

THE TRANSFORMATION OF CHINA

While China is on an accelerated path to become a consumer oriented market international companies face ever growing managerial challenges trying to keep up. Over two decades of attracting massive foreign investment and the creation of fast technology transfer mechanisms made China the world's main manufacturing base. 2011 and the new 12th five year plan shifted the focus of the Chinese policy makers to the strengthening of China's dynamic new homegrown companies both home and abroad. Domestic Private Enterprises (DPE) as they are called here contributed over 60% of the Chinese GDP in 2010. This is in striking contrast to 38% they contributed back in 2005. Adding to this the fact that the Chinese GDP is expected to quadruple itself (2007-2025) helps to draw a general perspective of the business threats and challenges facing Western companies in China as well as in home markets in the next few years.

The financial crisis since 2008 from one side, and the fast growing Chinese consumer market as well as the abundant wealth available for investment in China today, amplify even more the growing need to penetrate and operate in Chinese markets.

Turnaround & Transformation Triggers

China is well known for being a challenging management environment for foreign companies. There are many cultural and structural market reasons that create those unique difficulties. As the new year of the dragon begins it will be interesting to focus on two recent trends affecting manufacturing small and medium sized enterprises (SME). These are both good reasons for many European based companies to reconsider their approach towards opening a new operation in China; globalisation of supply chains and the increased threat of competition by Chinese DPE in China and within a few short years in Europe's own backyard.

With a growing number of global companies actively increasing their operations in Asia, demand on their approved suppliers to be able to provide them with closer support in the region, is also growing. Since many of them already have large operations in China, more and more SME's in Europe get asked if they are intending to extend their operation there. "You will only be able to participate in our Asia bid for 2012 if you have a second manufacturing base in Asia". Is what Peter Gallagher former CEO of the UK based LycoRed Europe Ltd heard from one of his key global customers in 2010." This started an 18 month process designed to transform LycoRed Europe Ltd from a single manufacturing based provider of nutritional blends predominantly in the UK and Western Europe, into a global provider through the construction of a new state of the art and much enlarged manufacturing facility in Changzhou, China.

The need to manage such a demanding process in a relatively short time presented a significant managerial challenge given that it was on the other side of the world. It also presented a unique opportunity for an experienced local professional Turnaround & Transformation management firm. LycoRed approached us back in 2010 and became our first UK customer.

Typically foreign companies penetrating Chinese markets are very aware of their global competitors, the Chinese local players are an enigma. In many cases the local potential competitors are operating on a significantly lower level (technology wise). This technological gap is closing rapidly and to the great surprise of many western companies as the gap narrows the natural local Chinese company's advantages such as low prices, aggressive payment terms, strong sales capabilities, government relations, local presence and size are becoming very hard to beat. Leaning on technology alone doesn't cut it anymore, you have to offer your clients the whole marketing mix and every "P" is just as important. Typical turnaround

situations in China involving subsidiaries of western companies tend to start with a background of such loss of competitiveness and a significant drop in sales. Though many well-known checks and balances or simple operational best practices are far from being in place in such cases the owners tend to be reluctant to intervene before their companies are facing alarming losses. This is probably a similar phenomenon of our business anywhere and why it is more comfortable to sell our professional services during sharp turns in the market, downsizing or upsizing operations within a limited time frame. This opportunity is exactly what is happening these days in the Chinese market for many potential SME customers and they do need professional support.

With two feet on the ground

The secret weapon of the Chinese economy has always been its flexible attitude towards IP ownership and other rigid legal concepts. This helped technology and relevant business know-how to transfer fast into the hungry mainland helping capable individuals to dominate the business arena rather than well established companies. We seem to forget that companies like Huawei or Heier, well-known global Chinese brands today controlling near 20% of the global market in their respective segments barely existed only 20 years ago. Their culture is highly dynamic, entrepreneurial and very much into risk-taking. Personal relations oriented sales are still the dominant concept here while brand loyalty is a novelty in most B2B Chinese markets. This results a business culture that is based on individual talents and a web of personal relationships with a unique character. Normal evaluation methods for companies miss that. I have seen over and over again financial and legal auditors pointing at regulatory or financial risks of local entities, what you seldom see is an auditing method that floats up the value of the hidden talents working in a company and the risk involved in losing them. Even more difficult is to forecast the business



by Zvi Shalgo

opportunities certain individuals could add to a company. The value of a sales pipeline in China (one example of many) is strictly affiliated with the individuals behind it. One totally normal Chinese salesperson's practice is to giveaway potential transactions to the competition if a high enough commission was offered in return. In times of uncertainty or crisis companies tend to loose sales fast and in many cases their sales persons are still in very good control of "their customers" just channeling the sales elsewhere. This is just one example why stability and vision forward are so important to maintain at any turnaround situation. These very personal agendas exist in many functions of every Chinese enterprise they are only one characteristic of the complexity of projects here.

Many other factors contribute to the difficulty in evaluating or transforming a business in China; frequent regulatory changes, quick social changes, strong government involvement in the markets, intense aggressive competition and more. This all helps to understand the critical need for the development of operational audit methodologies. One cannot underestimate the importance of robust operational management capabilities, which are critical for survival in the Chinese market.

A new methodology

In the normal turnaround scenario a customer will hire an interim specialist to cover the operational change process while other professional consulting firms will do the financial and legal restructuring. In China the efficiency of a single manager dropped into a crisis zone is severely reduced by several subjective factors: a) language barriers, b) business culture, c) conflicting agendas by existing local managers, d) limited China experience in HQ. The pace of change processes is much slower than optimal, transparency is simply against the local culture and so is direct criticism (never mind how constructive or just). Under these realities making a timely transformation, gaining the upper hand on those who oppose change is directly related to how independent and professional the turnaround specialist can be.

Since gaining professional know-how and independent decision-making capabilities is so critical to the success of a project the best way to accelerate it to an agreeable speed and transparency level is to add a management support team around the turnaround specialist. These managers should all be local professionals with deep up-to-date understanding of how the customer's managers should be conducting their business. This fortified task force can function as an operational audit team; it can focus on coaching local managers to do better and in extreme situations it can replace failing managers on the spot. Typically in this operation mode the turnaround specialist will be a generalist functioning as a project manager and responsible to communicate efficiently with the customer HQ. In order to make the turnaround cost reasonable to SME the support team cannot be retained for the duration of the project, in fact they are very active in specific critical periods [initial operational audit, drilldown in specific weak links, hard negotiations in the first few weeks] and most of the time function as mentors of the turnaround specialist and as a fast intervention team. The fact that the customer's staffs are

aware of their existence and their managers are all under close supervision makes a big difference in the acceptance of the change processes required. A chance to test this style of operation presented itself early 2009 with a Dutch turnaround project we conducted. This manufacturing and sales operation in China was nearly losing its market and at the same time had a major managerial break of confidence with its own Dutch BOD. The urgency was so great that an operational audit was set in place within a week and a summary of the findings was presented two weeks later. This resulted a BOD decision to sack a foreign GM and transfer the whole company to our care for 6-7 months. Our mandate included getting in control of the budget, restructuring all the company departments and management structure and securing the financial position of the company within the first three months. We chose to hire a Dutch turnaround specialist who had limited experience in China as the project manager; the customer vetted and approved our choice before he flew to China to take the position. In the meantime our professionals in HR, Finance, Logistics, Operations and general management were all analysing the customer's current state of affairs focusing mainly on creating clear job descriptions to all the employees, assessing their abilities, renegotiating urgent debts and service contracts and preparing the ground for the new project manager's arrival. The success of this methodology was very clear from the start. After the Dutch project manager took control of the company, except a full time HR consultant and one controller all our supporting managers reduced their involvement to specific cases where they were needed. Later on the customer's CFO (a Dutch national) was also dismissed and the top financial control was transferred to our CFO for the duration of the project. This was the first project we managed in this way and it actually started our company's awareness to the concept of offering turnaround management as a service. We did this for many years

without being aware that it is a profession by itself. This project was awarded only recently the 2011 SME turnaround project award by the ATTA (Asia Turnaround & Transformation Association). We kept fine-tuning this concept and I believe there is a great value in this methodology specifically for SMEs for the future.

Just around the corner

Just as I believe Transformation specialists can be the natural support group for European companies in their expansion east and especially when being aided by local managers in the way I mentioned above, there is a huge wave of Chinese firms who are expected to penetrate European markets in the coming decade. Chinese Government planners aim to support the leading 50 large companies in china to go global and this is very likely to happen in the coming few years. An interesting twist in the LycoRed story I mentioned before happened during 2010, Chem-China a giant state owned manufacturer purchased 60% of Makhteshim Agan the Israeli agrochemical group that fully owns LycoRed the parent company of LycoRed Europe. Chem China is currently building a PMI team headed by an Israeli China veteran G.M. to facilitate the restructuring of the group.

Looking at such mergers in the years to come it will be right to ask who will be the perfect managers for those future Transformation processes. My best guess is that only specialists with significant mileage in both markets (Chinese and European) and with deep understanding of both business climates will be up for the task. An even more teasing question would be how one will get such jobs in the first place and my answer to that is clear, one should be as active as possible in the Chinese market and build a business network that in time will deliver such opportunities. The recent cooperation between IFT and ATTA is a positive sign that such networking channels do exist and the need is already there.

CPD Workshop

Specifics of Management & Turnaround in China
Wednesday 7th March 17.30;
one-to-one sessions on the 8th

Speaker: Zvi Shalgo,
Owner & CEO of PTL Group

Workshop will cover the following topics:

- **Realities of China market and where it is heading. Current situation and trends for industrial markets.**
- **Management environment in China. Analysis of the weaknesses of management system in China. Main challenges of running business in China.**
- **Turnaround process in China. Threats and barriers. Role of government. Differences from turnaround in Europe.**
- **Case study: Operational audit and turnaround of European manufacturer in China.**
- **Marketing turnaround services in China. Challenges and solutions.**

About the speaker:

Zvi Shalgo is a dynamic entrepreneur with extensive business development and general management experience. Over 20 years of top management positions in industrial and trading companies. For the last 17 years Zvi has lived and worked in China.

Accomplishments include: developing and deploying a reform plan in a J.V. with the Chinese Government as General Manager of edible oil refineries (96-97, Liaoning Province with the UDI Group of Companies), deploying the takeover of a Chinese Company and transforming it to a wholly owned foreign enterprise as its first foreign General Manager (97-2000, Kunshan-Jiangsu Province with Frutarom Industries).

Since Year 2000 Zvi has invested in several companies in Hong Kong and China forming what later became PTL Group where he serves as the chairman and CEO.

About PTL Group:

PTL Group supports international companies to manage their business in China. PTL Group provides management solutions and ready-made infrastructure for companies in different stages of penetration in China from setting up local sales and distribution, building factories and production lines to restructuring and turning around underachieving operations. Over the last 10 years PTL Group has managed the Chinese operations of more than 30 industrial companies from Europe and the Middle East.

PTL Group received Turnaround of 2011 award from Asia Transformation and Turnaround Association (ATTA).



For more information about PTL Group visit www.ptl-group.com

Swift PEOPLE

IFT Fellow

Tony Henfrey

is a keen military historian and during November had the opportunity to walk in the footsteps of General Gordon and Lord Kitchener in northern Sudan. However he had been advised beforehand not to follow too closely since Gordon had been beheaded and Kitchener had disappeared at sea without trace.

During the expedition Tony went to the now rarely-visited and completely unchanged site of the battle of Abu Klea which was fought in January 1885 by a British army column trying to relieve Gordon. At the height of the battle 1000 dervishes had skilfully managed to penetrate to the heart of the British "square" and had brought the entire column to the brink of total disaster. Described in the words of the famous poem by Sir Henry Newbolt "the Gatling's jammed and the colonel dead" this was a critical turnaround situation.

Disciplined and cool under fire like true turnaround professionals the British army regulars eventually managed to retrieve this catastrophic situation although the column eventually reached Khartoum too late to save Gordon.

This successful turnaround is surely worthy of a posthumous IFT Turnaround Award!!

Tony is seen here on the perimeter of the Abu Klea base camp occupied in January 1885 by a company of the Sussex Regiment.



Manfield Partners Acquires Mitsui's European Packaged Food Businesses

Manfield Partners, the investment and advisory firm, has acquired two packaged food businesses, MCM Select Foods Limited in the UK and MCM Foods BV in the Netherlands, from Mitsui & Co Ltd of Japan.

Partner in Manfield and IFT Fellow (a previously, long-serving director) **Bill Gore** explained, "The two businesses import, distribute and market a mixture of exclusive brands and own label foods for retailers and food service companies. The product range comprises a selection of foods but primarily canned fish (tuna, salmon etc) and fruit. The combined business is expected to generate revenues of circa £75m in the year to March 2012 with profits in excess of £1m.



"Manfield was attracted to the two businesses by the strong customer and supplier relationships the businesses have built in a stable sector and believes there is a significant opportunity to grow the businesses into more branded higher value areas. The firm will use the operational and financial skills that it has deployed on other FMCG businesses, most recently the acquisition of Waverley TBS from Heineken. Initial implementations will include Manfield seeking to improve the key functions within the business including procurement, supply chain and sales and marketing. This deal represents another major success for Manfield Partners, highlighting its expertise in successfully transitioning companies from large corporate firms to stand alone businesses. Manfield will bring in relevant operational expertise to assist the current management team in taking the business forward.

"This is another landmark deal for Manfield. Following our recent acquisition of Waverley TBS from Heineken we have demonstrated once again that we can work with large corporates to acquire non-core businesses through a professionally managed process. Such businesses often need assistance in the transition to independent existence and we look forward to working alongside the current management team, as co-shareholders, to build on existing strong foundations."

David Arrow, CEO of MCM Select Foods UK, says: "This transaction represents a great opportunity for MCM and its employees. The business has developed well over the past 18 months and under Manfield ownership we have the ability and commitment to develop and grow further. I look forward to working with the Manfield team to take the business to the next stage of development and to achieving the potential that undoubtedly