

**Role Play**

**Surfsub:**

Role of Jiayi

06/2024-6923

This role play was written by Raag Sanjay, Vasileios Liaros, Olivier Moitroux, Deepayan Roy, and Anna Stepanova, INSEAD MIM Alumni, under the supervision of Bart Zhou Yueshen, Assistant Professor of Finance at LKC School of Business, Martin Schweinsberg, Associate Professor of Organisational Behaviour at ESMT Berlin, Horacio Falcão, Professor of Management Practice of Decision Sciences at INSEAD, and Eric Uhlmann, Professor of Organisational Behaviour at INSEAD. It is intended to be used as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

The authors gratefully acknowledge funding from the Hoffmann Institute.

To access INSEAD teaching materials, go to <https://publishing.insead.edu/>.

Copyright © 2024 INSEAD

Copies may not be made without permission. No part of this publication may be copied, stored, transmitted, translated, reproduced or distributed in any form or medium whatsoever without the permission of the copyright owner.

You are Jiayi Zhang, the Head of Mergers and Acquisitions (M&A) at BojinWaves, a Beijing-based beachwear and apparel conglomerate. It is a reputable and competitive market leader with a strong track record of acquiring companies that show strong growth potential. As Head of M&A, you are famous within the conglomerate for having a sharp sense of which businesses are going to be big and which ones are going to go bust. Just in the past year, you closed 3 successful deals to acquire small companies showing strong potential for major growth in the next 2 years. Under your guidance and leadership, BojinWaves has enjoyed considerable inorganic growth in areas like beachwear, swimsuits, and underwater gear. To complete the repertoire, it made sense to begin thinking of acquiring a surfboard company.

When looking at surfboard companies in Asia Pacific, Surfsub – a fast growing start-up – caught your eye. Based in Queensland, Australia, Surfsub is an indie surfboard start-up that designs and manufactures innovative and eco-friendly surfboards (Eco-Boards) that are made out of non-toxic and biodegradable materials. Surfsub was co-founded by Francine Barker, the Chief Executive Officer (CEO), who personally ensures that the Eco-Boards are put through rigorous standards to ensure durability as well as environmental sustainability. The start up’s mission to create innovative and sustainable surfboards caught the attention of Australian surfers and quickly went viral on Australian social media for its unique angle. Their online social media accounts are a mixture of flamboyant, eclectic surfboard designs and eye-catching infographics raising awareness about oceanic pollution and environmentalism. Just in the past financial year they raked in AUD$18.7 million in revenue, an impressive number for a start-up in this industry.

You quickly saw the benefits of acquiring this company. Firstly, its innovative concept, combined with its social responsibility, garnered nationwide success in Australia despite the Australian market being saturated with large multinational conglomerates (MNCs) manufacturing surfboards catered to the mass market. This made it a good company to buy in order to gain access to Australian markets, a region that BojinWaves has not managed to penetrate so far. Secondly, the start-up’s reputation for being environmentally sustainable makes it an attractive company to buy in order to appeal to the younger demographic, who are increasingly interested in supporting companies that champion a social cause.

Furthermore, buying Surfsub could improve BojinWaves’s reputation, which had been sullied in the past due to a few environmental scandals regarding your supply chains. In the past few years, global human rights organizations as well as environmentalists have been continuously targeting MNCs such as BojinWaves for human rights violations and environmental damage. While these scandals have done little to impact the bottom line, the Public Relations (PR) team is not happy and has been pushing an internal campaign to incorporate Environmental, Social and Governance (ESG) business practices at a corporate level and implement it within each of their subsidiaries and business units. Ruiyan Peng, the Head of PR, has been hounding you and your team to forge a deal that will look good on the company’s press statement. Ruiyan holds a reputation for not only holding high standards for corporate social responsibility but is also on good terms with Kai Hao, the Chief Executive Officer (CEO). In fact, she has already convinced the BojinWaves leadership to make changes in the manufacturing assembly line amounting to CNY5 million to make manufacturing more environmentally sustainable and obtain the highly respected Green Label from the Chinese government, with a provision to further increase the investment to CNY15 million if BojinWaves acquires one more eco-friendly company. These developments only made it clearer to you that acquiring Surfsub is the right way to go.

Your proposal to acquire Surfsub was met with several raised eyebrows at the management meeting, except for Ruiyan, who was one of the only supporters in the meeting room, explaining advantages of the acquisition for BojinWaves’s brand image. You know that Ruiyan has been facing stress because of the environmental and supply chain scandals that have been threatening BojinWaves’s reputation. Furthermore, she is a big fan of sustainability (as evidenced from the ESG campaigns) and deeply admires Surfsub CEO Francine Barker’s work in raising awareness of ocean pollution and crafting long lasting products. You know that Ruiyan is strongly in favour of this acquisition because it will look good for her in the upcoming performance appraisal. It was no surprise that she volunteered to join you in the acquisitions negotiation to personally ensure its success. You reluctantly agreed but are now worried that she will concede to the founders’ financial demands too easily. In contrast, you have a reputation for being direct and ruthless when it comes to acquisitions. Your efficient and methodical approach has worked well for many M&A deals in the past, even though you know that this demeanour does not sit well with everyone. Nonetheless, your business instinct has been impeccable so far and you are sure that Surfsub is a unicorn start-up in the making.

One of your aims is to achieve a full acquisition of Surfsub by BojinWaves. Many times, you have left the table during negotiations with start-up founders who did not understand the value proposition that BojinWaves was offering them. The numbers speak for themselves, and it makes more sense to acquire companies entirely, rather than enter into joint ventures or long- term partnerships and spend years arguing with starry eyed founders over how to run things. Thus, it would be your preference not to offer the Surfsub founders, either CEO Francine Barker or CFO Sarah Barker, any decision-making authority over Surfsub post-acquisition by BojinWaves.

You are focused on getting the best deal possible for BojinWaves, but if this deal does not work out, you could find another small surfboard company, most likely in Thailand. However, that deal would not have the added value of providing a geographical foothold in Australia for BojinWaves. Your department is given a budget for each acquisition once the proposal is approved, and for this potential acquisition, a budget of maximum CNY360 million is allocated. As the representative of BojinWaves, you will have to stick to this budget during the negotiation with the Surfsub team. However, you do not intend to use the full budget because your personal end-year bonus as well as that of your team is tied to that amount of money saved from the budget. It is crucial to retain a bonus as large as possible to improve the morale of your team. You wish to understand the true standalone value of Surfsub before making an offer to them that is in line with that value.

You are worried that Ruiyan, who is very excited for this acquisition and less price oriented than you, might derail the negotiations. In particular, she might concede to whatever price the Australian founders ask for, hence undermining your negotiating position. However, you are determined not to let Ruiyan derail the price discussions and have decided to meet her beforehand. You need to meet with Ruiyan to explain the numbers to her and ensure that she understands the true value of Surfsub. You then wish to explain your position and strategy for dealing with Surfsub. It is crucial that you do most of the talking to make sure that the acquisition process goes smoothly. In fact, it would be ideal to secure Ruiyan’s agreement to let you negotiate with the Australians alone.

As you prepare for this negotiation, here are some of the issues at the forefront of your mind.

1. **Find out the correct valuation of Surfsub**. As the Head of M&A, it is your topmost priority to understand the real value of the company and avoid being blindsided by the Australian cofounders, who will most likely inflate the valuation to extract more money out of BojinWaves. For this purpose, you have tasked your team to analyse the financials of Surfsub and forecast its future free cash flows. Exhibit 1 and 2 present the findings to you.
2. **Maximize your financial gains from this deal**. You have a maximum budget of CNY360 million for this deal. The savings from this budget will directly influence your personal bonus and bonuses for your team members. You want to push Surfsub’s price as low as possible and keep the rest of the gains for BojinWaves as well as you and your team.
3. **To achieve full control over Surfsub via full acquisition**. You prefer to make a full acquisition of Surfsub rather than enter a joint venture or partnership of some kind in which the cofounders retain decision making power. This is because you want to make sure that BojinWaves possesses full control over the Surfsub business once acquired to ensure that the surfboard company is fully integrated with the conglomerate.
4. **Maintain a positive relationship with Ruiyan.** The role ofHead of Public Relations (PR) is increasingly important at BojinWaves, and Ruiyan Peng has demonstrated her ability to influence the firm’s top leadership. As Ruiyan could be a key political ally for future deals, it is important to you to maintain a good working relationship with her. You are less concerned with your relationships with Francine and Sarah Barker, who you hope will exit Surfsub after the acquisition.

Please prepare for your meeting with Ruiyan (PR), then move on to the team-on-team negotiation with the Australian co-founders of Surfsub, Francine Barker (CEO) and Sarah Barker (CFO).

Exhibit 1

Surfsub Financials

|  |
| --- |
| **BALANCE SHEET (latest fiscal year, AUD\* thousands)** |
| Cash and Equivalent | 408 |  | Accounts Payable | 439 |  |
| Accounts Receivable | 1,280 |  |  |  |  |
| Inventories | 838 |  | Debt Capital | - |  |
| PP&E | 8,335 |  | Equity Capital | 10,422 |  |
|  | 10,861 |  |  | 10,861 |  |
| **INCOME STATEMENT (latest fiscal year, AUD thousands)** |
| Sales revenues | 18,721 |  |
| Cost of Goods Sold | 10,088 |  |
| Operating Expense | 2,534 |  |
| Operating Profit | 6,099 |  |
| Interest Expense | - |  |
| Pre-tax Income | 6,099 |  |
| Tax Expense | 15,25 |  |
| Net Income | 4,574 |  |
| \* AUD1 = CNY5 based on the current market data |

Exhibit 2

Surfsub Free Cash Flow (FCF) Forecast (as a stand-alone company)

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Year 1** | **Year 2** | **Year 3** | **Year 4** | **Year 5** |
| **FCF** | 3,898 | 4,043 | 4,180 | 4,276 | 4,349 |

The numbers are in thousands of AUD. After year 5, it is expected that the FCF will continue to grow at 1.2% per annum.