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PROPOSED TURNAROUND CORPORATE LEVEL STRATEGY FOR ALPHA CORP

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Abstract

Oil was oversupplied in the world in 2014 and were majorly contributed by an unexpected near-twice of U.S. oil production from 2008 levels due to substantial improvements in shale fracking technology. By January 2016, the OPEC Reference Basket down into US$22/bbl, which was less than one-sixth of its peak in July 2008 ($140), and dropped below the April 2003 starting point, which was $23. This condition led to a downturn in energy sector, especially in the upstream.

Alpha Corp as state-owned enterprise in energy sector must balance its roles as a profit-oriented corporation with its mandate as a national oil company to meet domestic demand, both in upstream sector as well as downstream sector. Alpha Corp itself is a diversified enterprise with 24 subsidiaries, ranging from Alpha Corp's core related business in upstream and downstream of oil & gas, up to non-related business such hospital, finance, airlines and hotel.

By using vertical integration diversification, the low oil price is not hitting hard the Alpha Corp as enterprise, although it is giving a difficult challenge to its upstream subsidiaries. In terms of performance, the return on net asset (RONA) of Alpha Corp is still below industrial standard. With the current global condition and performance, it is a good opportunity for Alpha Corp to review and align its corporate strategy to overcome those challenge.

The purpose of this study is to develop a proposed turnaround corporate-level strategy for Alpha Corp. The study will focus more in reviewing the Alpha Corp portfolio performance, alignment and prospect. After reviewing all the subsidiaries, the next step is to develop a proposed business strategy of Alpha Corp's subsidiaries and the corporate governance, so the corporate can have rigid economic value and valuable synergy between subsidiaries to support corporate vision & mission.

***Keywords*:** Oil & Gas, Corporate Strategy, Portfolio & Turnaround.

1. Introduction

Alpha Corp as the state-owned company and backbone for Indonesia's oil & gas business need to have great operational & financial performance to support Indonesia's energy security and to support the GDP contribution. This can be done through its corporate strategy, especially in order to maintain high performance of its subsidiaries.

From Alpha Corp annual report in 2018, it shows that return on asset (ROA) of Alpha Corp is only 4.2%. This is relatively low since oil and gas sector typically generate ROA more than 7.5%. For the Return on Investment (ROI), it is stated high as it can generate 15.66% where the company operates in WACC of 12,8%. In addition, the return on equity (ROE) is considerably high with 13.21%. However, this value could be biased in actual since recent data show that

Alpha Corp is still receiving government subsidies, which, in 2018, can be summed up to $5 billion

The relatively low performance mainly contributed by low oil prices and its unrelated diversification corporate strategy that have wide range portfolio. In 2014, Alpha Corp and oil industries in general was facing a tough challenge. Oil was oversupplied and the price raised to US$22/bbl.

Therefore, a new corporate strategy needs to be developed to overcome this problem. To support the portfolio management, each subsidiary need to be assessed for its performance, synergy, and its business prospect. After all the analysis has been conducted, development plan for each subsidiary will be created based on the condition. After that, the corporate governance needs to be improved to ensure control and alignment between corporate and the subsidiaries.

2. Conceptual Framework

Based on Wheelen 2012, Corporate-level strategy defines the activity that a corporate executes to gain a competitive advantage by electing and managing a portfolio of different business operating in different product markets. The corporate-level strategy supporting the corporate to enhance its value. Typically, there are three grand strategies of orientation, which are: growth, stability and retrenchment. Corporate may utilize the retrenchment strategies when it is facing weak competitive position in some or all of its business. These strategies focus on improving the performance.

One of the retrenchment strategies is turnaround strategy. This strategy focuses in improvement of operational efficiencies, and its best to utilize if the corporate facing massive problem, but not yet critical.

The framework consists of the concept and step of analysis required to solve the business problem, and focus on reviewing the subsidiaries performance, alignment and prospect. After reviewing all the subsidiaries, the next step is to develop proposed business strategy of Alpha Corp's subsidiaries so the corporate can have rigid economic value and valuable synergy between subsidiaries to support corporate vision & mission.

Following the framework, the first stage is to calculate the economic value added (EVA) to assess its performance. The EVA will be evaluated and assessed based on each subsidiary annual report. The result of EVA calculation can give us insight whether the subsidiary is giving economic profit to the corporate or reducing it.

The second stage is to assess whether the subsidiaries have strategic value and are aligned with the corporate core business. For this purpose, the subsidiaries will be explored based on each subsidiary main business and its alignment with the corporate. This assessment is important so that the corporate can be more focused on the main business and nurture it to gain more value

The third stage is to assess business prospect of each subsidiaries by using BCG matrix tools. This is used for portfolio planning and strategy development of each subsidiary. By running this assessment, it will help the corporate to understanding the prospect of each business, so the corporate can efficiently allocate the resource.

The last stage is strategic implementation to each subsidiary based on their condition. The strategy includes invest it, search strategic partner to grow, or divest the business. For subsidiary with negative EVA, it needs to conduct hexagonal restructuring to increase its value prior to merge with another partner or divested.

In summary, the framework can be found as per figure 1

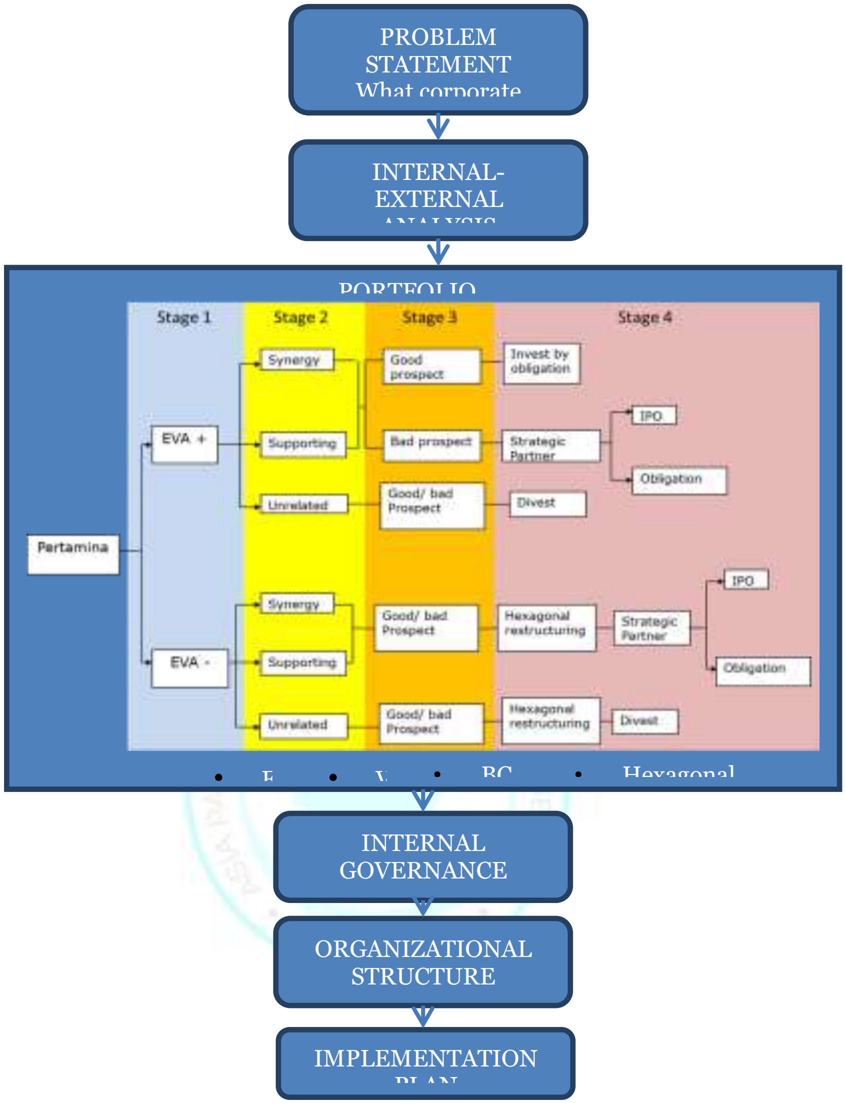

Figure 1: Conceptual Framework

3. Internal-External Analysis

Internal-external matrix is utilized to assess the corporate internal and external factors and define the general direction that the corporate will take. The direction could be steady, growth or retrenchment.

The tools will assess the internal factor and organize it into generally accepted categories of strengths and weakness, and the external factor as the opportunity and threats. The internal factor and external factor will be quantified and weighted relative to the importance of each items to the company.

The summary of Internal factor analysis can be found in table 1, and for the external factor analysis in table 2

Table 1:Internal Factor Analysis

Strength		Weight	Rating	WxR	Remark
S1	Vertical integration	0.15	3	0.45	Have subsidiaries from upstream to downstream
S2	Domestic market share domination	0.15	4	0.6	Domestic market share up to 90% for several subsidiaries
S3	Experienced top management	0.1	2	0.2	high turn-over for top management
S4	Employee relation	0.1	3	0.3	Employee turn-over relatively low
Weakness					
W1	Unrelated diversification	0.1	2	0.2	Many unrelated subsidiaries have negative EVA
W2	High COGS	0.1	2	0.2	several subsidiaries have COGS up to 95%
W3	Capability of employee	0.1	3	0.3	Gap on middle management due to employee retired
W4	Global positioning	0.1	1	0.1	Low global positioning compared other Oil & Gas company
W5	Weak corporate culture	0.1	3	0.3	Good corporate governance are improved in the last decade
		1	Total	2.65	

Table 2. External Factor Analysis

Opportunities		Weight	Rating	WxR	Remark
O1	Proven field acquisition	0.1	3	0.3	have priority to take over expired field
O2	Technology transfer for EOR	0.1	1	0.1	R&D for EOR need to be improved
O3	Holding plan from GOI	0.1	3	0.3	Will give good position in domestic gas industry
O4	Expand to overseas market	0.1	1	0.1	Only lubricant product that ready to expand
Threats					
T1	Low oil price	0.2	1	0.2	Low oil price on last 5 years
T2	Relatively steady market	0.2	1	0.2	Relative market growth only 3%
T3	Political intervention	0.1	2	0.2	Ex top management criminalization
T4	New entrants on domestic market	0.1	4	0.4	New entrants will not interfere domestic market share
		1	Total	1.8	

In conclusion, the IE score from the analysis shows that the Internal factor score is 2.65 and external factor score is 1.8. This will put the Alpha Corp in categories VIII. Thus, this gives the general direction of Alpha Corp using Retrenchment. In this case, the turnaround strategy will be used to improve Alpha Corp operational and financial aspect

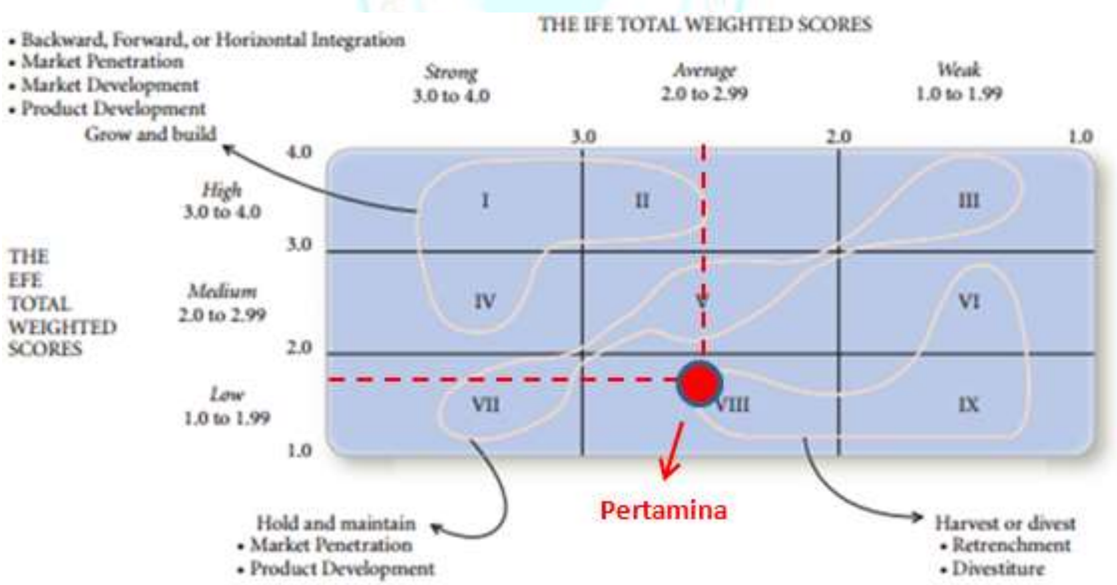

Figure 2. Alpha Corp IE matrix conclusion

4. Portfolio Analysis

4.1 Performance

Economic Value Added (EVA) analysis tools are used to assess the subsidiary performance. Economic value added (EVA) is a technique to assessing performance of company or corporate which introduced by Stern Stewart & Co. (now Stern Value Management). The objectives of EVA are to measure the actual economic profit produced by a company. Sometimes, it is also referred to as "economic profit," and provides a measurement of a company's economic success (or failure) over a period of time. This metric is useful for corporate to assess the performance of subsidiary adding value for its parent enterprise. EVA also can be used for a quick analysis to compare each subsidiary's performance

Economic Value Added (EVA) can be calculating follow:

Net Operating Profit After Taxes (NOPAT) - Invested Capital * Weighted Average Cost of Capital (WACC)

The first stage to calculate the EVA is to calculate the Net Operating Profit After Tax (NOPAT). NOPAT represent company/ subsidiary potential cash earnings if the company/ subsidiary operating without any debt. For this study, the author used the last three years NOPAT for each subsidiary. Note that each subsidiary has different issuance of annual report, and several reports are using Rupiah instead of Dollar. Therefore, for conversion purpose, in this study was used 1 $ = IDR 14,000

As the result, table 3 shows the summary of the EVA

Table 3. EVA summary

No	Subsidiary	Average 3 years EVA	Positive/ Negative
1	Alpha Corp EP	$ (368,561.86)	Negative
2	Alpha Corp Hulu Energi	$ (242,422.01)	Negative
3	Alpha Corp EP Cepu	$ 202,480.38	Positive
4	Patra Niaga	$ 25,708.32	Positive
5	Trans kontinental	$ (7,284.94)	Negative
6	Alpha Corp Retail	$ (2,275.19)	Negative
7	Lubricant	$ 12,804.28	Positive
8	Tugu Pratama	$ (55,624.73)	Negative
9	Bina Medika	$ (3,999.04)	Negative
10	Pelita	$ (6,801.42)	Negative

4.2 Strategic Value and Alignment

For strategic value screen purpose, each subsidiary will be explored compared to the Alpha Corp's long-term plan and the value chain analysis to reduce overall cost. By doing this, the subsidiaries are divided into three categories, which are:

- Synergy: Oil and Gas related business, ranging from upstream & downstream business. The business unit also fully align with Alpha Corp's long-term plan and also have significant role

- Supporting: Non-Oil and Gas related business, but has very important role for Alpha Corp operation and no other company can serve
- Non-related: Non-Oil and Gas related business, has less important role for Alpha Corp operation other company can serve or substitute

The Value Chain Analysis of Alpha Corp can be found in the table 4, and the summary of strategic value & alignment summary can be found in table 5.

Table 4. Value Chain Analysis

Step 1. Alpha Corp's Primary Activity				
Upstream production & lifting	Crude trading/ export & import	Refineries and petrochemical	Product import & trading	Selling & Marketing
Step 2. Total Cost				
$ 3,321,895.00	$ 14,264,017.00	$ 2,773,027.00	$ 14,852,561.00	$ 353,052.00
Step 3. Cost Driver				
-Fuel price for electricity generation -Technology cost	-Oil price -Transportation cost	-Crude oil price -Scale of plants -Refinery efficiency -Fuel price for electricity generation	-Oil price -Transportation cost	-Transportation cost -Location
Step 4. Links between activities				
1.Higher exploration cost and lesser upstream production quantity will increase overall cost				
2.Refinery & depot location will affect distribution cost				
3.Market oil price will be affecting overall cost				
Step 5. Opportunities for reducing cost				
1. Increase upstream production to reduce raw material cost and crude import cost				
2. Build new refinery to reduce product import cost				
3. Utilize facility sharing between subordinate (example: oil wharf, crude oil pipeline, storage tanks, warehouse)				
4. Resource sharing for R&D and engineering				

Table 5. Strategic Value & Alignment Summary

No	Name of Subsidiary	Remark	Type
1	PT Alpha Corp EP	-Align with upstream sector strategies to increase oil reserve and production in organic manner thru exploration and development, Enhance Oil Recovery (EOR) and production optimization -Align with value chain analysis to reduce total cost	Synergy
2	PT Alpha Corp Hulu Energi	-Align with upstream sector strategies to increase oil reserve and production in organic manner thru exploration and development, Enhance Oil Recovery (EOR) and production optimization -Align with value chain analysis to reduce total cost	Synergy
3	PT Alpha Corp EP Cepu	-Align with upstream sector strategies to increase oil reserve and production in organic manner thru exploration and development, Enhance Oil Recovery (EOR) and production optimization -Align with value chain analysis to reduce total cost	Synergy
4	PT Alpha Corp Patra Niaga	-Core business is in trading and logistic of oil and gas for industrial needs -Have significant synergy value, especially in logistic and distribution	Supporting
5	PT Alpha Corp Trans Kontinental	-Has no direct relation to oil & gas business -Other company can serve or substitute -Doesn't align with Alpha Corp long term plan or value chain analysis	Unrelated
6	PT Alpha Corp Retail	-Core subsidiaries in oil & gas downstream business -Have mission to carry out government mandate regarding fuel distribution -Align with Alpha Corp long term plan, especially to fulfil domestic product demand with competitive supply chain	Synergy
7	PT Alpha Corp Lubricants	-Core business in petrochemical downstream production, selling & marketing -Have significant synergy value, especially in downstream process	Supporting
8	PT Tugu Pratama Indonesia	-Has no direct relation to oil & gas business -other company can serve or substitute -doesn't align with Alpha Corp long term plan or value chain analysis	unrelated
9	PT Alpha Corp Bina Medika	-Has no direct relation to oil & gas business -other company can serve or substitute -doesn't align with Alpha Corp long term plan or value chain analysis	unrelated
10	PT Pelita Air Service	-Has no direct relation to oil & gas business -other company can serve or substitute -doesn't align with Alpha Corp long term plan or value chain analysis	unrelated

4.3 Prospect

BCG matrix tool was used to assess the prospect of each subsidiary. The BCG Matrix or Growth-Share Matrix was developed in the late 60s by Bruce Henderson, which the founder of the Boston Consulting Group used as a tool to help corporate to allocate the resources efficiently among the portfolio of different business. It is widely used as a portfolio planning and analysis tool for marketing, brand management and strategy development. Based on the subsidiaries selected, there are five business market need to be analyzed for the market growth. Each subsidiary has different scales of market, depending on each operation. These markets are: global market for crude oil, Indonesian Industrial fuel, Southeast Asian market for lubricants, Indonesian market for general insurance, Indonesian market for hospital, Indonesian market for rotary airplane.

Table 6. BCG Matrix Result

No	Name of Subsidiary	Asset (mil. $)	Market growth	remark	Market share	largest comp MS	relative market share	Summary BCG
1	PT Alpha Corp EP	7621.5	3%	Low	50%	28%	1.79	cash cow
2	PT Alpha Corp Hulu Energi	4780.8	3%	Low	50%	28%	1.79	cash cow
3	PT Alpha Corp EP Cepu	2608	3%	Low	50%	28%	1.79	cash cow
4	PT Alpha Corp Patra Niaga	960.39	3%	Low	70.3%	10%	3.20	cash cow
5	PT Alpha Corp Trans Kontinental	287.01	3%	Low	7%	13%	0.54	dog
6	PT Alpha Corp Retail	150.64	3%	Low	90%	5%	10	Cash cow
7	PT Alpha Corp Lubricants	500.64	4.7%	Low	61%	15%	4.07	Cash cow
8	PT Tugu Pratama Indonesia	836.39	9.7%	Low	3%	4%	0.67	dog
9	PT Alpha Corp Bina Medika	111.01	2%	Low	17.75%	20%	0.89	dog
10	PT Pelita Air Service	65.66	2%	Low	20%	30%	0.67	dog

Figure 3. BCG Matrix

4.4 Strategy for Each Subsidiary

Strategy for each subsidiary is based on its economic value added, alignment and the prospect. In summary below are the strategy for each subsidiary:

Table 7. Strategy for each subsidiary

No	Subsidiary	EVA	Alignment	Prospect	Strategy
1	Alpha Corp EP	Negative	Synergy	Good	Hexagonal restructuring and IPO
2	Alpha Corp Hulu Energi	Negative	Synergy	Good	Hexagonal restructuring and IPO
3	Alpha Corp EP Cepu	Positive	Synergy	Good	Expand and invest by obligation
4	Patra Niaga	Positive	Synergy	Good	Expand and invest by obligation
5	Trans kontinental	Negative	Unrelated	Bad	Hexagonal restructuring and divest
6	Alpha Corp Retail	Negative	Synergy	Good	Hexagonal restructuring and invest by obligation
7	Lubricant	Positive	Supporting	Good	Hexagonal restructuring and IPO
8	Tugu Pratama	Negative	Unrelated	Bad	Hexagonal restructuring and divest
9	Bina Medika	Negative	Unrelated	Bad	Hexagonal restructuring and divest
10	Pelita	Negative	Unrelated	Bad	Hexagonal restructuring and divest

5. Internal Governance Improvement

Internal Corporate governance is one of the mechanisms created to control and define the strategic directions and performances of the corporates, and also to manage the relationships among stakeholders. At the center, corporate governance is focused on identifying ways to make sure that strategic decisions are effectively made and facilitated the corporate's efforts to gain strategic competitiveness. This can also be defined as the means to establish and maintain alignment between all parties, which the corporate share holder and its top-level managers, whose might have conflict of interests.

There are three internal governance mechanisms used with the addition of single external mechanism. The three internal governance mechanisms are:

1. Ownership concentration
2. The board of directors
3. Executive compensation.

Ownership Concentration

Alpha Corp need to maintain its large-blocks of ownership to ensure that the subsidiaries can be easily monitored and controlled. This means it needs maintain more than 51% of ownership on each core subsidiaries. Alpha Corp and its subsidiaries need to focus more on long-term strategy rather than responding to the short-term.

Board of Directors

Board of directors (BOD) is a group of individuals elected by the company's owner with main responsibilities to act in the owners' behalf by conducting formal monitor and control to the company's top-level managers or directors. BOD task is to oversee directors and ensure the company runs in the ways to best served the stakeholder's and owners' interests. In Indonesian companies, board of directors are best known as Board of Commissaries.

In general, Alpha Corp and its subsidiaries need to have specific policy in determining the composition of board of commissioner. The Board of commissioner need to have diversity in gender, area of expertise, education background and experience related to the subsidiaries major industrial, financial and corporate governance activities

Executive Compensation

Executive compensation is one of the mechanisms to control and align the interest of the directors with the owners by using wages, bonuses and long-term incentive like stock and options. The compensation for the top executives Alpha Corp and its subsidiaries should be performance based to ensure the directors and managers make decisions that aligned and best serve the owners' interest. This could be done by using KPI

By using long-term incentives, it is expected that the agency problem can be avoided since it will link the wealth of directors with the wealth of the owners. Long term incentives are also effective to ensure that the directors pursue the long-term goals instead only for short term.

However, this is relatively new for Alpha Corp and its subsidiaries since most of stock is owned by GOI. Thus, the proposed strategy is to give the top executives of Alpha Corp and its subsidiaries the stock options to ensure alignment of the top executives with the owner, where in this case is GOI.

Conclusion

In Conclusion, Alpha Corp need to review its corporate strategy, especially its business portfolio to support its long term plan and sustain in the challenging business environment. The portfolio need to be restructured so it can fully aligned with Alpha Corp core business and increase the corporate value.

In parallel with the portfolio restructuring, the corporate governance of Alpha Corp and its subsidiaries need to be improved to ensure each subsidiary will align and can be controlled to the head quarter. The three internal mechanism, which are the ownership concentration, board of commissioners and executive compensation will be utilized to ensure good corporate governance within Alpha Corp can be achieved.

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