Most of the large paint companies are fully leveraging IT tools to communicate across regions and for managing data to support business operations more quickly and responsively. PPG, for example, is using a digital platform to manage in-process ideas and proprietary information assets, the very essence of competitive strength for companies in the so-called 'knowledge economy'. A web-based platform helps the company control latent intellectual capital and accelerate the commercialisation of promising innovations across business units and multiple locations.

The global economic slowdown has had a major impact on the venture capital market and is threatening to wipe out smaller firms. It is expected that the level of consolidation activity is likely to pick up, once the global economy rebounds.

Big is here to stay

The paints & coatings industry still boast of long established names as

well as an array of smaller companies. This ranges from Akzo and PPG, to the smaller ones like Tambour and Diamond Vogel.

Akzo's acquisition of ICI in 2008 at \$ 16.6 billion enabled it to become the largest paints & coatings company in the world. PPG spent nearly \$ 2 billion by 2000, snapping up about 20 of the most desirable coatings companies in the market. This strategy continued in 2006 & 2007 and in 2008, PPG completed its biggest deal with Sigma Kalon at \$ 3.2 billion, which was recognised by Wall Street. Today,

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PPG and Akzo are continuing to innovate through thick and thin. Obviously, big companies will never go away, and today there are still plenty of first-rate ones.

However, there is a symbiosis between large and small companies in the paints & coatings industry. Large companies operate across nations in most part, while smaller ones are regional. The appetite of large companies is taking them to seek new and greener pastures. They have turned their sight towards emerging markets like India. Companies like Nippon, Akzo, Jotun, DuPont and BASF have expanded their activities in India. Nippon Paints had built plants in Gurgaon and Chennai. Jotun Paints had set up plants in Pune.

A large portion of the technology in the coatings industry is considered mature and not subject to revolutionary

change. However, there is a need for continuous innovation. Often this innovation does not come from the industry itself, but from related industries. These include raw materials suppliers as well as high-technology aerospace and electronics industries. Granted that powder coatings and UV radiation curable coatings are now well accepted, but the pace of adoption of transformational innovation has been slow.

The aerospace and electronics industries require highly specialised types of coatings. Many specialised coatings have been developed, which command a high price, but expect only small specialised usage within the aerospace and electronics industries. Generally, these coatings are manufactured either by specialty companies or by industries that need them. For the most part, only a handful of coatings companies, such as Akzo and PPG, participate in these areas.

Hence, business should not make a fetish of size, particularly if this means diversifying into a lot of unrelated areas. The conglomerate model may be tempting when cash is hard to find. But the moment will not last. The most successful economic ecosystem contains a variety of big and small companies. 



Dr Mosongo Moukwa is currently vice president - Technology at Asian Paints Ltd based in Mumbai - India. He was vice president - Global Technology at Reichhold, based in North Carolina, and before that vice president - Global Technology at Johnson Polymer (now part of BASF). He holds a PhD from the Universite de Sherbrooke, Quebec, Canada, and an MBA from Case Western University, Cleveland, Ohio. He is a member of the American Chemical Society, the Commercial Development and Management Association, and the Licensing Executive Society. Email: mosongo.moukwa@asianpaints.com