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Private equity and the pandemic: An interview with the CEO of Hahn & Company

Scott Sang-Won Hahn, CEO of the South Korean private-equity firm Hahn & Company, discusses forces at work in his country and how the dynamics unleashed by COVID-19 are an impetus for change.

South Korea is to Asia what private equity is to South Korea: a vital player, though not quite the largest, and a disruptor. While the South Korean economy might not be as massive as those of China, India, and Japan, it's one of the world's biggest, ranking among the global leaders in sectors such as automotive, electronics, and heavy industry. And though private equity is a bit untraditional in a country known for chaebol (family-owned conglomerates), it's a more powerful growth engine than you might suspect, generating returns of 1.4 times invested capital in recent years and accounting for some 25 percent of South Korea's M&A.

That's thanks in no small part to Hahn & Company, a Seoul-based firm that manages the largest private-equity fund committed to investing solely in South Korean businesses. It has invested more private-equity capital in Korea than any other firm since its inception in 2010. Acquiring, managing, and growing companies across sectors requires a micro and a macro view. Hahn & Company has demonstrated both, with a portfolio that includes everything from manufacturing and building materials to automobile components, consumer goods, transportation and logistics, and e-commerce. Many of its companies, like many other South Korean businesses, are active in foreign markets. This requires its managers to be exceptionally well informed about neighboring Asian economies—and global ones, as well. Particularly in the wake of COVID-19, the firm encourages its portfolio companies to maintain their geographic balance and, even more important, to adapt quickly.

Scott Sang-Won Hahn, the CEO and founder of Hahn & Company, recently provided his South Korean perspective on these and other imperatives in a discussion with McKinsey's David Schwartz and Joydeep Sengupta.

The *Quarterly*: *What, if anything, distinguishes an Asian company from those of the West? And what distinguishes a South Korean one?*

Scott Hahn: Asian companies are becoming more similar to Western companies than different. That said, Asian companies probably have a greater need to be global. China is a big market, but in a number of industries, the European and US markets are even bigger. That forces businesses in Asia to be more export driven, which requires Asian companies to better understand success factors across multiple geographies and necessitates full-scale operations across all of the big markets. The other distinction of the Asian company, broadly speaking, is how private enterprises work together with the public sector. Asian businesses are generally more familiar with those nuances.

For Korea, I'd say the biggest differentiator for successful companies right now is size. Korean companies with more capital at their disposal are responding faster to the COVID-19 crisis. Companies that have a full-scale presence in the big markets—North America, Europe, and China, in addition to Korea—have performed better than companies that were purely export geared or based solely in Korea and China. That's certainly the case for our businesses: the bigger companies have been able to respond faster. Size leads to speed, which leads to flexibility and increased adaptability. That was true before the crisis, as well. There has been nothing before on the level of COVID-19 in terms of requiring businesses to react and to transform, of course, but in Korea we're used to dealing with volatility and unstable environments; Korean companies, particularly those of size, are used to responding to rapid and significant disruptions in supply chains and additional markets. That's because our home market, while sizable, is certainly not the largest.

The *Quarterly*: *Many CEOs are telling us that trends that had been present before COVID-19 have been accelerated by the COVID-19 pandemic.*

Scott Hahn: I agree. We see it in the maneuvering that our managers have been required to undertake. Whatever was going to take ten years, managers have been forced to deal with over the past six to eight months. Like it or not, in this environment you're forced to adapt. All companies are now forced to deal with rapid change. They're going to have to get faster, much faster, than anybody had planned prior to COVID-19.

In Korea, more than 25 percent of exports are to China. Some companies sell only to that market. But if you've built in flexibility, you can look beyond China and balance supply chains and additional markets geographically. We've been accelerating that rebalancing. It requires not just the CEO but the entire team to make important decisions very quickly. Whatever weak spots you have—whether by division, function, or region—are being tested. Weaknesses are becoming readily transparent in this era where you need both accuracy and speed.

The *Quarterly*: *What consequences from the pandemic do you foresee?*

Scott Hahn: What's happening this year is an impetus for change. It sharpens the divide between successful and unsuccessful companies. Companies that can adapt faster and act quicker are going to get even more of the lion's share of capital, whether that's through additional capital raising on attractive terms or through increased valuations. It's happening already, and not just in what you would call COVID-benefitting industries that, for example, facilitate work and stay at home. I see it in private equity, where standout firms are attracting even more capital. It's happening in traditional retail and in manufacturing. The benefits of speed and flexibility are clear and becoming even clearer.

Consider digital marketing. Before the outbreak, we acquired the country's largest offline used-car retail business. After the acquisition, we built an online e-commerce platform that has now become the largest e-commerce used-car sales platform in Korea, with full-scale online-payment systems and direct-to-home car deliveries within 24 to 48 hours to anywhere in the country, combining both our offline and online businesses capabilities. When COVID erupted, we made a difficult decision to do within six months what we planned to do over 24 months. That took more capital and more resources. But we did it—and even with COVID, this is a business that is actually going to grow this year, both in profitability and the top line. A big reason for that success is because we successfully folded our two-year plan into a six-month plan.

One of the consequences from the pandemic is an increased premium on those owners and managers of businesses who are able to make the right, informed decision under tremendous time pressure, where the stakes are certainly higher. "Hope and pray" was never a strategy, and now "wait and see" is no longer an option in this environment either. Flawless execution of strategy in record time is starting to define success as much as the strategy itself.

The *Quarterly*: *The perception, at least in the West, is that, certainly among the larger economies, Asia is very digital-centric and becoming even more so. Is the perception correct?*

Scott Hahn: I think it is. The familiarity with digital, the access to it, has been in Korea for a while. The adoption was here. The infrastructure has always been here. And the transformation I've seen in Korea will continue to progress. Comfort with digital in Korea was somewhat demographic- and age-specific prior to COVID. Now, because of the pandemic, those who are older are doing a significant amount of their daily activities online. Korea was certainly digital-centric and has become even more so since COVID. I expect this to continue.

Capital is smart, and it's now going to overwhelmingly favor those companies and business leaders who aren't resistant to high levels of rapid change, including digital adaptation. You are already starting to see considerable separation and binary outcomes in each industry, dividing those companies that embrace digital and are already executing their digitalization strategy from those that merely pay lip service to it and are executing only at the speed of inertia.

The *Quarterly*: *What are the implications for M&A?*

Scott Hahn: M&A activity is almost a necessity now in Asia, and in Korea specifically. Think of the emphasis on size; if you want to balance supply chains and want to do that quickly, you're going to need to buy rather than build. I suspect there's going to be a wave of transactions for businesses that want more geographic balance. Broadly, given the massive amount of liquidity globally, the capital to do transactions exists. Those businesses that are market leaders and have demonstrated success in navigating through this current pandemic, irrespective of their industry, will command even greater capital backing.

That said, some Korean businesses have a big question mark: How successful are they at making global acquisitions? From a Korean context, the track record of successful acquisitions and implementation of cross-border M&A is spotty. The need to do M&A to make your company larger, more flexible, more competitive is clearly there. But the market will put an even higher premium on a demonstrated track record: "They've done this before. They know how to do this. They are reputable and trusted buyers, owners, and sellers of businesses." A pandemic isn't the right time, irrespective of the influx of global liquidity, to test-run on those organizations that have yet to demonstrate their ability to successfully acquire, implement, and grow via M&A.

The *Quarterly*: *On the divestiture side, we sometimes see Asian conglomerates that find it hard to sell companies or refresh portfolios because doing so can be seen as a sign of failure. Does that ring true in Korea?*

Scott Hahn: Yes, clearly. The refresh rate is certainly slower in Asia. It's very slow in Korea and Japan—developed markets in Asia tend to be slower about refreshing their portfolios. Yet the need to do this is even greater. You've got to be faster, bigger, and more flexible—which means that it's more important than ever to divest companies that don't return their cost of capital or are uncompetitive or suboptimal in size. Much of the resistance to divestitures in Asia and Korea is organizational. To some, it's also sentimental. But I think owners of businesses in Asia and Korea need to overcome these emotions and embrace change. You are already seeing some stories of very successful divestitures in Korea. Divestitures are not an admission of failure but of the imperative to take bold action to be better.

Now, more than ever, those companies in Korea that can successfully acquire and divest faster, as well as do so at meaningful scale relative to the size of their existing businesses, will have a higher probability of becoming globally leading businesses. When I speak to some of the decision makers of big conglomerates in Korea, not one person says, "I don't need to be global, I'm not going to be impacted by anything that happens outside of this country, I'm very happy just in my Korean home market."

Since we focus on making private-equity investments in Korea, where buying and selling companies is just part of the private-equity operating model, our portfolio refresh is largely predetermined. But a number of the companies we acquire make big expansions globally, organically and inorganically. There's clearly a need to do that at an accelerated pace. One positive outcome coming out of the pandemic is that those that have the capital, the desire, and capabilities for M&A will be even more rewarded. There's been a change in mentality. This is a country that enjoyed 5 to 6 percent GDP growth per year 15 years ago, but no one believes that we're going back to those growth rates. There's a change, too, in the types of M&A that people are considering; they're also looking at deals that are more than geographical expansion—to get active in a larger market or to obtain technology—and considering acquisitions that balance the organization or diversify supply chains. It's difficult to do that quickly without M&A.

The *Quarterly*: *It's interesting that you mention low growth. One risk of the massive amount of stimulus in response to the pandemic is that the low-interest, low-growth challenges that have faced Japan will spread to other countries. Are you concerned about that in Korea?*

Scott Hahn: Even prior to COVID, many Korean business leaders expressed concern that Korea could go the way of Japan in terms of prolonged low interest rates coupled with a very low economic-growth environment. One of the reasons is population growth, or lack thereof. But the world now has witnessed a massive increase in liquidity, and, ultimately, capital needs to get deployed somewhere. From a macro perspective, we were already asking what would it mean to our businesses if Korea was the next Japan. At the micro level, where our private-equity business activity actually takes place, there will still be many winners and unfortunately a lot more losers if such an environment becomes reality in Korea. We now really need to understand and devise well-informed views on what we think will be the businesses that will become more valuable and that will become much less so if Korea becomes the next Japan and enters a low interest rate, low-growth environment.

The *Quarterly*: *Speaking of value, do you see a tension between "shareholders" and "stakeholders"? There must be exceptional pressure, as a private-equity investor, to balance constituencies.*

Scott Hahn: I look at it this way: business ownership has always required juggling different responsibilities. You can't say that, as private equity, it's just 100 percent for the shareholders' interests each and every time, because, ultimately, it is in the shareholders' interest to look after every stakeholder. I think that has always resonated in Korea, probably more so with the prevalence of very large businesses that dominate the economic landscape of the country. When you think in terms of what's sustainable—issues that every society has got to deal with—you realize that you need to achieve some optimal balance considering all constituents. I think as business owners calibrate that optimal level of balance, they need to keep in mind what is in the shareholder's interest across time, from the short and medium term to the long term.

At the same time, I don't think you can take private enterprises and say they should now function as public organizations. I *do* think there is an opportunity for public and private sectors to collaborate. But collaboration doesn't mean a combination of the two—making a private company operate more like a public company. It means the public sector and private companies can work together. A good example is digitalization. We can actively implement digitalization strategies across a number of our businesses. Take, for example, factory automation. I think we're getting to the point, in certain industries, where fully automating them is now possible and is going to make sense. But this private-company initiative needs to be accompanied by a public-policy one that can try and alleviate some of the pressures and tensions of digitalization. Because we shouldn't have to say, "Let's *not* embrace the latest technologies, let's *not* embrace efficiency or productivity, because of HR considerations." But some of the tensions that digitalization brings to society need to be managed, and a collaboration, not an amalgamation, of private and public sectors seems to be the most effective. Certainly, our investors look at it that way, albeit to different degrees. I don't think there's a single investor in our funds who now says, "I'm not concerned about ESG[1] issues."

The *Quarterly*: *Does that represent a change?*

Scott Hahn: Things have changed over the last couple of years. Our dedicated ESG department within our own organization has accelerated its initiatives to ensure that the companies that we own are responsible citizens. And I think we have achieved considerable success and differentiation in this regard. We find that when we put ESG metrics as a KPI for our respective managers, they get it done.

What has helped our business succeed, I think, is that we never forget about our reputation. Certainly, our reputation to investors; you don't want your reputation among investors to be that you're not a very good investor. [Laughs.] But we're mindful of our reputation among our stakeholders and our reputation in this country. We strive for balance and fairness, which go hand in hand with reputation. We're mindful of the risks we have chosen to assume and manage, and equally mindful of the risks and business decisions we will avoid on each and every investment. And this, too, ultimately leads to long-term success. Q

Scott Sang-Won Hahn is the CEO of Hahn & Company. This interview was conducted by **David Schwartz,** a member of McKinsey Publishing in McKinsey's Tel Aviv office, and **Joydeep Sengupta,** a senior partner in the Singapore office.

[1] Environmental, social, and corporate governance.