OLIVER WYMAN

# FIVE IDEAS FOR PRIVATE EQUITY IN ASIA

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Dear Private Equity Client,

In 2020, we are launching a set of ideas tailored to private equity clients – ideas on interesting sectors, investment themes, and value-creation opportunities. This first issue looks at five themes suggested by our partners: social listening techniques, the rise of populist banking, taking retail brands into China, telecom infrastructure, and the diversification of financial services companies.

The COVID-19 outbreak and its economic consequences mean that near-term investor focus is on preserving the value of portfolio companies — protecting their revenue and cash-flow, while identifying ways to make them more resilient.

However, the crisis will create opportunities for investors to partner with quality businesses and support the economic recovery. We hope that these ideas are interesting, that they provide you with food for thought, and that they prove helpful.

All the best,

**Ben Clemens Balzer**
Partner, Head of Corporate Finance & Advisory in Asia-Pacific

# SOCIAL LISTENING

## The revolution in understanding what your customers really want

Companies have traditionally relied upon consumer surveys, focus groups, and research reports to figure out what people think of their products or services. But these approaches have several shortfalls. Sample sizes are limited and subject to bias. The studies take time to organize, and the results quickly become dated. Moreover, what people say often differs from what they do, as when they complain about discount airlines but then use them all the same.

Social listening provides an alternative: It enables companies to tap into much richer consumer insights that are generated in real time. Until now, social listening has mostly been limited to public-opinion monitoring. For example, it is used to count the number of times a brand is mentioned – "buzz" – and whether the content is positive or negative – "sentiment". But this monitoring tends to yield only standardized or aggregated metrics, which seldom lead to actionable business decisions. Recently, advances in machine learning have made smart analysis of natural-language content possible, as well as the monitoring of pictures and videos. The new techniques have been very effective in enabling companies to investigate a wider range of consumers' feelings and follow different aspects of their lives. We have seen how their preferences can be mapped and updated immediately, as can the ways in which customers connect with and influence each other.

Machine learning can also overcome the problem of "unclean" data. Companies often buy social media data from a vendor, but many of the source posts do not actually come from consumers; instead, they have been written by the brand's marketing agency, e-commerce sellers, or robots. We discovered one case in which more than nine out of 10 posts provided by a data vendor had not actually been written by consumers. Such posts are typically overly positive and give a false impression of a brand's health. Machine learning can analyze social-media accounts and their content in order to filter out such fake posts.

We are only beginning to scratch the surface of these advances' potential to rewrite the rules for consumer product companies. Already, social listening is overturning development, marketing, and packaging. One manufacturer doubled its rate of hit products from one in 10 to one in five thanks to better consumer information, halving the cost of developing also-ran products. Various use cases will often be combined. A retail bank launching a greenfield digital unit, for instance, can first use social listening to identify and quantify customer pain points, segment potential customers, and inform product design. After launch, influencers can be sought out and targeted, and the brand perception tracked, in order to optimize products and services continuously.

Social listening techniques have been around for over 10 years, but very few companies are making the most of them. The main barrier has been the quality of data, which are usually too aggregated to provide significant insight into consumers, or else are based on social postings that include large numbers of fakes. Moreover, obtaining clean data that inform business decisions is not easy. It can require natural language recognition in different languages and advanced techniques to analyze social media accounts and their contents automatically and effectively. Soon however, these techniques will be common in consumer-facing industries, and those companies that neglect them will find it hard to catch up. By contrast, product manufacturers that learn how to understand consumers in actionable ways — and to test consumers' reactions in real time — will have a huge advantage.

# POPULIST BANKING

## New technology to facilitate financial inclusion

Around 70 percent of individuals in Southeast Asia are thought to be either unbanked or underbanked. That means more than 400 million potential new customers — not including small and medium enterprises — if financial services can be provided in more-cost-efficient ways. Monetary authorities are currently awarding new licenses to banks with innovative plans to increase financial inclusion, so the companies (traditional banks and others) that crack this segment first could benefit greatly.

New technologies, such as open-source and cloud computing solutions, can enable virtual banks that provide financial services at a fraction of the cost of traditional banks. One fintech client of Oliver Wyman has been able to reduce the cost of maintaining a bank account to just $1.4 USD per year. That covers virtual banking services, cost-effective savings and payments facilities, and the provision of dynamic, flexible microloans to both individual and SME customers. Fifty-five percent of the firm's employees are technology employees.

Providing financial services such as loans to less-well-off individuals sounds risky: Their lack of economic means suggests a high likelihood of default. But this may not be the case. In the 2008 movie "Yes Man," Jim Carey plays a loans officer who simply approves every loan that comes across his desk. Most of the borrowers, once given the dignity of financial inclusion, then actually serviced their loans correctly. That was a comedy film, but one pre-mentioned Oliver Wyman fintech client has a non-performing loan rate of just 0.5 percent. This makes total sense given the human and social context. People who have previously been excluded from the financial system enjoy the dignity of inclusion once they can join in — which includes the dignity of repaying their loans and utilizing financial services. Dignity and respect are culturally important in Southeast Asia, so previously-excluded customers are actually a low-risk segment.

The commoditization of banking and financial services could unlock enormous potential. If this is done by non-traditional brands, they could create a form of "populist banking." Underserved individuals would resist or abandon traditional institutions that have historically ignored them, even if these institutions set up their own virtual presence to serve lower-income customers. Populist politics has risen in recent years in many countries, as the wealth gap continues to widen. Since banking and financial services are intrinsically linked to quality of life, opportunity and growth, this is a sign that the time is ripe for virtual banks to deliver a populist-banking revolution.

# A CHINA STORY

## Clear strategies for an increasingly competitive market

*This article was written before the COVID-19 crisis. We believe that this article and its conclusions will continue to be valid during but especially after this crisis.*

With a population of 1.4 billion and GDP growth rates over 6 percent for the last 30 years or so, China is the fastest-growing major economy and will be the world's largest by 2030. It continues to show huge potential in all sectors, including retail and consumer. One way to partake in this growth is to invest in Chinese companies, but acquisition targets will remain high in demand and high in valuations. An alternative is to take an overseas brand into China.

To have a positive impact on a company's valuations, an opportunity in China needs to be sizeable relative to the current size of its business. The brands best suited for such a move are those with a strong presence in their home market that still have limited international exposure. It is far harder now to launch an international brand in China than it was five or 10 years ago. In the past, a well-known brand name from Australia, for example, would be enough for success. Now, while international companies still have a branding advantage over local players in some categories, competition has become more intense. Many international brands are already present, and domestic brands are gaining in popularity, even in some trust-heavy categories. Infant milk formula, for example, was dominated by international brands after the 2008 melamine scandal, but local brands such as Fei He are now rapidly gaining share.

To avoid becoming one of the many international brands with a China presence that has little impact, companies need a distinctive strategy. If executed well, a strong, differentiated proposition channeled through China's unique online and offline ecosystem can still achieve growth in a short timeframe. Consumers demand and expect constant innovation, and retail got a significant boost in 2017 with new local formats such as Hema and the rapid expansion of others including Miss Fresh, Hey Tea and Miniso. A new international brand needs to offer something fresh, whether this be high quality at a reasonable price or a unique style, experience, product, or marketing approach. Above all, the offering needs to be localized: Too many international brands have failed and left China because they didn't adapt their propositions or products to the needs of Chinese consumers.

Lastly, for a company's Chinese business to have a real impact on its valuation, the commitment needs to go beyond strategizing on paper. Execution, planning and governance all need to be well thought out and tightly controlled. There are many examples of brands that wanted a China growth story with minimal investment of time, so they just outsourced their business to a local partner. But the local partners did not always act in the brands' best interests, and many partnerships were discontinued and stores closed.

If a brand fails once in China and then has to start over again, it confuses consumers and damages its image. It is better to invest more time upfront in well-planned execution. Brands should decide what they want to represent in China and what makes them unique.

# NEUTRAL HOST INFRASTRUCTURE

## Getting ahead of the wave of 5G opportunity

Global mobile-data traffic is expected to quadruple over the next five years,[1] as high-speed 5G connectivity fuels relentless demand for data. Serving this will require significant infrastructure buildup, including small cells, fiber, towers, and data centers. The economics of the infrastructure rollout could be made more attractive by neutral host infrastructure players. These provide shared small cells – either shared antennae or just colocation; wholesale fiber — from dark fiber to bitstream; shared macro-towers — for both passive and active equipment; and large-scale data centers — to support cloudification and the use of large quantities of data.

It is not new for private equity firms to invest in neutral host-infrastructure providers. However, globally, and in some key Asian and Pacific markets, a trifecta is emerging that should open doors for private equity investment:

1. **Telecom operators are facing capital challenges.** Price wars in multiple markets have eroded operators' EBITDA by up to 25 percent in the last 12 months, degrading their cash balances.
2. **A significant wave of zero-ROI capital expenditure will be required soon.** It will cost two or three times as much to cover an area with a 5G network as with a 4G network,[2] and the return on investment (ROI) will often be unclear.
3. **Neutral host infrastructure providers are valued higher than telecom operators.** Valuation multiples of infrastructure providers have historically been higher than those of telcos — in the range of 1.8 to 1.9 times. This is primarily because infrastructure providers have fundamentally different business economics, including more-stable cash flow and longer-term contracts with tenants.

In response, telecom operators are spinning off or selling infrastructure assets to unlock funds for their core telecom businesses. This also leads to shared infrastructure deployment and operations, which is more cost-effective in the context of the upcoming expansion of 5G networks. As a result, some incumbent telecom operators are starting to end their closed-door policy towards neutral infrastructure providers.

In some countries that can sustain only one network from an ROI perspective, there will be 'land grabs' for the highest-value areas, prioritized by 'street-level economics'. The winners will be those that set up capabilities early to be the first to deploy the network. (This was the thinking behind Verizon's program to roll out 1,400 route miles of fiber per month to enable 5G mmWave deployment.)

However, the opportunity will vary by market. In markets with high fiber-to-the-home (FTTH) coverage, the opportunity for neutral host infrastructure operators will be to broker shared 5G deployment using the sub-6 GHz spectrum on shared macro-towers. (The sub-6 GHz spectrum

1 Source: Ericsson Mobility Report November 2019

2 Source: [DBS Research]

enables wider coverage at lower speeds than mmWave, which refers to the frequency spectrum above 24 GHz.) In markets with low FTTH coverage, the larger opportunity for neutral host infrastructure operators is to fund consortiums to build out small cells and fiber infrastructure that disrupt and potentially replace existing fixed networks. (These cells could be either below 6 GHz or mmWave, depending on the specific market economics.)

The race to dominate future neutral-host infrastructure markets in the Asia-Pacific region is on, and the winners have yet to be decided in many countries. That said, peak valuations are expected to occur in the next few years, as 5G matures, and we anticipate significant valuation differences between first movers and those that come late.

# PRODUCT DIVERSIFICATION

## How traditional financial services players can evolve and thrive

“Super apps” such as Grab and Go-Jek have risen in Southeast Asia, and we can expect some of these to dominate their markets over the next couple of years. The apps use a flywheel approach, starting with a core business proposition and expanding into ancillary and complementary services, both financial and non-financial.

Players in traditional financial services — or any other industry for that matter — can learn from this flywheel approach, by expanding products and services to meet customer needs, deepen their customer relationships, and generate additional value.

One stark contrast to the unicorn apps is the traditional players’ relatively small safety net and limited resources. Without hundreds of millions of dollars to test and experiment with, they need to pick carefully which complementary products or services to offer. It’s not as simple as just plugging in other products and hoping customers will adopt them. Instead, critical success factors include clearly understanding what customers need, what needs are not being met today, and how customers like to be interacted with. Getting these right leads to a clear strategy for products, engagement and partnerships.

Consumer finance, for example, can benefit greatly from product expansion and cross-selling, as growth in its core business — lending — is often capped to prevent the growing lower middle class becoming over-burdened by debt. A typical synergistic product is insurance, but standard insurance products were never designed for mass-market or lower-income customers. Premiums are often high and non-flexible; the claims systems are complicated; and much of the coverage offered is not relevant. So they just don’t appeal to typical consumer-finance customers.

The first, critical step is to truly understand what protection products these customers might want. A consumer-finance firm can then work with insurance partners and regulators to come up with products that might meet customers’ needs. They can then design a suitable customer journey to deliver the products at the point of need.

Consumer finance firms can also consider new ways to bundle insurance products with loans at points of sale. They have a treasure trove of data on customers that can help predict both their insurance needs and their propensity to purchase. In the short term, they can score easy wins by bundling, say, insurance for a motorbike along with a loan to buy one; or mobile device protection with a loan for consumer durables. For future growth, they should use propensity models or more-advanced analytics to predict demand for products and the best form of interaction.

Finally, consumer finance firms should figure out how best to work with the external partners they will need to augment their products and services. They will have to navigate tricky areas, such as customer ownership and value sharing outside revenue, and they will have less control over underwriting and product features. Insurance partnerships are relatively easy, as agency and bancassurance models provide some precedent, but other product partnerships could be tougher.

As a general approach, traditional financial services providers should build on their current positions, start diversifying their products and services, and aim to get ahead of the curve. Those that don't will slowly but surely become less relevant, as virtual banks and digital platforms encroach on their territory. The combination of consumer finance and insurance is just one example. Other forms of synergies, too, will be able to generate value from the foundations of a core business.

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