

GUEST ARTICLE

Extracting Value From Deals In China

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The recent announcement that **The Carlyle Group**, the US-based private equity firm, was joining forces with Hong Kong's Dah Sing Bank to pay some \$130 million for 25% of Chongqing City Commercial Bank marked a bold first step by the buyout investor into China's newly opening financial services sector. Step two will be getting the value out of the deal.

Clearly, expanding profits at Chongqing Commercial Bank will test the new playbook that is helping private equity investors profit handsomely at a time when buyouts have never been bigger or more daring. As deal prices and the cost of debt rise, buyout firms can no longer count on leverage and deft financial maneuvers to deliver outsized gains. Instead, as soon as the ink on the deal documents is dry, they have to pivot from thinking like investors to acting like owners intent on making their assets more valuable.

With the offer for Chongqing at nearly 1.9x book value, the new owners are paying a premium over recent transactions for similar institutions. And like most provincial state-owned banks, Chongqing will need a lot of hands-on managerial and technical support. The bank will have to continue to whittle down its portfolio of non-performing loans, upgrade its information technology systems, and develop a customer-service culture if it is to meet its ultimate goal to seek an overseas share listing.

Asia's new owner-activists are following a three-step process for staging, leading, and profiting from such breakthrough operational improvements—and it's a playbook that corporate acquirers can adopt. Based on our work with private equity firms and interviews with investors and Asian corporate executives, here's what we've learned sets the activists apart.

Setting The Stage

Asia's private equity owner-activists quickly engage with management to zero in on their newly acquired holding's most attractive opportunities, gathering data to test their viability, and developing strategic objectives and financial targets. They use these insights to develop a detailed plan—like an architectural blueprint—that determines what gets done, with which



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resources, in what order, and by whom.

Sometimes this activity has to occur in several areas at once. Consider how **Newbridge Capital**, a partnership between **Texas Pacific Group** and **Blum Capital Partners**, used a carefully choreographed plan to quickly transform Korea First Bank from a bankrupt industrial creditor into a world-class financial institution. Soon after taking control and scoping out the most urgent priorities, Newbridge launched simultaneous initiatives to accelerate the bank's transformation. While frontline managers streamlined branch operations, the new owners assigned a high-level executive team supported by outside technical experts to spearhead a program to consolidate loan processing, credit collection and trade finance into two new customer service centers. Other dedicated project teams orchestrated the upgrade of Korea First's information technology organization, adding telemarketing and customer call-center capacities.

Meanwhile, Newbridge worked with management to reconfigure Korea First's branch network. When Newbridge assumed control of the bank, it was saddled with costly commercial and institutional branches built with dedicated space for back-office processes. The firm needed



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to establish retail branches with simpler layouts in high-traffic consumer locations. Rather than rebuild branches from scratch, a new team was tasked to redesign the existing infrastructure. It consolidated corporate business into a handful of large-scale branches, closed some branches, and then stripped the remaining ones of their back-office functions, focusing them instead on reaching out to consumers through customer sales. The simplification resulted in \$50 million of bottom-line improvements within a year and allowed Korea First to shrink its branch network by 31 offices. By executing these changes in parallel, Newbridge was able to make Korea First's new facilities operational within five months.

In other areas, though, Korea First had to move with deliberation. As in many Asian business cultures, Korea's labor and management have a loyalty-compact supported by strong employment laws. The turmoil of Korea First's bankruptcy and sale left the bank with a demoralized frontline workforce and an imperative to retain employees in the transition. Recognizing this, management tapped key human resource staffers as allies in the change campaign, (Continue on page 34) →

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making them more available to branch-office workers. Management broadcast the bank's commitment to retain employees who were made redundant by downsizing, helping to train those workers for new positions in customer service and sales. In all, branch closings and work-process changes ended up claiming 800 jobs, but these were more than offset by newly created positions that displaced workers could apply for. The candor and support—reinforced by cash incentives for working more efficiently—helped Korea First shift its business quickly to the consumer side and improve its efficiency, cutting loan-approval time by 75%.

By 2005, five years after Newbridge's acquisition, the bank's new infrastructure was best in class. With one of the industry's lowest ratios of nonperforming loans, its balance sheet was the nation's strongest. The payoff: In January 2005, the British banking group Standard Chartered bought Korea First for \$3.25 billion, a nearly four-fold return on the private equity fund's cash investment.

Leading The Turnaround

With a "blueprint" pointing the way, activist buyout firms monitor progress toward operational goals before it shows up in the financial results. Experienced activists focus on a few key measures that can be understood throughout the organization. Before being purchased by private equity investors, for example, Singapore Yellow Pages was giving out a whole lot of wrong numbers. Despite an 87 percent market share, the company had seen revenues slide from S\$104 million (US\$61.3 million) in 1999 to just S\$62 million in 2003, with profit margins shrinking apace. Advertisers were defecting in droves. So, too, were sales reps, with an annual turnover rate topping 50%.

Getting those numbers right in a hurry was therefore the top priority of **CVC Asia Pacific** and **CCMP Capital Asia** (formerly JPMorgan Partners Asia), the two firms leading the private equity consortium that bought the telephone directory publisher from SingTel, Singapore's telecommunications company, in June 2003. Emblematic of a new breed of activist buyout firms, the new owners set about creating a book of their own—an operational one that included a way to quickly develop a detailed blueprint.

FIVE KEY INGREDIENTS FROM THE PE ACTIVIST COOKBOOK

1. Flesh out the investment thesis. An investment thesis posits why there is an opportunity for a buyer to extract value from an acquisition, but as with any plan hammered out with incomplete information in an arm's-length deal negotiation, it is bound to get some things wrong. Activist owners quickly engage with management and put meat on the thesis's bare bones.

2. Draw up an operational blueprint. Developing a detailed plan identifies new opportunities, helps the management team sort through competing priorities, and charts a coordinated path forward. Our analysis shows that dealmakers who take such an active approach in the first year outperform others by a margin of better than two-and-a-half to one.

3. Hire hungry managers. Activist owners look to build a great team, recruiting top talent, backing them up with expert technical advisors and the resources they need to reach their objectives, and giving them an equity stake in the turnaround's success.

4. Measure what matters. Experienced activists don't get blinded by data blizzards. Instead, they focus on a few key measures—an operational "dashboard"—that can be understood throughout the organization.

5. Script a happy ending. By understanding how their portfolio company makes money at each stage of the business cycle and engineering performance improvements, buyout activists create a brighter future for the company and position themselves for a more profitable exit.

Getting the metrics right was the cornerstone of Singapore Yellow Pages's post-acquisition turnaround. It started with a global benchmark and internal assessment of its underperforming and demoralized sales force, which was the key to generating new growth through what the company developed as a "value proposition" sales approach. This was based on meeting customers' actual needs as expressed during interviews and

personal visits. Further, customers were segmented by business potential, giving specific direction to sales efforts. Meantime, new training, higher compensation and special incentives for outstanding performance against specific targets provided even greater focus. The company gave salespeople challenging goals, including revenue targets of nearly \$1 million each. But these same salespeople could now make three times their prior pay packages from the new variable rewards. And, they now had a say in who was hired and promoted.

The result: A little more than a year after making the acquisition, the private equity partners floated an initial public offering of SYP shares, reaping S\$213 million (\$128 million), locking in a gain of 2.6 times their initial investment while still retaining shares worth another S\$50 million.

Investing to profit

Finally, activist owners defy a common knock against buyout investors: Rather than stripping value for a quick sale, they cultivate new growth opportunities for the next set of owners to harvest. They don't hesitate to invest in R&D projects, new technology, acquisitions or expansions—even if they may bear fruit only years after the sale. Such early owner-activism primes the asset's eventual sale by demonstrating that the company has a prosperous path forward. Our experience shows that deal makers who actively plan and launch initiatives in this way during their first year of ownership outperform the buyout industry's average return on investment by a margin of better than two-and-a-half to one.

Smart corporate managers have begun borrowing from the private equity toolkit, and are watching and learning as this new wave of owner-activists applies the discipline that has made them world-class acquirers to the challenge of truly making companies more valuable. ❖

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