

**Role Play**

**Surfsub:**

Role of Ruiyan

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You are Ruiyan Peng, the Head of Public Relations (PR) 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. In the past year, BojinWaves has acquired 3 companies in the following areas: beachwear, swimsuits and underwater gear.

As head of PR, it is your responsibility to ensure that BojinWaves’s brand image is well maintained so that it can continue growing in the industry. In particular, you believe that instilling good governance policies and sustainable business practices in multinational companies (MNCs) is a crucial step to ensuring that corporations are driving capitalism as a force for good. Too many conglomerates make rash and ill-advised decisions regarding workplace practices, wages and the environment in the blind pursuit for profit instead of societal welfare. Ever since you joined the firm 8 years ago, you have played an important role in guiding BojinWaves to make well informed decisions based on holistic assessment rather than simply based on what looked best for the bottom line. Your insights and decisions regarding BojinWaves’s corporate social responsibility (CSR) has led the company to great success and fostered trust among your consumers. You believe that PR is the main driver of success for any company. BojinWaves’s superior brand image has led to many new corporate clients approaching your company for collaborations and joint ventures, thanks to your hard work over the past 8 years.

Last year, you were promoted to become the Head of Public Relations, managing 5 brands that BojinWaves had acquired. While this was a major milestone of your career that you gladly accepted, there have been several challenges along the way. Over the past year, BojinWaves faced severe allegations of worker exploitation and breaches of environmental standards from non-profit and non-governmental organizations. After putting out these fires and releasing press statements reaffirming BojinWaves’s commitment to Environmental, Social and Governance (ESG) business practices, you set out to spearhead an internal campaign aligning corporate functions and business units to this vision of social good. You have made some good progress – during an important quarterly review meeting, you managed to convince BojinWaves management to make changes in the manufacturing assembly line amounting to CNY5 million to make manufacturing more environmentally sustainable as well as obtain the highly respected Green Label from the Chinese government. You also managed to negotiate a provision to further increase investment in environmentally sustainable manufacturing by another CNY15 million if BojinWaves acquires another eco-friendly company.

Despite all of these internal changes, you and your team had to face the heat from the media and answer for the recent scandals regarding environmental degradation and worker exploitation. Your performance appraisal with Chief Executive Officer (CEO) Kai Hao is in only six months, and you know that you need further achievements in this domain before then. You have been working overtime in the past few weeks to enhance the campaign and think of new, innovative ways to improve BojinWaves’s image. Imagine your thrill when Jiayi Zhang, the Head of Mergers and Acquisitions (M&A), unexpectedly announced at the latest management meeting that she intended to acquire Surfsub, drawing raised eyebrows and scepticism from everybody else except for you, who expressed strong support and volunteered to personally oversee the acquisition talks to ensure success.

Based in Queensland, Australia, Surfsub is a fast-growing 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 unique 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 an interesting 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 AUD18.7 million in revenue, an impressive number for a start-up in this industry.

When you learnt about Surfsub, you were impressed by Francine Barker’s unique mission to combine innovation and social responsibility, which had garnered nationwide success in Australia. You quickly saw the benefits of acquiring a company so renowned for their efforts in environmental sustainability. You could already envision the press release – “BojinWaves follows through on their pledge to sustainability by acquiring the fastest growing eco start-up in Asia Pacific.” Surely this would be the company’s saving grace. If acquisition negotiations went well, BojinWaves would finally be able to position itself as one of the most environmentally conscious corporations in Asia Pacific and capture market share from the growing segment of younger, eco-conscious consumers. Perhaps you could even feature Francine Barker as one of BojinWaves’s employees in Chinese articles and magazines post-acquisition, further improving BojinWaves’s image.

Despite the management’s scepticism, you expressed your strong support for Jiayi’s proposition, explaining the PR angle of this acquisition and even offered to join in the acquisition negotiations personally to ensure its success. Jiayi’s only response was a tart nod of the head. You know she has not been happy with your PR team, who has been badgering her team with the ESG campaign demands, but you are determined to make this negotiation work. If you can state that you personally contributed to the acquisition of Surfsub, it would reflect extremely well on you and your team during the performance evaluation. You will do whatever it takes to ensure that BojinWaves’s name is closely associated with Surfsub, even if it takes a little more out of the M&A budget. You are sure that the synergies between Surfsub and BojinWaves will create free cash flows in the coming years that will more than make up for the higher cost of acquisition.

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

1. **Ensure that the Surfsub acquisition goes forward**. You and your team desperately need a win on the PR front and being able to claim that you led this successful acquisition could do wonders for your career. It is your top priority to keep the Australian founders interested in selling to BojinWaves and ensure that they agree to the deal. Having BojinWaves’s name closely associated with Surfsub will bring many non-financial benefits that may not be immediately seen on the balance sheet but will reap big gains in the future. To this end, you explicitly quantified the synergies of the acquisition, as summarized in Exhibit 1. In addition, you revisited the latest financials of BojinWaves, with key information presented in Exhibit 2, hoping to bring the relevant information to Jiayi and to hint on the affordability of such an acquisition.
2. **Secure another CNY15 million in investments from BojinWaves for environmentally sustainable production.** You especially want the Surfsub acquisition to be a success because it will unlock even more investments into environmentally sustainable manufacturing. ***The only condition to unlock this money is to secure acquisitions of another green company like Surfsub***. This is a crucial step towards ensuring that BojinWaves goes green in the long run and becomes a more sustainable MNC.
3. **Manage relationships with your teammate and counterparts.** The role ofHead of Mergers and Acquisitions (M&A) is incredibly important at BojinWaves. To continue to push your agenda for eco-conscious acquisitions, it is important to maintain a good working relationship with Jiayi Zhang. Since it is likely that Francine and Sarah Barker will remain as leaders of the Surfsub division post acquisition, you also wish to build the most positive relationship with them that you can during this negotiation.

Prepare for your meeting with Jiayi, then move on to the team-on-team negotiation with the Australian cofounders of Surfsub, Francine Barker (CEO) and Sarah Barker (CFO).

Exhibit 1

Quantification of the Synergies

Sources of the synergies: The potential synergies for Surfsub will arise after acquiring it. They will mainly manifest through a more streamlined production process and faster expansions into Asian markets.

Short-run Effects: After the acquisition, the synergies will help boost Surfsub’s Free Cash Flows (FCFs) in the immediate five years by:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Year 1** | **Year 2** | **Year 3** | **Year 4** | **Year 5** |
| ***Changes* in FCF** | +585 | +606 | +627 | +641 | +652 |

where all numbers are in thousands of AUD.

Long-run impact: The synergies have long-run benefits. Specifically, from year 5 onwards, Surfsub’s annual FCFs are expected to grow at 1.8% per annum – a much higher rate than the stand-alone growth rate.

Risks involved: As the synergies mainly arise from manufacturing and expansion in the same “surfing industry,” the operation and business risks remain unchanged as what a stand-alone Surfsub faces. Consultations with experts in the industry suggests that such risks translate to a 9.3% cost of capital per annum for a typical pure-play company in surfing.

Exhibit 2

Overview of the Financials of BojinWaves

|  |
| --- |
| **BALANCE SHEET (latest fiscal year, CNY millions)** |
| Cash and Equivalent | 1,708 |  | Short-term Debt | 1,297 |  |
| Accounts Receivable | 2,502 |  | Accounts Payable | 1,439 |  |
| Inventories | 1,338 |  | Long-term Debt | 9,724 |  |
| PP&E | 34,335 |  | Equity Capital | 27,423 |  |
|  | 39,883 |  |  | 39,883 |  |
| **INCOME STATEMENT (latest fiscal year, CNY millions)** |
| Sales revenues | 5,410 |  |
| Cost of Goods Sold | 4,088 |  |
| Operating Expense | 934 |  |
| Operating Profit | 1,322 |  |
| Interest Expense (Profit) | 735 |  |
| Other Income Expense (Profit) | (506) |  |
| Pre-tax Income | 1,093 |  |
| Tax Expense | 273 |  |
| Net Income | 820 |  |

Highlights

* BojinWaves is a large conglomerate focusing on beachwear and apparel headquartered in Beijing, China. While maintaining its own brands, its recent growth and expansion are largely driven by mergers and acquisitions with domestic to international peers.
* Operation: Last year, a total revenue of CNY5.4 billion was booked, together with a record high profit margin of 28%. Moving fast with the eCommerce in China, an increasing fraction of the revenue is made from online sales from barely 1% ten years ago to 88% last year.
* Financing: BojinWaves has maintained a stable capital structure, with a (net-)debt-to-equity ratio of 1:3. Most of the debt is in the form of corporate bonds with a “Baa3” rating from Moody’s and an “BB+” from S&P. On average, these bonds yield 6.2% a year in the current market condition. The majority equity shares are held by Chinese mutual funds, hedge funds, and banks. For internal circulation, it is estimated that these institutional shareholders, on average, expect BojinWaves’s shares to deliver at 9.79% annually. Compared to other competing companies and related industries, overall, BojinWaves enjoys a relative low cost of capital.