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Results

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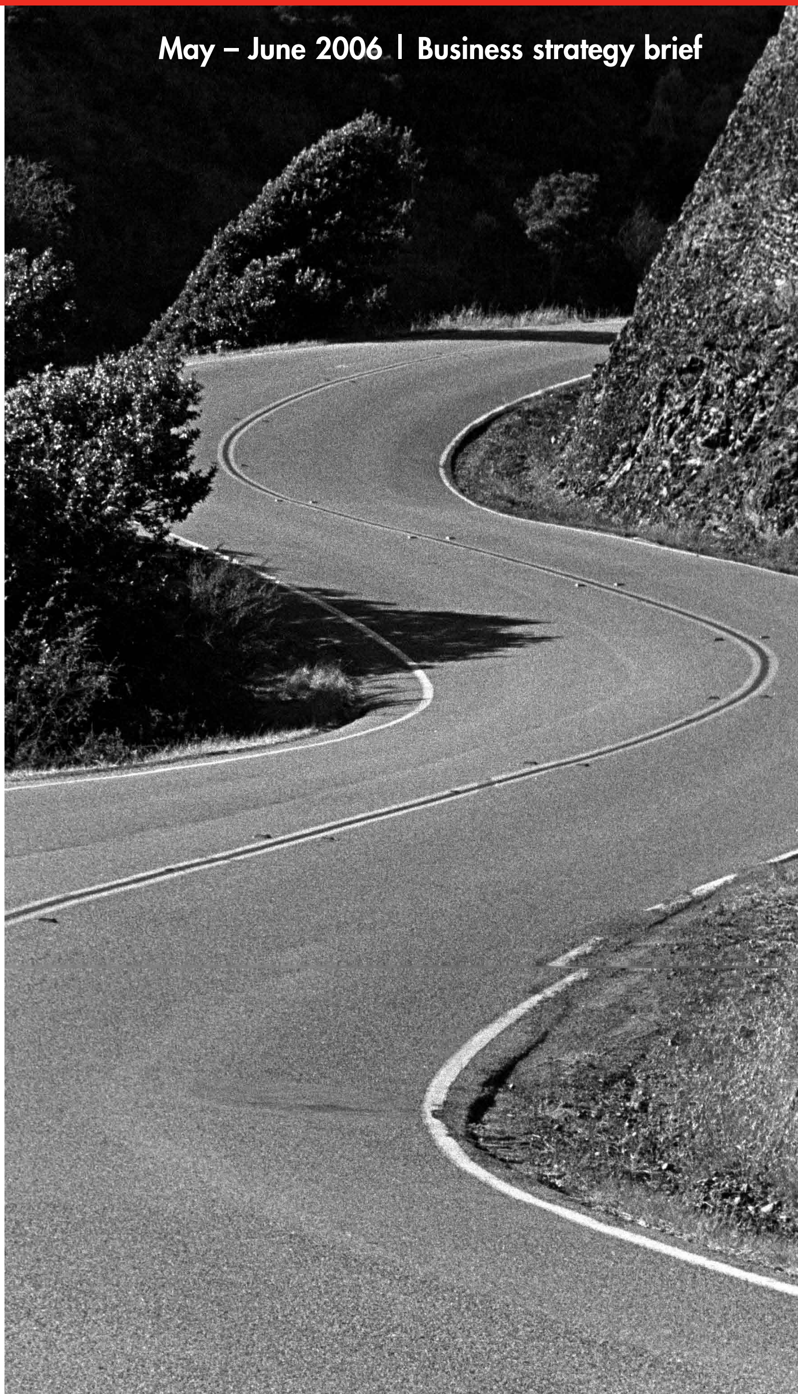

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LEADING FROM THE FACTORY FLOOR

"When a German manufacturer got the workers at a poorly performing plant deeply involved in its overhaul, the results were spectacular."

Louis Amory
Partner
Bain & Company

For all the talk about lean manufacturing, it still seems to be the exception: Factory floors are cluttered, bottlenecks delay production, and the wrong products pile up in inventory while the right ones can't be found. Fixing a dysfunctional factory isn't easy, but consider this surprising case from Germany, where resistance to managerial innovations on the factory floor has traditionally been strongest.

Rather than close a poorly performing plant, materials manufacturer Isola Group gave workers a chance to start over, literally and symbolically. Inspired by the Japanese tool known as the five S's—for "sort," "store," "shine," "standardise," and "sustain"—plant managers asked the workers to clean out the factory and suggest ways to make it more efficient.

First, out came 70 tons of excess "stuff"—60 empty inventory racks, 100 cubic meters of unneeded packaging material, 150 pallets of empty drums—hauled away in 45 truckloads. Next, the workers came up with 800 ideas for improvement, most of which were ultimately implemented. Then employees used more than 150 cans of paint to give the place a face-lift.

Then managers took off their ties. Everyone donned the same uniform: factory coats and protection glasses. The head of site, production planner, and site controller turned their work space on the shop floor into a "project office" and continued to invite informal feedback; soon workers were dropping by to offer suggestions or report problems. The project office team also sponsored more formal sessions with workers on all shifts to discuss problems, analyse root causes, and rapidly identify solutions. Daily meetings on yield losses provided quick feedback on the workers' initiatives; every day, the project office team watched for glitches in the previous day's yield and devised countermeasures.

Finally, the team asked: "What is the current true performance level of the plant? And what is an achievable level?" Central controllers had in the past set arbitrary performance benchmarks, none of which made sense to the workforce. So the team selected new targets for productivity and yields—targets based on employees' own assessment of their capabilities—and developed and posted charts in common areas so everyone could track the plant's progress. The fact that management was listening to workers' ideas—and was quickly trying them out—helped boost morale and directly improved processes, reducing cycle times and virtually eliminating work-in-progress inventory. As the initiative gathered momentum, employees began volunteering to work overtime on improvements.

The results? After three months, the plant achieved a yield boost of 4%, from 91% to 95%, with each percentage point of improvement representing about €660 000 in annual material-cost savings. Additionally, EBITDA improved from roughly a 15% deficit to break-even. By year's end, the plant was on track to deliver a 10% to 15% positive EBITDA.

We hope you can achieve the same results.

Louis Amory
Partner

A version of this article was published in the November 2005 issue of *Harvard Business Review*

MASTERS OF THE UNIVERSE

"Today's versions of the Masters of the Universe are now intent on running big corporations, not just breaking them up."

Geoff Cullinan
Partner
Bain & Company

"Executives who embrace the activist-owner approach improve the odds that they will end up being masters of their own destinies."

Thierry Catfolis
Manager
Bain & Company

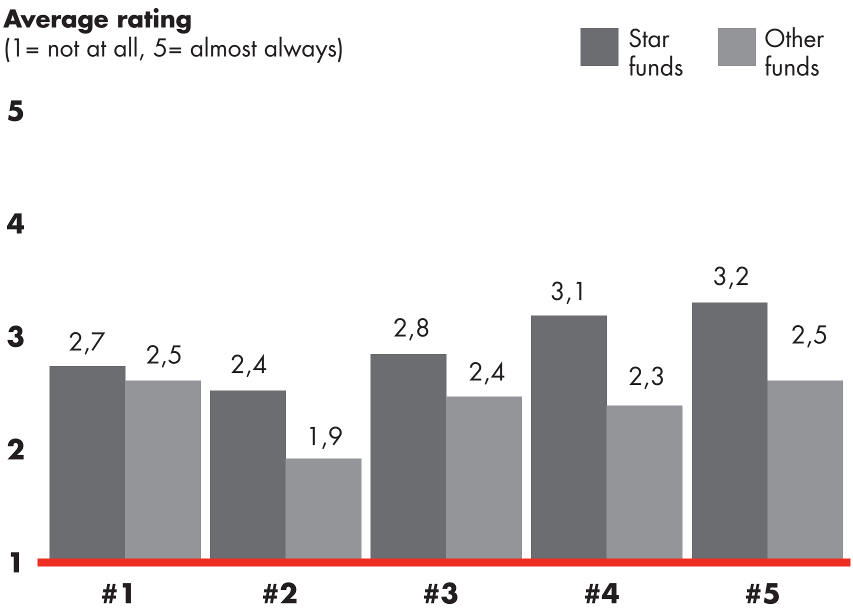
Seventeen years after Kohlberg Kravis Roberts made its storied €19,4 billion bid for RJR Nabisco, private equity firms are again big news. A consortium including KKR snapped up Toys "R" Us, and private equity firm Ripplewood was one of the leading contenders in the high-profile battle for Maytag, eventually won by Whirlpool. In Europe, Cinven and BC Partners paid €4,3 billion for Amadeus Global Travel in Spain; and EQT teamed up with Goldman Sachs Capital Partners to acquire ISS, the Denmark-based cleaning services firm, for €2,95 billion.

In fact, today some private equity portfolios are among the world's largest conglomerates. Texas Pacific Group, for example, owns or has recently divested major stakes in more than 50 businesses worldwide, in industries as diverse as food, film, fashion and financial services. With near-record sums of money bidding up deal prices—global buyout funds raised about €194 billion in 2005, up more than 200% from a year earlier—PE firms know they can no longer count on the magic of leverage to deliver quick returns. Instead, they are donning the mantle of owner-activists who realise they have to accomplish more in less time than the next highest bidder.

The top firms are tripling their cash returns, results that make it seem like the 1980s "Masters of the Universe" are back. But it's different today: The big players' masterful abilities now entail running corporations, not just breaking them up and selling them off.

This new activist mindset serves their ultimate goal of achieving fast, predictable gains. Numbers are hard to get, given private ownership, but there are strong indications that the best-run companies under private equity ownership outperform publicly-held corporations by a significant margin. How? They avoid the mistake of managing their portfolios for synergies. Rather, today's private equity investors forge bonds with management teams that align the interests of managers and the shareholders they work for, addressing one of the longest-running mysteries in business: the "agency gap."

What's their approach? Bain's experience with more than 3000 private equity transactions reveals a winning formula that starts with a clear hypothesis of how to make



#1 Defining the company's full potential, with specific strategic objectives and financial targets, in the first six months
#2 Creating an explicit plan with prioritised initiatives, timeline, and metrics
#3 Actively monitoring progress of initiatives
#4 Supporting companies with a network of resources
#5 Having an explicit exit strategy

Figure 1: Leading PE firms are developing more activist muscles

When Bain compared private equity funds, we found that in five key practices, star funds* consistently rated higher on activism

**Based on net returns indexed for overall returns for each fund's vintage year.*

Source: Bain analysis.

money. Once owners, these private equity masters flesh out their thesis with a detailed strategic and operational "blueprint" with time limits on results, hire managers who act like owners, and establish a few key measures of success that all employees can understand. Plus, they make their capital work hard, redeploying underperforming assets quickly. Finally, they live by the "80/100 rule," meaning that an 80% solution that is good to go beats a 100% solution that is not.

Blueprint the path to value

Buyout firms are masters at spotting hidden value. To unlock it, they create a three- to five-year "blueprint" once the deal's ink is dry. Consider Berkshire Partners'

2001 purchase of The William Carter Company. Berkshire bought the children's clothier for €4,65 a share with the certainty that to grow profits, Carter's needed to sell more clothes and expand into mass-market channels. The blueprint showed how: by placing its products in Wal-Mart and Target, cutting costs, streamlining distribution and developing new apparel. By 2003, when the company went public at €14,7 a share, Carter's earnings had tripled. Last year Carter's acquired OshKosh B'Gosh, creating a €1 billion giant, whose stock is now worth more than €40 a share. Our analysis shows that dealmakers who use a blueprinting process outperform others by a margin of 2,5 to 1, measured on cash return.

Hire hungry managers

Private equity firms hire managers with a relentless will to succeed. After Perseus LLC and Infinity Associates paid €90,7 million for ailing sneaker maker Converse in 2001, they brought in Jack Boys, who had made The North Face into an outdoor-gear phenomenon. Mr. Boys and other North Face alums did such a good job that Nike bought Converse two years later for €236,4 million.

Measure what matters

Buyout firms zero in on a few key metrics, focusing on cash and tailoring measurements to the business. Thus, when Texas Pacific Group bought Beringer Wine Estates from Nestlé in 1996, it revamped the winery's performance metrics to focus on its cash flows, not return on assets and economic value added. The latter penalised Beringer for hanging on to assets like vineyards and aging wine, which were actually increasing in value over time. Once banks realised Beringer's strong cash position, TPG was able to finance Beringer's assets with bank debt and reduce the amount of equity it put into the company. This maximised TPG's return on capital—and led to a ninefold return on TPG's initial investment in five years.

Make equity sweat

The average private equity firm finances close to 70% of its assets with debt, versus 30% at a typical public company. Scarce cash forces managers to redeploy underperforming capital and choose wisely. DLJ Merchant Banking, Credit Suisse Group's private equity arm, squeezed costs when it purchased Mueller Water Products, an old-line maker of high-pressure valves, in 1999 from Tyco International Ltd. for €727 million. Closing uncompetitive foundries and innovating leaner manufacturing methods freed up cash for acquisitions that helped boost revenue from €670 million in 2001 to €814 million in 2004. Walter Industries Inc. purchased Mueller for €1.48 billion in October.

Go with what works

Leading PE funds use their conglomerate breadth to apply tested techniques across companies they own, drawing on a range of experience that quickens judgment without compromising execution. They act once they have an 80% fix that is 100% ready to implement. The directors at Newbridge Capital Group, the Asian investment arm of TPG and Blum Capital Partners LP, are deft at avoiding "analysis paralysis." Newbridge applied the 80/100 approach to reinvent Korea First Bank, once a pre-eminent lender to South Korea's industrial giants. After the bank fell victim to the Asian currency crisis, Newbridge scooped up a 51% stake from government receivers. From January 2000 to the following spring, the Newbridge-Korea First team developed a plan to transform Korea First into a retail bank. Over the next three years, Korea First re-engineered its branch network, created a cross-selling culture, designed and outsourced a centralised back office and launched an Internet banking strategy. In early 2005, Standard Chartered Bank plc, the big UK banking group, purchased Korea First for €2,52 billion, netting Newbridge a nearly four-fold return.

Even companies that don't have a private equity investor can apply these lessons. Some, such as General Electric, manage their businesses with the rigor of private equity firms. Former General Electric CEO Jack Welch's exhortation—to be "No. 1 or No. 2, or fix, sell or close"—could have come right out of a fund's game plan. Maybe that's why Mr. Welch has begun a second career in private equity. Indeed, executives who embrace the activist-owner approach improve the odds that they will end up being masters of their own destinies.

CHANGE MANAGEMENT: CHANGE ROAD MAP

We continue the tour of the Bain toolkit exploring its six dimensions. In this issue of Results we are highlighting the change management capability.

Description

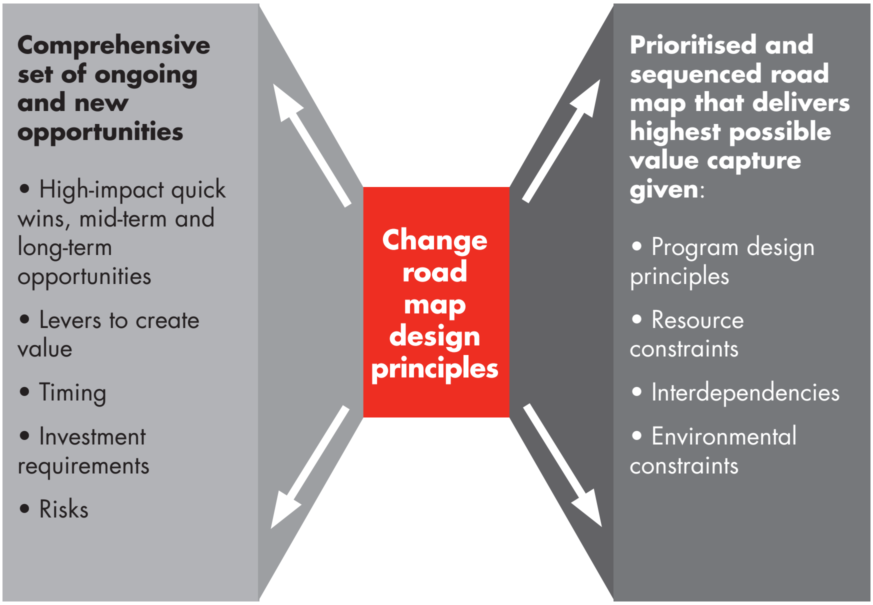
The change road map is the first element of any change program; it outlines the business rationale for change in an organisation. It lays out the design principles of the program, describes the sequence of steps it will encompass and sets priorities to ensure that initiatives realise their maximum value.

Bain's differentiation

Bain helps clients create road maps that are tied to business objectives, driven by data and pragmatic. We use benchmarks and diagnostic tools extensively to quantify opportunities. Our program design takes into account required investments, organisation and operational needs, and company culture. The result is a practical plan of action that delivers the most possible value.

Bain's approach

We start by working out an initiative's timing and setting "stretch" goals, linked to strategy and informed by benchmarks and analysis. Next we help clients reach consensus on the change program's design, covering everything from its financial to its organisational principles. Then we prioritise opportunities, taking into consideration investment needs, personnel requirements, and potential internal roadblocks.


Comprehensive set of ongoing and new opportunities
• High-impact quick wins, mid-term and long-term opportunities
• Levers to create value
• Timing
• Investment requirements
• Risks
Change road map design principles
Prioritised and sequenced road map that delivers highest possible value capture given:
• Program design principles
• Resource constraints
• Interdependencies
• Environmental constraints

CONVERGENCE CALLING

A talk with Didier Bellens, Chief Executive Officer Belgacom

Is it any accident that the man in charge of Belgium's biggest phone company previously ran Europe's biggest commercial television network? Not when you consider the ongoing convergence among voice, data and video that is now revolutionising the telecommunications business. Didier Bellens, the CEO of Belgacom (and former head of RTL Group), has a sharp focus on the challenges facing this former fixed-line monopoly as it tries to stay ahead of consumer demand, technological innovation and market uncertainty. He tells us what to expect.

The buzzword in telecom these days is *convergence*. What does it mean to you?

"Some people say it's just about convergence between telecommunications and media, but I think you have to be much broader and say it's a convergence between telecommunications and services. What we've done at Belgacom is transform the company from a pure telecom company—pure connectivity—to a more service-oriented company."

What about convergence between fixed and mobile telephony?

"In Belgium today 28% of the population use mobile only. By definition these people are no longer customers of Belgacom. They're usually young kids, customers of mobile companies, and also of broadband firms. For some reason, they don't want a fixed line. They represent huge potential for us, but we have to have a creative solution for this target group."

We've already been expanding into new kinds of offerings. We're close to launching Naked DSL, which is an ADSL line without a normal phone line. Last year we launched Discovery Line, which is an ADSL line together with a PSTN line that costs just €6,50. It's been very successful."

And technologies are converging as well, right?

"Tomorrow you will see convergence among fixed, mobile and Internet technologies, as well as services. Today you already can get TV on ADSL lines and on your mobile in 3G. It's not the same number of channels, it's not the same quality, but you can get it. Tomorrow you'll be able to download your music on all your devices. You may download a film at home and then take it with you and access it when you travel. You will have a convergence between all those elements. It's really starting; it's not just a dream. It's driven by consumers and by technology."

The Belgacom Group is the first telecommunications company in Belgium and a market leader in many fields, particularly in wholesale and retail fixed line services, mobile communications, Internet and broadband data transmission services.

Does Belgacom still have an image as just the old phone monopoly?

"Some people still see us as the old incumbent, fixed line for phone calls. That was basically the origin of the monopoly. That business is definitely under pressure or in decline because of the evolution of the technology. But other people see us as a very innovative company. We have probably one of the best broadband networks in Europe. When you explain to people abroad that we cover 98% of the population with ADSL, they say, 'That's incredible, how did you do that?'"

Plus, you have other brand identities.

"Look at Skynet. It's one of the most important portals and content providers in the Belgian market. It's also very far away from the image of the incumbent. Proximus has been developed from scratch. They have really built mobile activity in the Belgian market. They still have a 50% share of the market and they're delivering the best service. Our problem is that we have all these very valuable assets, and some people recognise it, but we still have a strong image as a monopolistic company, heavy, old-fashioned. Yet in terms of innovation this company has been just fantastic. We have to be innovative, because a telco that is just living on its incumbency is going to disappear."

Where will Belgacom be in five years' time?

"With regard to technology and service levels, we're very well positioned compared with our peers in Europe. And in some cases we're ahead of them—even though the country is a small country and the company is a small company. But longer term, I believe we'll see the consolidation of the telco business across Europe. We have to take part in that. I don't believe that somebody can remain isolated in a relatively small country. With the development of these new services and new technology, it's not just a telecom at the end of the day. Everything is changing. We have to grow and change along with our customers."

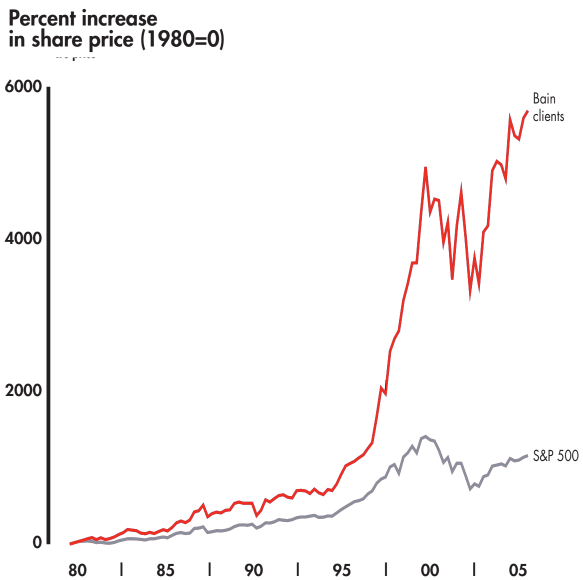
Interview conducted by Craig Winneker

Didier Bellens

- President, CEO and director of Belgacom since March 2003.
- From 2000 to 2003 he acted as CEO of RTL Group. Previously, he held positions with Deloitte Haskin & Sells, Pargesa Holding and Groupe Bruxelles Lambert.
- Member of the board of directors of AXA Belgium, VOKA, and the Foundation Erasme. Member of the management committee of the FEB-VBO.
- Mr. Bellens holds a M.Sc. in management from the Solvay Business School.

Making companies more valuable

Bain clients outperform the market 4 to 1.



Note: Methodology and data are attested by PricewaterhouseCoopers through December 2005

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