

**Role Play**

**Surfsub:**

Role of Francine

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You are Francine Barker, CEO of Surfsub Surfboards Australia - a well-known indie surfboard brand that designs and manufactures eco-friendly and innovative surfboards in Queensland, Australia. Surfsub was born 7 years ago out of your passion for surfing and the ocean. When you realised the damaging impact of pollution and global warming on the world’s oceans, you made it your mission to find a solution by creating sustainable and environmentally friendly surfboards (Eco-Boards) that would not release toxic dyes and microplastics into our oceans. You spent many hours developing ergonomic design and carefully selecting organic, non-toxic materials that were biodegradable and durable. You were inspired by ancient Polynesian cultures, who used locally grown, non-toxic materials to create durable boards that could be easily repaired if broken. You also ensured that your Eco-Boards were subject to the highest and most rigorous standards of environmental quality.

Surfsub’s unique mission quickly caught the attention of Australian surfers and went viral on Australian social media, leading the company to nationwide success. Australian consumers greatly resonated with Surfsub’s passion for surfing and its mission to save the environment, as depicted on its online social media accounts through an interesting mixture of eclectic surfboard designs and infographics designed to raise awareness about oceanic pollution. The core of Surfsub’s nationwide success stems from its passion to save the oceans from plastic pollution as well as your commitment to innovative, high quality, and durable surfboards.

Surfsub is a company that you built from the ground up, incubating it from the start and assiduously growing it steadily over the years; it is your baby. It took a tremendous amount of effort and dedication for a small start-up to break into the surfboard market and target a niche market of premium, eco-conscious surfers. In the Australian market so saturated with huge multinational companies (MNCs) that manufacture surfboards through economies of scale, it was truly a remarkable feat to make a dent in the industry. This was only possible due to your hard work, commitment and in-depth involvement in the company. You live and breathe surfboards and could talk about the topic for hours and hours. Surfing, the ocean, and surfboards are your biggest passions in life.

Although you are the CEO of the company, you have always turned to your older sister Sarah Barker for business advice. Having graduated with an MBA from INSEAD, Sarah possesses a sharp sense of business acumen and has performed exceptionally in her role as CFO, guiding you to nationwide success over recent years. Among others, it is her effort that helped the rounds after rounds of financing during the past years’ growth and expansion. Fairly recently, Sarah also managed to tear down the burdening terms from the initial seed funding and venture capitals. A full-equity Surfsub is the result, you and Sarah being the largest equity holders, equally splitting the controlling shares.

While you are grateful to your sister for her financial insights, you have always felt that she did not quite share the same level of passion for sustainable surfboards as you. Nonetheless, what began as two sisters working in their garage has now transformed into a leading premium brand in the market for environmentally conscious surfers, raking in AUD$18.7 million in revenue over the past financial year. Spurred on by the incredible growth you’ve seen in Australia, you are excited to see what global expansion has in store. The first priority is to penetrate the Asia Pacific region.

BojinWaves, a Beijing-based conglomerate, has expressed interest in buying Surfsub. BojinWaves is a beachwear and apparel company with a strong record for inorganic growth through acquisition of companies showing strong growth potential. In the past year, they acquired 3 companies in the following areas: beachwear, swimsuits and underwater gear. It seems logical now that they would want to acquire a surfing company, and it would be reasonable to expect potential synergies. When they first reached out to the both of you, Sarah was practically over the moon and very excited about the prospect of catching the attention of such a huge Chinese conglomerate. You, on the other hand, are more ambivalent. While it is true that the synergies will increase both the free cash flows and the growth rate of the company in the coming years, you have some major concerns and reservations about BojinWaves acquiring Surfsub.

Firstly, large multinational corporations (MNCs) with global supply chains have some of the worst track records when it comes to environmental impact. Most conglomerates have little to no transparency about their supply chains and are notorious for causing serious environmental degradation through pollution. Over the years, BojinWaves has been found guilty of various environmental breaches, such as toxic dyes and microplastics contaminating waterways as well as poisonous chemical spills. Secondly, it is common knowledge that MNCs like BojinWaves exploit global supply chains to minimise cost, looking to the lowest cost countries to make investment and sourcing decisions, especially when production processes do not require highly skilled labour.

You are reluctant for your brand, a brand that you painstakingly developed over the past seven years, to be associated with such a company unless they take major steps towards going green. Although BojinWaves have paid fines and made pledges to do better in the future, any association with past and future scandals BojinWaves may face regarding worker exploitation and environmental degradation could hurt your brand image. While you are aware that BojinWaves is optimising its production lines to become more eco-friendly, you want to ensure that BojinWaves invests an additional AUD$2 million in the next year to get the Green Label certification from the Chinese government if you are to agree to this acquisition.

You also have many questions about the mechanics of being acquired by an MNC like BojinWaves. What happens to the company culture of Surfsub? Would the new Chinese owners be willing and able to manufacture high quality and innovative surfboards sourced from sustainable and organic materials in the same way your company has been doing? The last thing you would want is for the quality and durability of the surfboards to decline after the acquisition, or worse, for the dyes to start running off into the seawater after a couple of years. You believe in lifelong durability, as that is a core tenet of honouring ancient Polynesian traditions in addition to ensuring sustainability. It is extremely important for you to ensure that Eco-Boards continue to set the highest standards for sustainability in this industry. You are wary of BojinWaves and prefer to proceed with caution as you are unsure of BojinWaves’s motivation and intentions with regard to Surfsub. You are determined to make sure that you and Sarah remain involved in the Surfsub business and expect to continue working as the joint Heads of the Surfsub Division after the acquisition.

At the same time, you are aware that having a big conglomerate seeking to help you break into Asian markets is an enviable position to be in. You know it is not easy to try penetrating Asian markets alone as a single corporate entity and it would definitely be easier to have a partner or guiding force to help you break into the Asian market. BojinWaves’s expertise in manufacturing and operations would also give you access to greater production efficiencies, saving costs in the long run. You can already hear Sarah’s voice in your head and know that she would point out all the financial benefits of this acquisition.

As you enter the negotiation, these are the issues at the forefront of your mind:

1. **Making sure that Surfsub retains its green values.** Your top priority is to ensure the rigorous environmental standards that Eco-Boards are known for. One way to ensure this is by remaining a strong contributor to the business. You therefore aim for you and Sarah to continue to lead the Surfsub Division after the acquisition.
2. **Concrete steps from BojinWaves to go green.**You expect BojinWaves to invest at least AUD$2 million in the coming year to get Green Label certification, ideally more. You know that this will increase costs for them but are willing to accept a lower overall price for Surfsub, and perhaps even reduced future involvement and decision power, if you can obtain their commitment to the Green Label certification.
3. **Expanding Surfsub’s reach.** So long as you can maintain Surfsub’s core identity and values as an eco-conscious firm, you would love to expand globally, starting by penetrating the Asia Pacific region. A partnership with BojinWaves would be a straightforward way to achieve this.
4. **Maintain a positive relationship with your sister.** Sarah is one of the closest and most important people in your life. Thus you hope to finish this negotiation with a relationship with your sister at least as good, if not stronger, than before. You also hope to build good relationships with the BojinWaves negotiators since you will be partners and colleagues after the acquisition.
5. **Obtain a fair price for Surfsub.** Although money has never been your main motivator**,** in the event you sell your beloved company to BojinWaves, you would of course want to receive a fair price after the years of work you have invested. For this purpose, you hired a reputable consulting company to obtain an overview of the financials of Surfsub as well as a forecast of its operations. These numbers are summarized in Exhibit 1 and 2.

Prepare for your meeting with Sarah (CFO), then move on to the team-on-team negotiation with the BojinWaves representatives, Jiayi Zhang (M&A) and Ruiyan Peng (PR).

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 |  |

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.