

Defining a winning strategy for Southeast Asia's conglomerates

Strategy realized





Executive summary

Conglomerates are multisector organizations with a combination of at least three distinct business units under a parent group.

Globally, conglomerates have underperformed in the market over the last decade, delivering a total shareholder return (TSR) - i.e., the total amount of returns a shareholder enjoys on the investment - that is almost 10 percentage points (pp) below that of their pure-play counterparts. Unlike the pure-plays that focus on a single business or industry, conglomerates operate across multiple industries. While this tends to confirm that the “conglomerate discount” is still a reality, it is critical to recognize that **conglomerates in Southeast Asia are structurally different from their global counterparts:**

- ▶ **Different structural and operational ecosystems:** Conglomerates in Southeast Asia are smaller in size, have fewer subsidiaries, a smaller geographic footprint and have less-diversified businesses than conglomerates globally. A higher proportion of them are also family owned.
- ▶ **Access to capital and resources:** Historically, conglomerates in Southeast Asia have had privileged access to capital as well as natural resources. This has allowed them to thrive unchallenged in sectors such as industrial and energy.

However, some inherent advantages of conglomerates in Southeast Asia have slowly eroded over the last decade. While conglomerates in Southeast Asia had outperformed their global counterparts in TSR performance by 20pp during the 10-year period from 2002 to 2011, that gap shrank to 3pp from 2012 to 2021. The two key reasons for this are:

1. Pure-plays are now outperforming conglomerates in Southeast Asia: TSR for pure-plays are higher by up to 37% in some sectors.
2. Stagnant portfolio that is not future proof: The portfolio mix for conglomerates in Southeast Asia has remained static with a similar exposure to industrial, energy, and consumer products sectors since 2001.

Hence, it is pertinent for conglomerates in Southeast Asia to rethink their strategy to win in the next decade. Learning from the successes of global and local players, and considering the characteristics of conglomerates in Southeast Asia, there are **four strategic pillars** that these conglomerates should focus on:

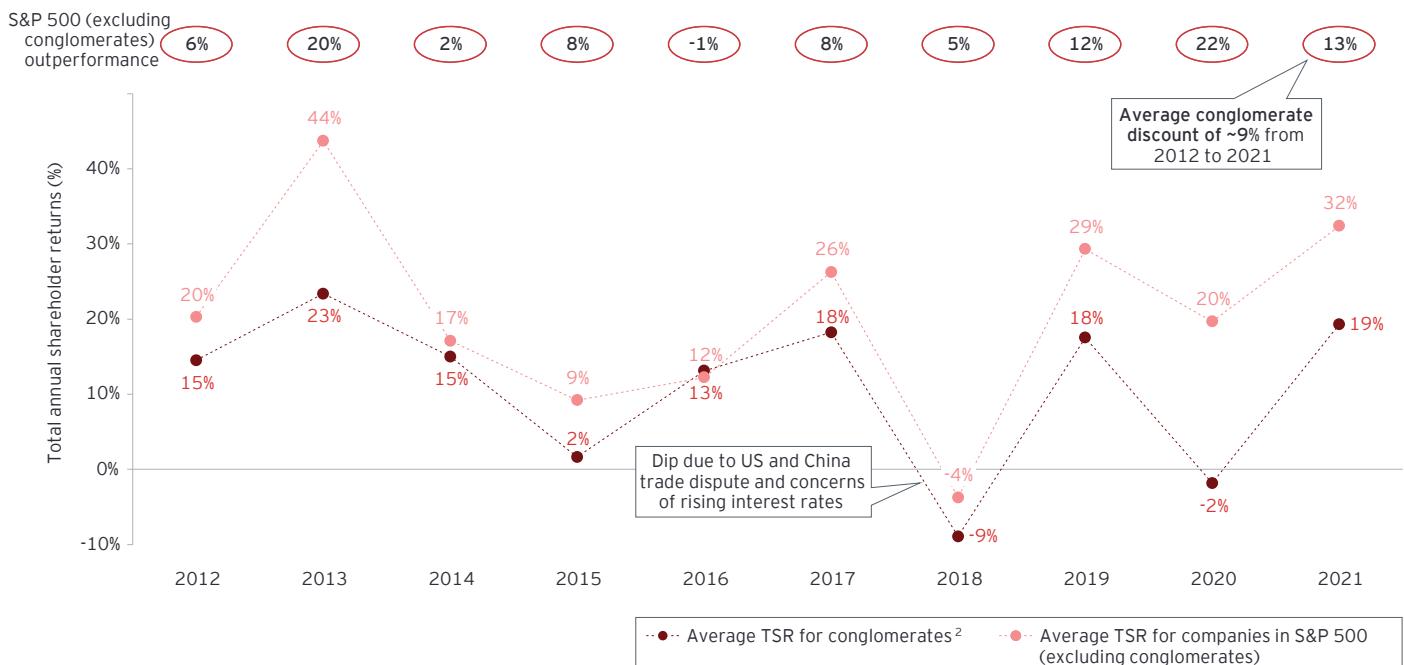
- ▶ **Develop an agile capital allocation strategy:** Conglomerates in Southeast Asia need to future-proof their portfolio and increase exposure to higher growth sectors, such as technology and health care, while balancing that with exposure to dividend-yielding, lower-risk and capital-heavy sectors.
- ▶ **Build a digital ecosystem:** Conglomerates in Southeast Asia need to actively pursue digital adoption within their businesses to drive productivity and new revenue streams and start investing in venture building capabilities.
- ▶ **Build a mindset of creating long-term value:** Sustainability should be integrated in the long-term group strategy and embedded in each business of the conglomerate at the operational level.
- ▶ **Move toward asset-light business models:** Conglomerates in Southeast Asia can improve valuation multiples by shifting toward deployment of third-party capital instead of balance sheet investments only.

Lackluster performance of global conglomerates

For years, conglomerates were thought to thrive due to their advantages of size, synergy between portfolio companies, brand advantage and diversified business model, wherein the poor performance of one subsidiary could be counter-balanced by better performing subsidiaries.

In reality, evidence has shown that the “conglomerate discount” is real, and conglomerates typically tend to be valued at less than the sum of their parts. An EY-Parthenon analysis of 262 publicly listed conglomerates globally revealed that conglomerates have underperformed the market, delivering annual TSR of approximately 9% below their pure-play counterparts in the last decade.

Figure 1: Total shareholder returns (TSR)¹ for global conglomerates benchmarked against Standard & Poor's (S&P) 500 companies



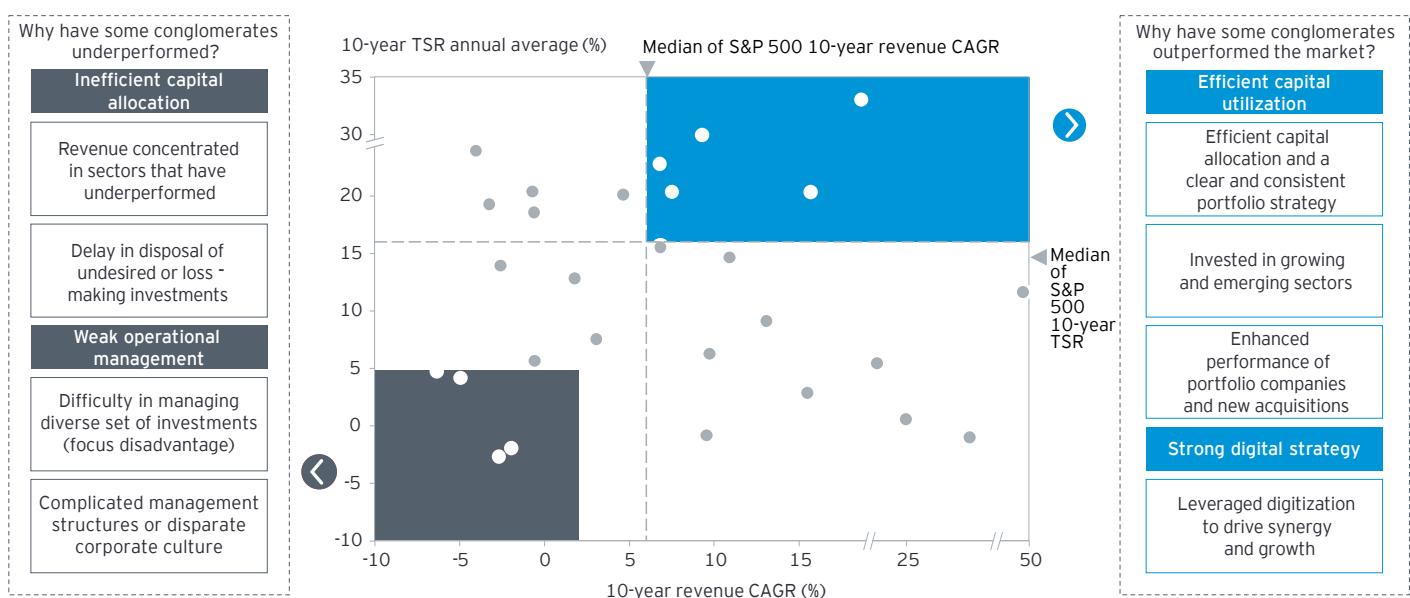
1. Based on weighted average of annual TSR, weighted by revenue in FY2021; annual TSR determined by $\{($ price at end of year - price at beginning of year $) + \text{dividends}\} \div \text{price at beginning of year}$

2. TSR for conglomerates calculated for a global sample of 262 publicly-listed conglomerates as defined by Capital IQ

Source: S&P Capital IQ, EY-Parthenon analysis

While this gap in TSR is a clear indicator of the underperformance of conglomerates, the analysis also revealed that some conglomerates are able to consistently outperform the pure-plays in the S&P500. EY-Parthenon research suggests that the leading performers typically take a very proactive approach to capital allocation, frequently reviewing and reallocating capital across their businesses; as well, they also taking an active approach to M&A and divestiture to ensure that capital is effectively deployed at all times. Strong investments in digital transformation at the portfolio company and the group level have also helped these conglomerates deliver superior results.

Figure 2: Underperforming and outperforming global conglomerates benchmarked against S&P 500 companies



Source: S&P Capital IQ, EY-Parthenon analysis

While learning from global conglomerates would be a good starting point, it is also important to understand how conglomerates in Southeast Asia differ from their global counterparts to develop a winning strategy.

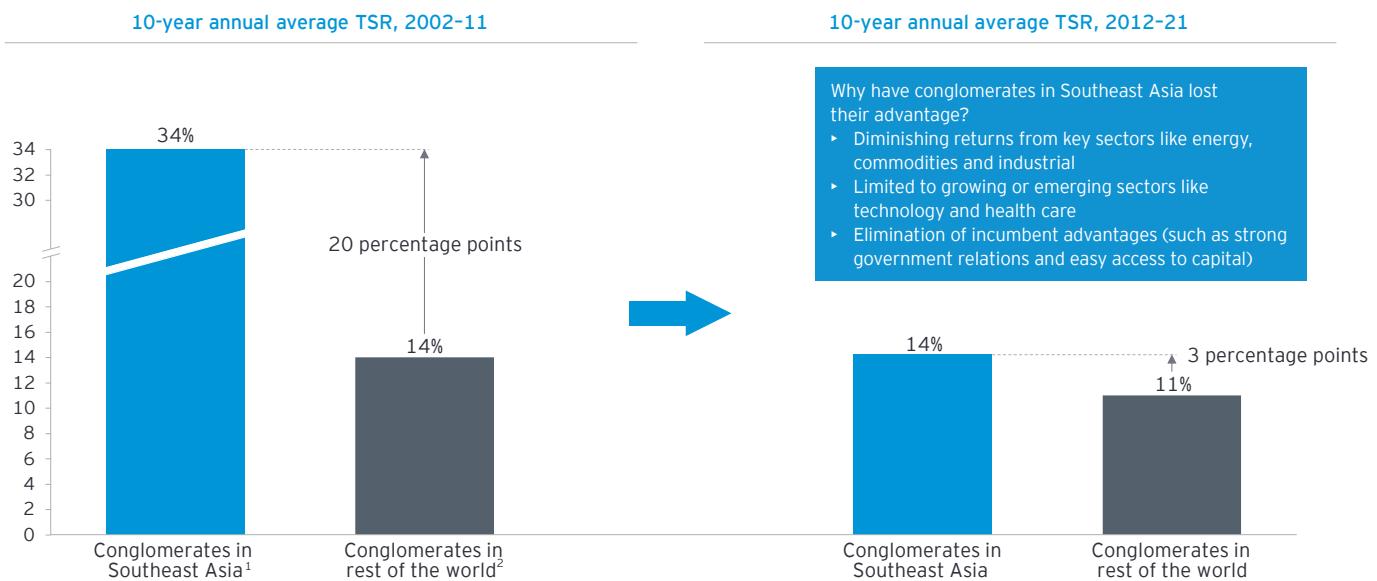
In this report, EY-Parthenon teams critically examine how conglomerates in Southeast Asia can compete in the market against stiff competition from focused and agile pure-plays and a growing ecosystem of startups with innovative business models. By revisiting key lessons from case studies of global conglomerates and evaluating the business ecosystem in Southeast Asia, the team aims to formulate a winning strategy for conglomerates for the next decade.

Conglomerates in Southeast Asia

Historically, conglomerates in Southeast Asia have outperformed their counterparts in the rest of the world. The 10-year annual average TSR during the 10-year period between 2002 and 2011 of conglomerates in Southeast Asia was a staggering 34%, compared to the conglomerates in the rest of world, which stood at only 14%.

This high returns of these conglomerates in Southeast Asia can be attributed to an inherent advantage possessed by these organizations in this region in the early 2000s. The inherent advantage stems from easy access to capital, strong government relations and early exposure to high growth sectors like energy, commodities and industrial in the region during this period.

Figure 3: Comparison between conglomerates in Southeast Asia and rest of the world



1. Sample of 36 publicly-listed conglomerates in Southeast Asia
2. Sample of 229 publicly-listed global conglomerates (excluding those in Southeast Asia)

Source: S&P Capital IQ, EY-Parthenon analysis

However, the inherent advantage of conglomerates in Southeast Asia is rapidly fading, and pure-play companies have emerged to challenge them in their individual markets. EY-Parthenon research shows that while conglomerates in Southeast Asia used to outperform their global counterparts by 20% between 2002 to 2011, this outperformance has reduced to only 3% between 2012 and 2021.

Characteristics of conglomerates in Southeast Asia

To understand how conglomerates in Southeast Asia can reinvent themselves and develop a winning strategy for the next decade, it is important to recognize the characteristics of conglomerates in Southeast Asia and the local market ecosystems they operate in. In a comparative analysis by EY-Parthenon teams, where they studied 36 publicly listed conglomerates in Southeast Asia and 229 publicly listed conglomerates globally, several characteristics of conglomerates in Southeast Asia were uncovered.

Southeast Asia's conglomerates structurally different from global conglomerates

There are broad structural differences between conglomerates globally and in Southeast Asia. First, nearly 75% of the conglomerates in Southeast Asia are family owned, compared to only 50% of global conglomerates that are so. Typically, family-owned businesses have a longer-term strategic outlook, in part due to the desire to create and pass on a legacy for future generations. Relationships and networks are also leveraged to perpetuate greater influence over the market.

Second, conglomerates in Southeast Asia are significantly smaller than their global counterparts, with an average revenue of US\$4.5b, compared to over US\$50b for the global conglomerates covered in this study. On average, conglomerates in Southeast Asia control close to 50 subsidiaries or portfolio companies, while their larger global counterparts operate nearly 175 companies.

Having fewer portfolio companies allows better strategic alignment and focused management, leading to a greater parenting advantage. Interestingly, in the sample of conglomerates analyzed, a larger size was not correlated with higher performance; while scale can typically benefit a business, the added complexity of managing many entities across different markets and industries contributed to overheads and inherent challenges.

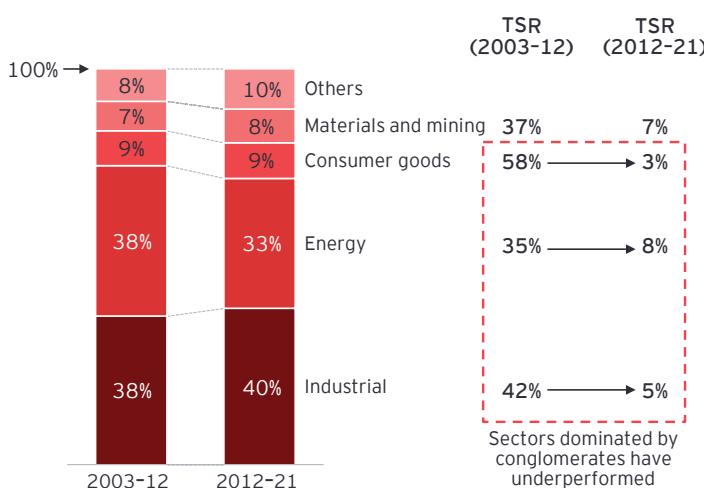
Third, conglomerates in Southeast Asia typically have a smaller footprint, operating in less than 10 countries, while their global counterparts operate in over 60 countries on average. The smaller footprint allows for greater focus on the management of the company. This also enables the portfolio companies to develop more focused and local strategies that help support deeper market penetration.

Finally, conglomerates in Southeast Asia are less diversified, and the top three sectors they operate in represent some 90% of the total revenues, compared to 75% for global conglomerates. While less diversified, conglomerates in Southeast Asia can access capital markets more easily, which can be used to enter new markets. However, the lower diversification exposes these conglomerates in Southeast Asia to a higher degree of financial and sector specific risks.

Eroding inherent advantage of conglomerates in Southeast Asia

The high returns that conglomerates in Southeast Asia enjoyed in the 10-year period between 2002 and 2011 had been eliminated in the last decade. A sectoral analysis of conglomerates in Southeast Asia reveals that there have not been any significant changes in the sector contribution mix. A majority 80% of the revenue of conglomerates in Southeast Asia has been concentrated in the industrial, energy and consumer goods sectors, which have seen diminishing returns over the past decade.

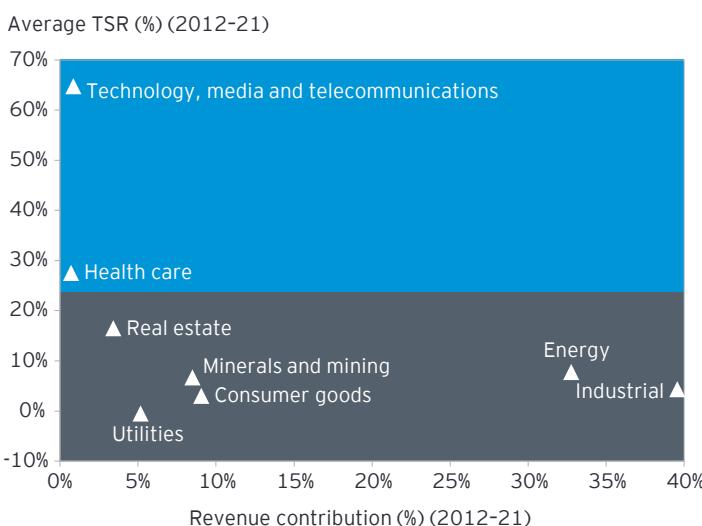
Figure 4: Revenue contribution of conglomerates in Southeast Asia (%) (2003-21)



Source: S&P Capital IQ, EY-Parthenon analysis

Despite diminishing returns from key sectors, these conglomerates in Southeast Asia did not engage in any material reallocation exercise. Taking a closer examination at the sector allocation in the last decade further revealed a very limited exposure to sectors such as health care or technology, media, and telecommunications (TMT), which have generated very high returns over the last decade.

Figure 5: Conglomerates in Southeast Asia - revenue contribution vs. sectoral TSR (%) (2012-21)



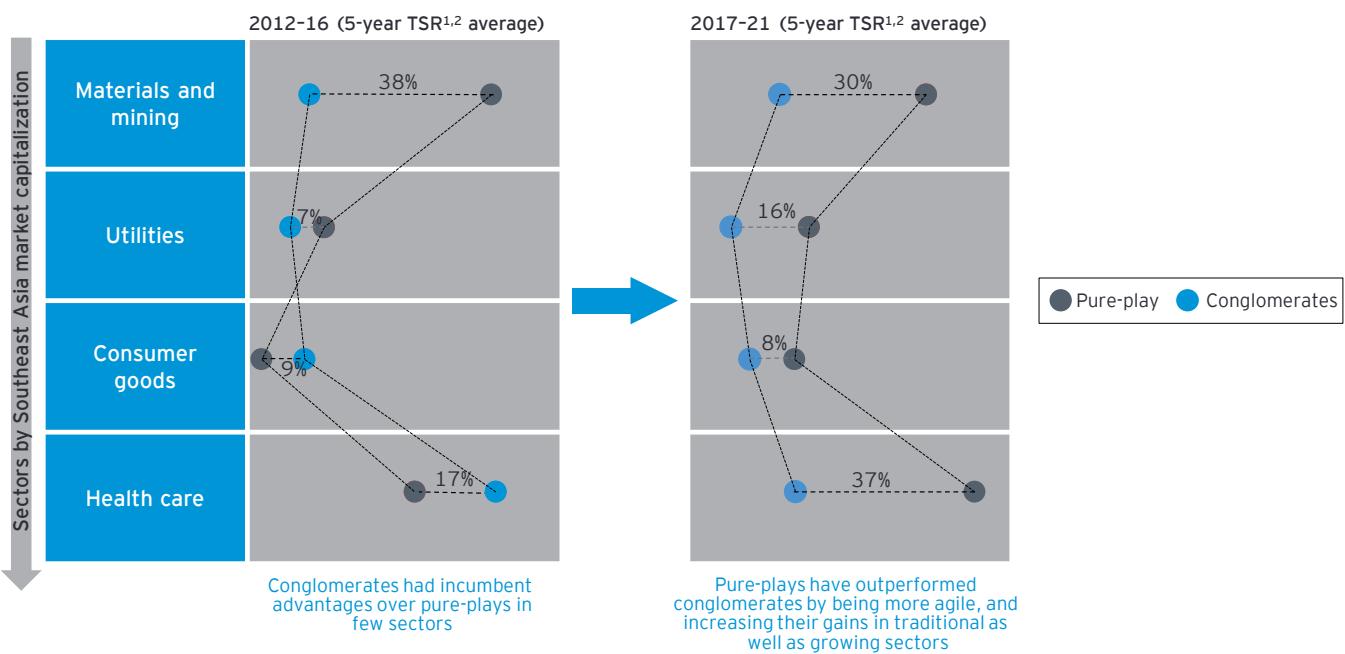
Source: S&P Capital IQ, EY-Parthenon analysis

In addition to having lost their edge over their global counterparts, the EY-Parthenon analysis shows that conglomerates in Southeast Asia are increasingly challenged by pure-plays in the last decade; pure-plays have been able to generate better returns than conglomerates in both traditional and emerging sectors.

EY-Parthenon research indicates that pure-plays have been more agile in capital allocation and operations, enabling them to take advantage of windows of opportunity for top-line growth and customer acquisition. For example, one of Malaysia's glove manufacturers was able to very quickly repurpose its production of surgical gloves capabilities to produce examination gloves, which saw a sharp increase in price during the pandemic. As demand starting falling sharply towards the end of the pandemic, the same player was able to once again shift its focus back to surgical and industrial applications. The pure-plays have also leveraged digital transformation to accelerate growth. For example, one of Asia's leading banks undertook digital transformation in 2014, following which its revenue increased by more than 60% between 2014 and 2021.



Figure 6: Sector performance of conglomerates vs. pure-plays



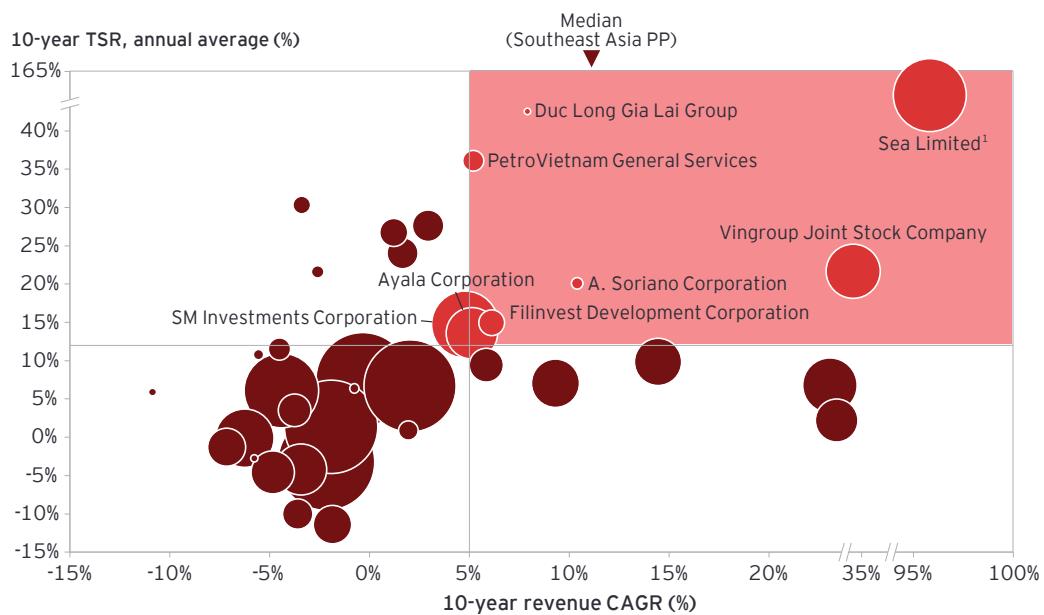
1. Based on weighted average of annual TSR, weighted by revenue in FY2021; annual TSR determined by $\{(price at end of year - price at beginning of year) + dividends\} \div price at beginning of year$
2. TSR calculated for a sample of 38 publicly-listed conglomerates and 57 publicly-listed pure-play companies in Southeast Asia

Sources: S&P Capital IQ, EY-Parthenon Analysis

Agile capital allocation

EY-Parthenon research highlights that conglomerates that took an agile approach to capital allocation were able to outgrow their peers while generating superior returns. A deeper analysis of these cases reveals that successful conglomerates in Southeast Asia have a flexible and well-defined capital allocation strategy. They actively identify and invest in newer emerging sectors and markets, which helps them future proof their portfolio, while shedding laggards from their balance sheet.

Figure 7: Conglomerates in Southeast Asia - 10-year revenue CAGR vs. 10-year TSR



1. Only five years of data considered for Sea Limited as company went public in 2017

Sources: S&P Capital IQ, EY-Parthenon Analysis



Four pillar value creation strategy for conglomerates in Southeast Asia

Given the characteristics of conglomerates in Southeast Asia, a tailored value creation approach is required for them to regain dominance over the next decade. Four key pillars, which can drive success in the next decade, have been identified.

Figure 8: Four key pillars for conglomerates in Southeast Asia



1 By **developing an agile capital allocation strategy**, conglomerates in Southeast Asia can overcome growth inertia. This involves formulating a well-defined capital allocation strategy and proactively managing their portfolios. For example, Ayala, one of the largest conglomerates in the Philippines, has demonstrated strong growth via efficient allocation and management of its capital through the adoption of an iterative three-step process.

First, Ayala periodically reviews its portfolio and quickly divests loss-making assets and businesses. Second, Ayala actively seeks out and invests in emerging sectors to grow organically or via mergers and acquisitions (M&A). For instance, AC Health, was set up in 2015 to focus on the growing health sector in Philippines, eventually acquiring Healthway, one of the leading health care providers in Philippines. Lastly, Ayala proactively manages the capital expenditures of its existing businesses, recently increasing spend by 25% to support investment in real estate and renewable energy projects.

Ayala's financial performance

US\$6.3b
Revenue (FY2021)

5%
approximate
Revenue growth (FY12-21)

13.5%
approximate
TSR growth (FY12-21)

2

Building a digital ecosystem is another strategy that conglomerates can employ to increase value creation opportunities. A digital ecosystem is formed through the combination of platforms – or omnichannel architecture that delivers value to the customer through personalized products and services – and strategic partnerships. This is not just about partnerships and M&As; it also involves creating a network of enterprises that facilitates and encourages the sharing of data, applications, technology infrastructure and capabilities. Conglomerates can aim to create these network effects within existing businesses and are well positioned to ultimately become the digital ecosystem orchestrators. This would, in turn, allow them to get better control over the ecosystem dynamics and often outperform other entities in revenues and profits. For example, Sea Limited, a technology conglomerate that operates in the digital entertainment, e-commerce and digital financial services, has successfully done this.

Sea Ltd. financial performance

US\$10b

Revenue (FY2021)

96%

approximate

Revenue growth (FY17-21)

162%

approximate

TSR growth (FY17-21)



3

Conglomerates in Southeast Asia should **create a mindset to drive sustainable long-term value** for all stakeholders. Vingroup, Vietnam's largest conglomerate, has spearheaded environmental, social and governance (ESG) initiatives, which proved beneficial as seen through their above-average financial performance.

To integrate sustainability into their long-term strategy, Vingroup developed the Vingroup Sustainable Finance Framework, under which the group issues sustainable financing instruments and allocates proceeds to finance sustainable projects. They also developed ESG standards in key areas such as clean transportation, sustainable water management and provide access to health care. Apart from introducing frameworks and standards into their operations, Vingroup committed to a dedicated workforce to review and select products that would deliver a positive environmental impact and foster sustainable practices, tracking and monitoring the impact of its ESG initiatives actively.

Vin Group's financial performance

US\$8.4b

Revenue (FY2021)

34%

approximate

Revenue growth (FY12-21)

22%

approximate

TSR growth (FY12-21)



4 Conglomerates in Southeast Asia can attract higher valuation multiples by **shifting toward asset-light business models**. Leading real estate conglomerates in Southeast Asia recently implemented an asset-light strategy to enhance market perception by shifting away from being conglomerates with massive balance sheets to becoming asset managers with improved quality of earnings and stable cash flows.

A diversified real estate company has consolidated its investment management platforms and lodging business into a single entity in early 2021 to sharpen business focus and unlock greater shareholder value. It has privatized its real estate development business and has started implementation of capital recycling through managed funds or third-party sales. It has also adopted an asset-light growth strategy in its lodging business by leasing property from third-party developers and earning recurring management fee without owning the asset.

A leading real estate conglomerate has set out a future roadmap to become a global asset manager and operator. As it has begun its transformation toward being asset-light, it has divested its legacy asset-heavy business. To further scale up its assets under management (AUM), it has also progressively implemented fixed asset monetization since to accelerate investment return cycle by acquiring more brownfield assets - instead of pure greenfield developments. Its asset management arm is on track to achieve significant AUM growth by end of 2022 as it is also actively working toward launching new real asset investment funds. In conclusion, by following these strategies, conglomerates in Southeast Asia can look to develop an agile capital allocation strategy, build a digital ecosystem and create a mindset to drive sustainable long-term value. Adopting such strategies will allow conglomerates in Southeast Asia to gain superior value, and ultimately regain their dominance.

Contact us



Vikram Chakravarty
EY Asean Strategy and Transactions Leader
vikram.chakravarty@parthenon.ey.com
www.ey.com/en_sg/people/vikram-chakravarty



Sriram Changali
EY Asean Value Creation Leader
sriram.changali@parthenon.ey.com
www.ey.com/en_sg/people/sriram-changali



Andre Toh
EY Asean and EY Asia-Pacific Valuation, Modeling & Economics Leader
andre.toh@sg.ey.com
www.ey.com/en_sg/people/andre-toh

Contributors

Xavier Saynac
Director, Strategy and Transactions
EY Corporate Advisors Pte. Ltd.
xavier.saynac@parthenon.ey.com

Arvin Aguinaldo
Director, Strategy & Transactions
EY Corporate Advisors Pte. Ltd.
arvin-b.aguinaldo@sg.ey.com

Shezaan Daya
Director, Strategy and Transactions
EY Corporate Advisors Pte. Ltd.
shezaan.daya@parthenon.ey.com

Uday Mehra
Associate Director, Strategy &
Transactions
EY Corporate Advisors Pte. Ltd.
uday.mehra@parthenon.ey.com



EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

About EY-Parthenon

EY-Parthenon teams work with clients to navigate complexity by helping them to reimagine their eco-systems, reshape their portfolios and reinvent themselves for a better future. With global connectivity and scale, EY-Parthenon teams focus on Strategy Realized – helping CEOs design and deliver strategies to better manage challenges while maximizing opportunities as they look to transform their businesses. From idea to implementation, EY-Parthenon teams help organizations to build a better working world by fostering long-term value. EY-Parthenon is a brand under which a number of EY member firms across the globe provide strategy consulting services. For more information, please visit ey.com/parthenon.

© 2023 EYGM Limited.

All Rights Reserved.

EYG no. 002264-23Gbl

ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, legal or other professional advice. Please refer to your advisors for specific advice.

ey.com