Emerging and Established Markets Converge

Mergers and acquisitions between companies in developed and developing countries increased by 50 percent in the past two years, but most deals are still initiated by firms in developed nations.
For years, mergers and acquisitions (M&A) between developed and emerging countries were initiated almost exclusively by companies in developed nations. While these deals still dominate, emerging markets have been on the rise in recent years. Several emerging-market countries—including China, India, Malaysia, Russia, the United Arab Emirates, and South Africa—are acquiring majority stakes in companies in developed economies at astounding rates. In 2011, of the 2,585 majority acquisitions between developed and emerging countries, 20 percent were initiated by companies in emerging countries. The total number of transactions in which companies from emerging countries acquired developed-country companies has been increasing since 2002 at an average rate of 17 percent per year.

In 2011, however, this growth stagnated when the economic uncertainty in Europe and the United States made acquisitions in those regions less attractive. While the rate of acquisition of companies in established countries by emerging countries remained flat at –2 percent, players in developed countries stepped up their acquisition activity in emerging markets by 20 percent; companies from established countries seem to increasingly pursue targets in developing countries not only as a means to capture cost synergies or access to growing markets but also as a means to counter competition from upcoming competitors.

Furthermore, A.T. Kearney’s latest study of global mergers and acquisitions finds that transactions between developed and emerging countries increased from 5 to 9 percent of global M&A activity in just 9 years. Since 2009 the number of those deals has increased by 50 percent (see figure 1).

This rate of growth far exceeds the rate observed for majority acquisitions within developed or emerging countries (an average annual rate of just 4 percent between 2002 and 2011). While still not large in absolute terms, it indicates how rapidly emerging markets are catching up in M&A activity.

This paper discusses the study findings, analyzes motives and trends, and lays out a three-pronged strategy for developed-country players to retain a competitive edge in a whole new world of M&A.

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**Figure 1**

**Since 2009 the number of transactions between developed and emerging countries has increased by 50 percent**

**Between developed and emerging countries**

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<thead>
<tr>
<th>Year</th>
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**Within developed and emerging countries**

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<td>2010</td>
<td>23,729</td>
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<tr>
<td>2011</td>
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Note: Deals include majority interest, outright purchase, and acquisition of assets (with final stake less than 50 percent).
Sources: Dealogic; A.T. Kearney analysis
The Time is Right for Investments

After the peak in 2007, with 30,745 deals valued at $3.78 trillion, the economic crisis hit the low point in 2009. The market recovered, with two years of 13 percent growth in the number of acquisitions in 2010-2011—approaching record deal activity in 2011 (see figure 2).

Companies in developed countries have a renewed interest in M&A. They have focused on restructuring, cutting costs, reducing debt, and spinning off non-core activities in order to ride out the recession and emerge in decent shape. By repairing their balance sheets and improving cash flow and profitability while lowering their debt levels, many now have large amounts of cash on hand to invest and are looking at emerging markets for new growth opportunities. The high growth of acquisitions from established companies targeting emerging countries in 2011 confirms this effect, and was clearly supported by more stable equity and debt markets.

In emerging countries, corporate champions are coming out of the financial crisis relatively unscathed compared to their peers in developed countries. For them, M&A is a way to realize their expansion strategies, and they often have an advantage—they’re backed by governments with aggressive economic development plans and sizeable pools of public and private money.

As one example, a recent report on China’s plan for developing the Pearl River Delta is explicit in its M&A policy: “…comprehensively employ various means to help the needy enterprises to survive, and encourage and support the advantageous enterprises to conduct mergers and acquisitions around their main business so as to form a batch of large enterprises with independent intellectual properties, world-class brands, and international competitiveness…”

Financing is especially cheap in China as the central government supports local companies pursuing international acquisitions in strategic industries.

Figure 2
Deals are slowly getting larger

Note: Deals include majority interest, outright purchase, and acquisition of assets (with final stake less than 50 percent).
Sources: Dealogic; A.T. Kearney analysis

Asia: Top Emerging Acquirer and Destination Region

Since 2002, emerging-market firms have been superseding firms from developed countries at an annual growth rate of 18.6 percent. Of the 93 companies from emerging countries listed in the 2011 Fortune Global 500, China dominates with 61 entries, followed by India with eight entries (see figure 3). The top three emerging companies within the Global Fortune 500 ranking—Sinopec, CNPC, and State Grid—are all located in China and already rank 5, 6 and 7 respectively in this study’s list.

It is no coincidence that in 2011, China, India, and Malaysia were the most active dealmakers in Asia, together accounting for more than 50 percent of all M&A activity (see figure 4 on page 5). China’s surge is likely to continue as the country’s National Development and Reform Commission urges Chinese companies to employ growth strategies feasible only through global acquisitions.²

Not only is China dominating the statistics of the top acquirers in the emerging countries, but it is also the most frequently targeted country by established companies—at 19 percent, it is significantly ahead of the next follower, Brazil (9 percent). India is number three in this ranking but, with 6 percent, has a rather minor stake in contrast to its powerful position as an acquirer.

In analyzing who buys whom, we found that from 2006 to 2011 the developed-country player was the acquirer in 78 percent of the 6,500 deals performed. No surprises here. But things begin to even out at the higher-value end of the spectrum: 41 percent of the 194 deals that exceeded $1 billion and closed during the same time period were performed by emerging-market companies. So while emerging countries still lag behind developed countries in the number of deals performed, the emerging country deals have more value, on average. This leads to

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²Helen Thomas, “China lights a fire in global dealmaking,” Financial Times, 5 April 2011

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Figure 3
Emerging players are superseding developed at an annual growth rate of more than 18 percent

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¹Represents seven companies, one in each of Colombia, Malaysia, Poland, Saudi Arabia, Thailand, Turkey, and Venezuela. Sources: Fortune magazine, A.T. Kearney analysis

²Helen Thomas, “China lights a fire in global dealmaking,” Financial Times, 5 April 2011
Figure 4
**In 2011, India, China, and Malaysia accounted for more than half of all deals where emerging country companies were the acquirer**

**Most active developing countries**

- China 29%
- India 21%
- Malaysia 9%
- Brazil 2%
- Bermuda 2%
- Mexico 4%
- South Africa 4%
- Russia 5%
- Other 24%

**Top eight developing countries targeted by developed countries**

- China 19%
- Brazil 9%
- India 6%
- Mexico 5%
- Russia 4%
- Indonesia 4%
- Argentina, 3%
- Poland, 3%
- Other 48%

Note: Figures may not resolve due to rounding.
Sources: Dealogic; A.T. Kearney analysis

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Figure 5
**U.S.-based companies lead as both acquirers and targets**

**Major acquirers from developed countries**

- U.S. 19%
- Canada 12%
- U.K. 9%
- Australia 9%
- Hong Kong 8%
- Singapore 6%
- Japan 6%
- France 6%
- Other 24%

**Top eight developed countries targeted by companies from developing countries**

- U.S. 25%
- Germany 10%
- Australia 10%
- Singapore 6%
- Hong Kong 7%
- Japan 3%
- Canada 5%
- U.K. 11%
- Other 22%

Notes: Percentages based on 2011 data. Figures may not resolve due to rounding.
Sources: Dealogic; A.T. Kearney analysis
Emerging and Established Markets Converge

Emerging countries competing neck and neck with the developed countries in terms of cumulative deal value between 2006 and 2011. Clearly, these new players have reached world-class status, with the funds that enable bold moves in established markets.

Among the developed-country players, U.S.-based companies lead both in acquiring and being acquired—and by substantial margins (see figure 5 on page 5).

Motives for M&A

Having survived the economic crisis, governments and private investors are renewing their interest in M&A. They have various reasons for doing so: Sovereign-wealth fund (SWF) investors appear to be especially hungry for long-term equity, emerging-market players want to buy into sophisticated technology and gain premium brand equity, and developed-country deal makers want to tap into the potential of new markets with new customers. The following offers more details of each:

Sovereign-wealth fund investors. Over the past decade or so, SWFs—state-owned funds that manage foreign-currency assets—have accumulated assets at an astonishing rate, drawing interest from the financial community and the public. Countries that lead the SWF trend have vast account surpluses: Our study reveals that the combined value of the top 13 SWFs is $4.08 trillion.\(^3\) By 2020 the total assets owned by SWFs are expected to range from $12 trillion to $20 trillion.\(^4\)

Several emerging-market countries are acquiring majority stakes in companies in developed economies at astounding rates.

While SWFs suffered a major blow during the economic crisis—as investment asset valuations plummeted, exports fell and commodity prices declined—our analysis suggests that SWFs will continue to be increasingly important to financial investors. Furthermore, despite declines in asset valuations, a higher share of fund assets is expected to be invested in equity to increase long-term returns.

Emerging-market players. Companies from emerging markets pose a challenge to developed-market competitors, because of the rapid growth of their activities and their underlying motives. For most emerging-market players, M&A represent access to established markets to secure reputable brands and loyal customers. Cross-border purchases are a means to acquire new technologies, extend product lines, diversify businesses, and gain access to distribution channels.

Emerging-market players are managed by a new generation of executives who are internationally educated and advocate growth through aggressive global acquisitions. Rather than acquiring a company and cutting costs—the strategy of choice in most domestic M&A—their cross-border

\(^3\) The 13 largest sovereign wealth funds, in decreasing order of size, are held by the following countries: UAE, China, Norway, Saudi Arabia, China, Kuwait, China-Hong Kong, Singapore, Singapore, Russia, China, Qatar, Australia.

\(^4\) “Crisis Reshapes Role of Sovereign Wealth Funds,” Bloomberg Businessweek, 21 August 2009
acquisitions can involve major capital investments, focus on growth, and provide a means to securing resource supply. These emerging players succeed in established markets by capitalizing on their low-cost structures against incumbent rivals or by leveraging their acquired resources and capabilities in their domestic markets. Examples of such acquisitions include:

- China Petrochemical Corporation (Sinopec): $2.9 billion acquisition of Canada’s Daylight Energy Ltd (2011’s second-biggest emerging deal), $4.65 billion purchase of ConocoPhillips’ stake in Syncrude Canada (2010), and $8.9 billion acquisition of Switzerland’s Addax Petroleum Corp. (2009)
- China National Chemical Corp (CNCC): $2.17 billion purchase of ELKEM AS and $2.19 billion acquisition of Makhteshim Agan Industries Ltd (both in 2011)
- Vimpelcom Ltd. (Russia): 2011’s top emerging deal, the $24.88 billion acquisition of the Italian Wind Telecomunicazioni S.p.A. and Orascom Telecom Holding SAE, which made Vimpelcom the world’s sixth-largest mobile-phone operator

Many developed-country companies have large amounts of cash on hand to invest and are looking at emerging markets for new growth opportunities.

Developed-country deal makers. The traditional M&A leaders are motivated by a need to establish a presence in high-growth markets, to gain a foothold in low-cost countries for manufacturing and sourcing, and to minimize competition from emerging-market rivals. Despite the recent wave of acquisitions by emerging-market companies, the developed-country players still perform the majority of global acquisitions. Some of the old guard’s M&A activity:

- Spanish Banco Santander SA: $5.11 billion acquisition of the Polish Bank Zachodni WBK SA (biggest deal by an established company in 2011)
- U.S.-based PepsiCo Inc: $5.24 billion purchase of Russia’s Wimm-Bill-Dann Foods OAO (2011), which made PepsiCo the largest food and beverage business in Russia
- Dutch beer maker Heineken: $8.1 billion purchase of Mexico’s FEMSA Cerveza (2010)

Target Sectors in Focus

A closer look at the industries and sectors where M&A activity has been most buoyant in the past few years reveals another paradigm shift: Emerging-market players tend to use M&A to move up the brand equity and technology ladders. The number one and two emerging M&A countries—India and China—have experienced 10 to 15 years of astonishing industrial development. Now, with these decades of providing low-tech manufacturing behind them, both countries are desperate for overseas purchases that help home-grown companies strengthen brand equity and gain access to improved technologies. As their domestic markets and consumers become more sophisticated, and the output of their services sector expands, most companies in their M&A
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Crosshairs focus on consumer products and retail, services, computer and electronics, and financial institutions.

M&A Challenges and Success Factors

Last year saw a surge of transactions from established into emerging markets with China being the dominant destination. Mergers and acquisitions are challenging, and success often hinges on several factors, including the 10 success factors noted in figure 6. While these relate to China in particular, they also apply to other emerging economies. It is crucial to consider how these factors apply at each stage of the acquisition process:

Stage 1: Target selection and due diligence. The quality of information about target companies from China and other emerging markets is significantly lower than that on Western companies. Information gaps or misinformation about customer and supplier relations or regulatory frameworks can result in poor due diligence. For example, a lack of integrated IT systems means year-to-date business results will be nearly impossible to report or the figures provided will be useless. Worse, poor due diligence can result in overpaying for what winds up being a less-than-ideal takeover target. Investing sufficient resources to close information gaps is money well spent. And on the topic of finances, effective due diligence must always consider hidden costs. Western companies generally have a rigid view of compliance and demand transparency in internal and external reporting, so hidden costs should be revealed from the outset to allow for an accurate calculation of the deal’s true cost.

Stage 2: Closing. Earn-out agreements are an effective way to reduce information asymmetry in the acquisition process. These agreements give the acquired company a strong incentive to preserve the integrity of the information, thus sparing the buyer from running into big surprises. In addition, acquirers should cultivate relationships with local authorities and become familiar with local legal systems and frameworks. This will help avoid misunderstandings with local authorities while honoring long-held cultures and customs.

Stage 3: Integration. Unlike domestic or regional deals, the typical Asian acquisition puts a large distance—both geographically and culturally—between buyer and seller which can create a problem as bridging cultural differences requires frequent interactions to help foster cooperation and trust.

Figure 6

Ten success factors for merger and acquisition performance in China

<table>
<thead>
<tr>
<th>Target selection and due diligence</th>
<th>Closing</th>
<th>Integration</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Do not overpay</td>
<td>5 Hedge information asymmetry with earn-out types of agreement</td>
<td>8 Identify key employees and tailor an effective retention plan</td>
</tr>
<tr>
<td>2 Be realistic about information availability and plan to bridge the gaps</td>
<td>6 Understand and anticipate Chinese regulations</td>
<td>9 Be cautious about hiring expatriates regardless of how rapidly they bring key functions under control and up to Western standards</td>
</tr>
<tr>
<td>3 Evaluate asset ownership, scope and validity of licenses, supply contracts, and past compliance with tax regulations</td>
<td>7 Demonstrate sincerity and build relationships with target company and regulators</td>
<td>10 Develop a strategy to protect intellectual property rights (even in full mergers)</td>
</tr>
<tr>
<td>4 Preemptively manage authorities and use local resources and relationships</td>
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Source: A.T. Kearney analysis
Under such circumstances, realizing restructuring synergies can be a difficult balancing act for the buyer. During the kick-off phase, before trust has truly formed and management is not yet sufficiently familiar with local conditions, it is smart to allow the acquired company extensive responsibilities. Moreover, geographic distance makes it difficult to build up sufficient presence within the target organization. Thus, it is reasonable for new management to focus on gaining control of critical positions—such as the chief financial officer—early on.

Since 2002, emerging-market firms have been superseding firms from developed countries at an annual growth rate of 18.6 percent.

Employee turnover rates are often higher in emerging countries than in developed ones. Uncertainty induced by the transaction is prone to increase turnover rates, eventually causing vital subject-matter experts to leave the organization. Putting employee-retention programs in place early is important, both to prevent turnover and to protect intellectual property, as unhappy employees could transfer to a local competitor if not encouraged to remain. Decisions about technology transfer should be initiated only after trust has been established and well after the kick-off phase.

Dealing with Increased Global Competition

The disproportionate rise of deals between the established and emerging world is both a cause and a result of the world becoming more integrated. Based on our experience in global M&A and strategy assignments for both established and emerging players, we observe three strategic pillars applied by companies that successfully deal with increased global competition:

**Defend domestic markets.** A company’s strength is its best means of defense in safeguarding domestic markets. Companies in established countries frequently have an innovative edge that they need to maintain and, ideally, expand, which requires continued R&D investment. In addition, protecting distribution channels is vital, and can be accomplished by setting up barriers to market entry through forward integration. Other effective defense strategies include closing off sales channels to foreign competitors by occupying distribution networks (in rural areas) and negotiating exclusive contracts.

It is also wise to build closer, long-term customer relationships, making the option to switch more expensive by tailoring offerings specifically to customers’ supply chains and operations, and by offering long-term after-sales services—in other words, setting standards and proprietary solutions to build barriers to entry for foreign competitors. Further, analyzing foreign markets with the goal of identifying potential competitors as targets is an effective—and often neglected—strategy by which to safeguard one’s home market. Strategies of this nature will, of course, need to be vetted with appropriate competition law counsel.
Emerging companies can leverage favorable factor cost, their close relations to governments, and a steep learning curve to continue to serve local customers with ever more sophisticated goods and services at a price that cannot be matched by competitors charging high rates.

**Battle foreign competition on their turf.** The most effective way to build and reinforce market position in a competitor’s country is to localize across the entire value chain—R&D, procurement, operations management, marketing, sales, service, and human resources, among other areas. For example, sourcing locally, including from state-owned companies, can improve relations with local authorities. Localizing production, acquiring stakes in suppliers, and improving local after-sales service are just a few additional examples that help penetrate the local market.

**Increase penetration in second-tier markets.** The economic significance of second-tier markets is often underestimated. For example, for the emerging markets, the discussion is mostly on China, obviously an enormous market, where larger economies of scale can be achieved compared to other emerging countries. However, considerable growth can be achieved in countries such as Turkey, Mexico, Indonesia, Thailand, Russia, Brazil, or the Gulf countries—all with different risk profiles than China.

The First Lesson in Every Contest

The paradigm shift on “deal street” will continue in the years ahead as emerging countries—particularly China and India—represent an ever larger portion of global M&A activity. For firms in developed countries, maintaining a sustainable leadership position in the global market space will require a profound focus and understanding of their emerging country rivals. After all, the first lesson in every contest is to know thy competitor. Make no mistake—this is a competition.

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