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Mergers & Acquisitions

The new face of global M&A

By Arthur R. Bert, Kristin Ficery and Kinsley Sykes

In developed countries, most CEOs have come to grips with the immediate effects of globalization—the low-cost competition as well as the new market opportunities. But they may be underestimating another factor: the dramatic rise of emerging-market multinationals, which is rapidly becoming a hallmark of global M&A activity.

As the balance of commercial power shifts from the economic Triad—the United States, Western Europe and Japan—to a much broader group of countries, business leaders from the historically dominant economies now see that globalization is very much a two-way street. Spurred by advances in communications, transportation and technology as well as by the spread of free trade, the global economy is now also defined by unprecedented capital mobility—and quite sudden shifts in ownership structure.

These shifts in capital and structure have become evident in the increasing presence of companies from emerging markets in global M&A activity. In 2007, Saudi Basic Industries Corporation purchased GE Plastics for \$11.6

billion. In 2008, India's Tata Motors bought two high-end British marques—Land Rover and Jaguar—from the Ford Motor Co. And two emerging-market multinationals—China Petroleum & Chemical Corp. and a subsidiary of India's Oil and Natural Gas Corp.—bid for Imperial Energy Corp., a Russian company (the Indian offer was ultimately accepted). The list of such deals will likely continue to grow, accelerated by the lure of large overseas markets and the maturation of stock exchanges in developing countries.

In today's multi-polar world, the complexity of industry combinations, business scale and structures has increased dramatically. It's an arena in which the developed world's business leaders must be especially vigilant. Not only

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do those CEOs and their lieutenants need to be scanning the horizon for potential acquisition targets they may not have even heard of, they must also be ready and able to negotiate ownership stakes in companies and under cultural circumstances that may be alien to them. But the most striking new feature in the rapidly changing global M&A landscape are the bold M&A moves from emerging-market contenders—moves that may put the developed world CEO's own company in play.

The evidence is in the numbers. In two recent M&A waves—1995–2000 and 2004–2007—cross-border M&A activity increased from 27 percent to 33 percent of deal volume, reaching a new high of 38 percent in 2007 (see “Cross-border M&A: Handle with care,” *Outlook*, September 2008). There has also been a clear shift in the geographic focus of deals. The volume and value of M&A deals involving the B6 nations—Brazil, Russia, India, China, Mexico and South Korea—and other emerging-market players is starting to increase. Acquisitions in those regions soared from just over 4 percent of global M&A activity in 1995 to 12.4 percent in 2007 (see chart, page 4). Figures for 2008 have not been included because the global financial crisis, with its aggressive government interventions in the banking sector, has so drastically distorted the pattern of deal flow.

In the most dramatic turn, acquirers from emerging-market countries are making large-scale, strategic acquisitions in developed countries. In fact, emerging-market buyers initiated some of 2007's largest deals, such as the \$17 billion purchase of Canadian nickel-mining giant Inco by Vale, the Brazilian minerals conglomerate.

Moreover, the value of deals in which companies from emerging markets bought companies in the developed world increased, as a percentage of

total worldwide deal value, from 1.4 percent in the 1995–2000 period to 4 percent in the 2004–2007 period. While the value is still relatively small as a percentage of the total, the growth represents a clear trend as emerging-market buyers gain comfort and experience in cross-border deals and continue to strive for global outreach. It is not just Chinese, Indian and Russian companies that have been active; acquirers from Malaysia, South Africa, Mexico and the United Arab Emirates have also ventured outside their domestic markets to do deals.

To be sure, economic and financial contagions like recession and extreme stock market volatility are global phenomena in a multi-polar world, and could well create a temporary lull in activity. But despite the current downturn, emerging-market corporations—which are, in most cases, well managed, efficient and globally competitive—remain confident in their M&A prowess.

The emerging-market players are smart to be exploring acquisition opportunities worldwide. In the midst of the economic downturn, many valuations are significantly lower than they were just six to nine months ago. Add the fact that many organizations are in desperate need of capital infusions and that translates into strategic opportunities. Some emerging-market acquirers have strong cash positions; in today's M&A environment, “cash is king” and could lead to successful deals with less competition.

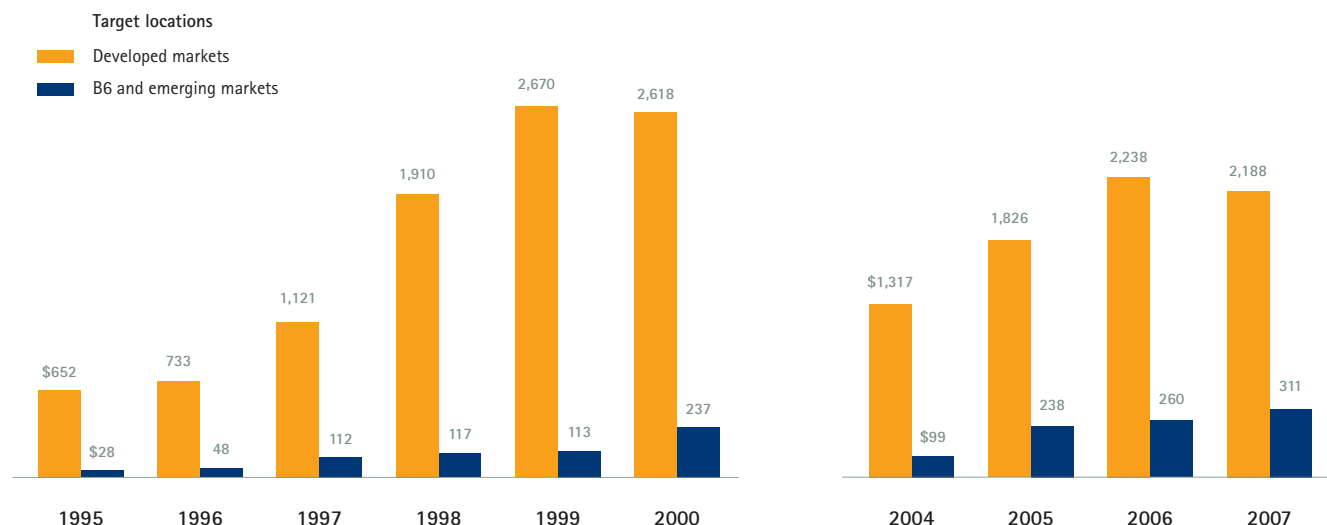
As the landscape changes, there are four implications to consider.

1. **Increased M&A activity from emerging-market buyers is heightening competition and raising the prices for the best targets in both emerging and developed markets.** While it is not unusual to see multiple bidders driving up the price of a merger, it is a shift for emerging-market companies to be the drivers.

Bold new contenders

The majority of M&A targets are still in developed countries. Even so, the total transaction value of M&A assets in the B6 and emerging markets jumped from \$28 billion in 1995 to \$311 billion in 2007.¹

Transaction value, \$ billions; completed deals above \$250 million



¹ Developed markets = High-income OECD members; Emerging markets = Non-high-income OECD members and other emerging markets; B6 countries = Brazil, Russia, India, China (including Hong Kong), South Korea and Mexico

Source: Thomson One; Accenture analysis

Consider the bidding war between India's Suzlon Energy and French rival AREVA for control of German wind power company REpower. Teaming up with Portugal's Martifer Group, Suzlon outbid its French rival. Then Suzlon bought out Martifer's stake, giving it about 90 percent ownership of the German company.

In 2005, appliance maker Maytag accepted a bid well above \$1 billion from private-equity firm Ripplewood Holdings, only to see it topped by China's Haier. Haier was then outbid by Whirlpool, but the final price Whirlpool paid amounted to several hundred million dollars more than the initial Ripplewood bid.

Given the current weakness of the global economy, we may not see bidding wars of this magnitude in the near future. But when they do return, emerging-market players will assuredly be playing key roles. There is already plenty of evidence that developing-market acquirers

are willing to do enormous deals to establish global scale. For instance, Tata Steel was the world's 56th largest steel producer in 2006. Its 2007 purchase of Corus—the combined former British Steel and Koninklijke Hoogovens—catapulted it to No. 5.

2. Western methods of valuation and due diligence may not be flexible enough for evaluating emerging-market targets.

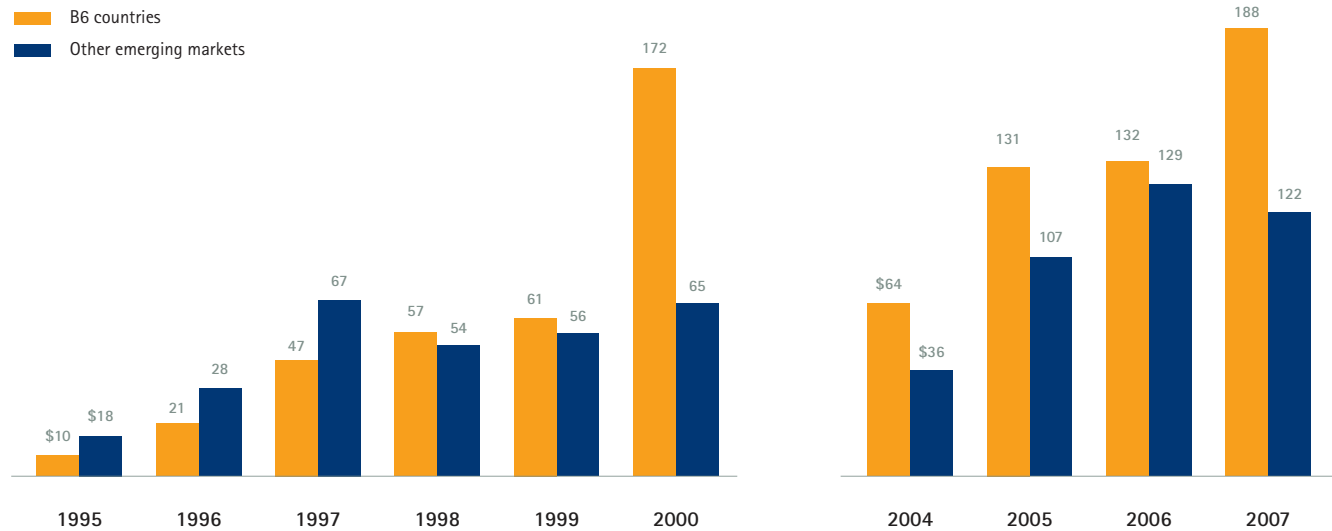
In many emerging markets, data for public companies is not as available or reliable as it is in the West, and data on private companies can be particularly hard to come by. Realistic value calculations are complicated by such human resources issues as local labor laws as well as environmental compliance mandates and tax law.

And in general, emerging markets don't have the rich stores of historic and regularly refreshed data on factors such as industry production, capacity, demand and spending on R&D and advertising. For potential

Soaring value

Although there has been growth in transaction values for both emerging markets and B6 countries, the biggest jump has been for deals in the B6.²

Transaction value by target location, \$ billions; completed deals above \$250 million



² B6 countries = Brazil, Russia, India, China (including Hong Kong), South Korea and Mexico
Source: Thomson One; Accenture analysis

acquirers, knowledge of how the target company's government is involved in a business or industry is also critical, in terms of both regulation and how different agencies and officials work.

Western business leaders may also have to rethink how to value intangibles when considering deals in emerging markets. Compared to what those deal makers may be used to, due diligence overseas may not place as much emphasis on formal risk assessments or on detailed consideration of the role of insurance coverage in deal making.

And although Western acquirers are usually on their guard against such well-publicized risks as less strict intellectual property protection, they're not as prepared to handle a range of risks around cultural and organizational differences in emerging markets. In China, for instance, some of the most attractive acquisition targets are family-controlled conglom-

erates. Political connections may also carry greater importance than potential acquirers are used to. In light of the current economic challenges, prospective buyers may decide that such factors add unacceptable levels of risk.

3. As emerging-market contenders become increasingly assertive deal makers, it becomes more important to understand their strategic intent. Sovereign wealth funds—huge pools of cash held by national governments—clearly have different objectives than most manufacturing or service providers, but they are changing the global M&A game by buying equity stakes in global companies. Although the funds have had limited impact to date, this is likely to change as they grow larger.

Cumulatively, these funds have grown from \$500 billion in 1990 to more than \$2 trillion today, and they are expected to reach as much as \$10 trillion by 2012—close to the current

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combined gross domestic product of Japan, China and the United Kingdom. The funds will probably look beyond fixed income to invest their growing capital pools, making it likely that they will become more active in equity investments. If they decide to take direct control of companies, as private-equity players do, they will add significantly to the complexity of the global M&A picture.

4. A company's strategic planning process will need to be more global in reach, and must ensure that industry-changing scenarios (such as a foreign company acquiring a local competitor) are fully considered. The arrival of emerging-market bidders is a sharp reminder that M&A is usually a strategic pursuit. A recent case in point: In 2007, India's United Spirits acquired Scottish spirits maker Whyte & Mackay, then the world's fourth largest Scotch whiskey maker, for nearly \$1.2 billion.

The deal was not only about gaining access to several well-established brands. United Spirits, which already had a sizable share of India's whiskey market, was able to bolster its brand portfolio there with premium imports that would appeal to the nation's fast-growing numbers of affluent consumers, open opportunities in other large emerging markets and more easily access developed US and European markets.

The deal will make it far harder for competitors to expand their Scotch business—particularly in the increasingly attractive Indian market. And given United Spirits' existing marketing and distribution infrastructure in India, profits from the acquired products go straight to the company's bottom line.

At the same time, the new M&A landscape reveals that some emerging-market buyers are rapidly moving toward market-leading positions. Just look at Brazil's Vale, which has, in

the last three years, become the world's second largest diversified mining company in terms of market value.

Vale is one of the best examples of a new phenomenon: the emerging-market player that grows from a largely regional company to a more global concern, with a significant presence in developed countries. In October 2006, Vale, previously mostly an iron ore mining company, diversified by buying the majority of Canadian nickel miner Inco. Then in 2007, the Brazilian conglomerate acquired Australian company AMCI Holdings Australia, which operates and controls coal assets.

The new face of M&A

Even buyers with deep local M&A experience will need to use different tactics and acquire additional skills. While the emergence of developing-market acquirers has not changed the nature of core M&A activities (target identification, due diligence, valuation and post-merger integration), the involvement of new and, in many cases, little-known participants means that deal makers must take into account a host of additional factors during both the pre- and post-close stages of the deal.

In the pre-deal area, key success factors include the following.

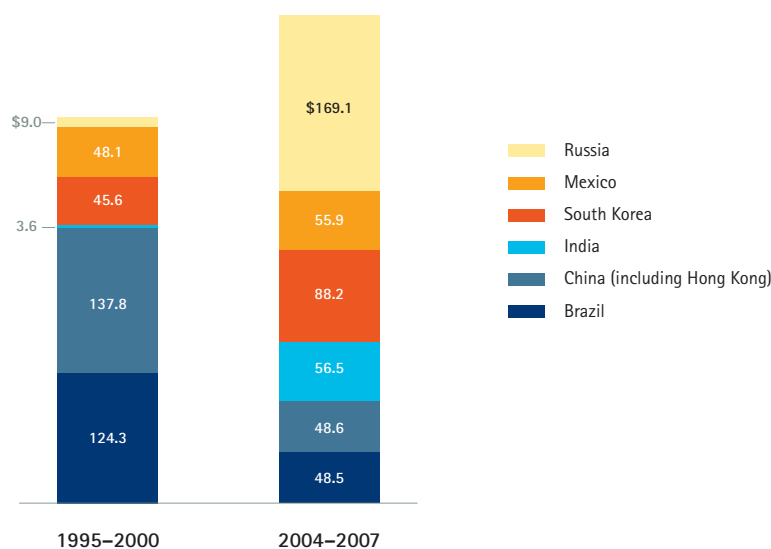
- **Recognize that the deal-making universe has quickly become much larger.** Be sure to include emerging-market contenders in deal scenarios. Make a list of every possible competitor and its presumed rationale for making an offer.

In 1989, when OAO Severstal won the bidding for Rouge Steel Co., the mill spun off by Ford Motor Co., Severstal was known by industry insiders as one of Russia's largest steel producers. Today, after four more US acquisitions, Severstal is the fourth largest steelmaker in the United States

Changing lineup

During the M&A wave from 1995–2000, Brazil and China dominated. In a more recent wave, from 2004–2007, new players—Russia, South Korea and India—emerged as dominant forces.

Transaction value of B6 targets, by country, \$ billions; completed deals above \$250 million



Source: Thomson One; Accenture analysis

by volume. While many in the North American industry saw Severstal as a force to be reckoned with, they might not have anticipated the Russian company's voracious appetite for US assets (see chart, above).

- **Realize that the deal is about different stakeholders' interests, not just about money.** Identify and engage key stakeholders such as government agencies, trades unions and others early and often. Certainly, this is not a new idea for M&A practitioners in developed markets, but those in emerging markets have mastered the practice in recent deals.

For example, Tata Motors won its bid for Land Rover and Jaguar in part because it was able to convince the British unions that Tata would be the best owner. Others can press the advantage of cultural similarity or operating model synergies. Within the expanded Europe—dealing with Eastern European companies—

acquirers can stress that geographic proximity and common EU concerns will result in better communication and understanding.

- **View emerging-market contenders as potential collaborators, not just as competitors.** If a company is almost certain to enter your market at some point, it is better that it does so as a partner than as a competitor. One example: In December 2007, Dow Chemical Co. announced plans to align with Petrochemical Industries Company of the State of Kuwait, a wholly owned subsidiary of Kuwait Petroleum Corporation. The 50/50 joint venture provided Dow with access to PIC's feedstock in emerging regions and enabled KPC to diversify its international petrochemicals presence.
- **Put your insurers to work.** When the quest for continued growth extends to emerging markets, it calls for a greater risk tolerance than many developed-nation CEOs are

To refrain from doing deals in emerging markets risks missing valuable opportunities or being forced to react to an unexpected acquisition move.

used to. Deep due diligence becomes a vital element of risk management, and insurance coverage can assume a larger role. Increasingly, deal makers are buying warranty and indemnity insurance to protect themselves against financial losses resulting from inaccuracies in the representations and warranties provided by the seller as part of a company's acquisition or sale.

Once the deal is closed, everything that applies to any cross-border

merger applies to a far greater extent when emerging-market targets are involved. The challenge of talent retention can surprise those with preconceptions of docile, loyal employees. For example, China's booming economy has given experienced and talented managers and employees substantial mobility, making retention particularly difficult. And cultural issues always loom large, necessitating thoughtful, well-planned cultural integration initiatives.

The M&A practices that have been well proven in the traditional economic Triad regions are hitting their limitations in the multi-polar world. But to refrain from doing deals in emerging markets risks missing valuable opportunities or being forced to react to an unexpected acquisition move.

At a minimum, business leaders from the developed world now must accommodate a far wider universe of vibrant, ambitious, well-managed and fully competitive contenders. Most of those organizations will likely be unfamiliar to US or European executives, but they must now be viewed as true competitors, or acquisition targets, or alliance partners.

It is also essential to understand the emerging contenders' motives. They could be battling for control of resources, as Brazil's Vale has been doing in minerals. Or they could be striving for growth in higher-value markets, as Tata Motors has demonstrated in the automobile industry. It is also vital to know how the financing picture is changing, not only in terms of the availability, freedom and cost of capital in an atrophied economy but because of the new role sovereign wealth funds are likely to play in the future and because many emerging-market players are placing surprisingly large bets.

Until the global economy begins to stabilize, emerging-market companies aren't likely to be making headlines with the boldness of their global forays. But they have already made their long-range intentions crystal-clear. Their moves to date should be signal enough for developed-nation CEOs to rethink their own global objectives for the next decade.

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