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Case Study

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Shock Absorber Firms: How they create Sustainable Moats?

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Mr. Raj Kumar is the Chairman of Featherlight Ltd., the largest footwear company in India. The company has a market capitalization of Rs 25000 crores. The firm was founded in 1976 along with his brother Mr. Surya Kumar taking forward their father's footwear business to what Featherlight is today –the largest and most popular footwear company in India. Featherlight Limited is the largest footwear manufacturing company in India. Products include rubber/EVA slippers, canvas shoes, sport shoes, sandals, school shoes and other types of footwear. The company is headquartered in Mumbai and clocks an annual turnover of over Rs. 2,500 crores. It has 10 manufacturing facilities across India with a capacity of over 10 lakh units per day. It has a wide distribution network of 35,000-40,000 stores.

Featherlight produces a wide range of footwear through various brands which sells at various price points that cater to customers across various age groups. The company sells its products through retailers served through distributors, retail outlets, exports and different online platforms. The company currently runs 500 Exclusive Brand Outlets in the country. They are planning to add to 50-60 stores in the upcoming year. Most of these stores are run of COCO (Company Owned & Company Operated) Model. However, the company is also, focussed on opening stores with the asset light FOFO (Franchise Owned & Franchise Operated) Model. There has been recent growth in FOFO stores. These stores generally serve the purpose of product display and branding and they mostly run on profit neutral ideology.

The company spends significantly on advertising campaigns where prominent film stars and cricket players are brand ambassadors of the firm. The company is a much sought after firm among investors in the country. In the last ten years sales increased by 10 times and operating profit increase by 15 times by increasing the profit margin from 10% to 15 %. The average Return on Equity (RoE) of the company during last 10 years is 25%. The stock price increased 50 times over the last 10 years and dividend payout ratio also increased from 10% to 15% during the same period. The capital expenditure also increased roughly by 10 times. Approximately 50% of the expenses are fixed costs. The excellent set of numbers are achieved with a very marginal increase of 10% in the price of the products in most segments except the premium category. This is a very significant achievement since

the raw material prices appreciated by 50% in the last 10 years. There is no footwear company in India that caters to different types of customers at various price points. The installed capacity in Featherlight is 10 times the second biggest player. Featherlight is known as Moat company in the investing community. Warren Buffet defines moat as a company with the sustainable competitive advantage. Most of the moat companies have passed on the increase in raw material prices to customers since they are in a position to do that. However, Featherlight, in most of years kept the price constant when there is an increase in raw material price, thereby increasing the market share and further strengthening of the moat. They have increased the price only in 3 out of last 10 years. This has resulted the company getting into the category of shock absorber companies where the company keep the prices constant(or even decrease) irrespective of the increase in raw material prices.

Mr. Raj Kumar interacts with media very frequently to provide update on the activities of the company. He gets calls from different media channels, investment conferences and business schools to talk about the success of the company. One day, he gets a call from one of the topmost business school in the country to handle a session in a course on Equity Research. This means that he has to explain his financial success combining financial theory and providing adequate illustrations of financial concepts and its applications. Mr. Raj Kumar sat down and listed following questions that will help him in making the presentation.

- 1) Identification of financial concepts that can explain company performance.
- 2) How company is able to absorb the shock(by keeping prices constant) of increase in raw material price?
- 3) Why competitors are not able to keep the prices constant?
- 4) How the company is able to increase the operating margin during increase in raw material price by keeping the prices constant?
- 5) What is the main moat characteristic of the company?

Raj also decided to create simple excel illustrations andthat can explain and demonstrate the answers to above-mentioned questions.

You may help Mr. Raj Kumar in his task