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‘Royalty costs for benefit of all shareholders, not just Unilever’

The FMCG sector is not only witnessing more competition, but also a shift in product distribution. **SANJIV MEHTA**, MD and CEO, Hindustan Unilever, speaks exclusively to **Vishal Chhabria** and **Sharleen D'Souza** about
1 the firm's strategy on acquisitions. Excerpts:

Q&A

SANJIV MEHTA
MD & CEO, Hindustan Unilever

How is rural demand panning out? When do you expect volume growth to return?

In the first half, there will be price growth, albeit at lower levels. This will essentially be a carry-over from last year. Therefore, the rate of inflation will be lower. But we have still not reached a stage where commodity prices have started to deflate.

The next two years will be a state of flux — price growth will be lower; volume growth will kick in only when the benefits of low commodity prices are transferred to consumers.

You need a trigger for commodity prices to start deflating. One of the big triggers could be the end of the Russia-Ukraine stand-off.

If commodity prices remain at inflated levels, there will be some degree of stress from a consumer standpoint.

But if they start tapering off, we will be able to start passing on the benefit to consumers. Consequently, volume growth will move to normative levels.

I believe volume growth should get better in the second half of the calendar year.

Which categories is HUL looking at to make acquisitions in?

Only if the valuation is sensible will we consider acquisitions. Beauty and well-being will always be important. We are open to acquisitions in any space. Whether it is food or home care, it needs to be a strategic fit.

'INDIA IS NOT A ZERO-SUM GAME' P6

“MOM-AND-POP STORES WILL REMAIN THE MOST DOMINANT CHANNEL EVEN AFTER A DECADE, AND IN A HIGHLY DIGITISED FORM”

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India is not a zero-sum game, says HUL chief Sanjiv Mehta

New distribution formats are gaining ground. Supply chains are getting digitised. How do you see the distribution of FMCG products playing out?

The contribution of mom-and-pop stores will come down from 75 per cent, but will remain the most dominant channel even after a decade, and in a highly digitised form.

We are clear that the bulk of our distribution will happen through our net-
1 work, and other channels will complement our distribution. It will not replace our distribution network. We will have different products for different channels to ensure minimal overlap. It is in our interests to strengthen our distribution network.

What has led HUL to hike the royalty to Unilever at this point in time?

One is the royalty fee on trademark and technology use; the other component is service fee. The service fee is for services rendered to us by Unilever.

Unilever is a €60-billion busine with high purchasing power. Very often, we entrust Unilever to get us better rates in areas like procurement. We also get access to the capabilities and expertise Unilever develops globally in areas like supply chain and marketing.

If we don't pay Unilever, we will have to set up our own expertise centres. But that might still not get us a competitive edge.

The royalty fee for trademark gives us the right to use an extensive portfolio of Unilever-owned brands and the corporate logo. The royalty for technology use gives us access to the best-in-class technology and innovation wherewithal.

We have three research nd development (R&D) centres in India. When you look at our profit and loss, the R&D expenses are low.

This is because much of the R&D expense goes back to Unilever but comes back to us as royalty.

One of the pillars our organisation has grown on is access to cutting-edge innovation and technology. The old effective rate of both the brand and technology royalty, as well as service fee, was 2.65 per cent. This is going up by an 80-basis point (bp) spread over three years. But are we getting any value for it? The answer is an unequivocal yes. These costs give us a massive competitive edge in the marketplace. This is why we remain the pre-eminent consumer goods company in the country. I say these costs are for the benefit of all our shareholders, not just for Unilever. Regardless, our overhead costs today are best among the peer group.

What is the impact of a higher royalty payout in the near term for HUL?

At the start of the earlier decade, the royalty and service fees had effectively gone up by about 135 bps.

During this period, our margins increased 1,000 bps. Through saving on cost, a better mix through our premiumisation programme or our market development thrust, we were able to cover the cost.

Reliance Retail recently announced its entry into the FMCG space. How will this increase competition in the sector?

India is not a zero-sum game. It is a big enough market for multiple players. The runway to grow is massive — not just for us, but for many players. A good competitor always brings out the best in HUL.

Our quest is to build great brands, based on product superiority, technology, and R&D.