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BRICs Versus Mortar?

WINNING AT M&A IN EMERGING MARKETS

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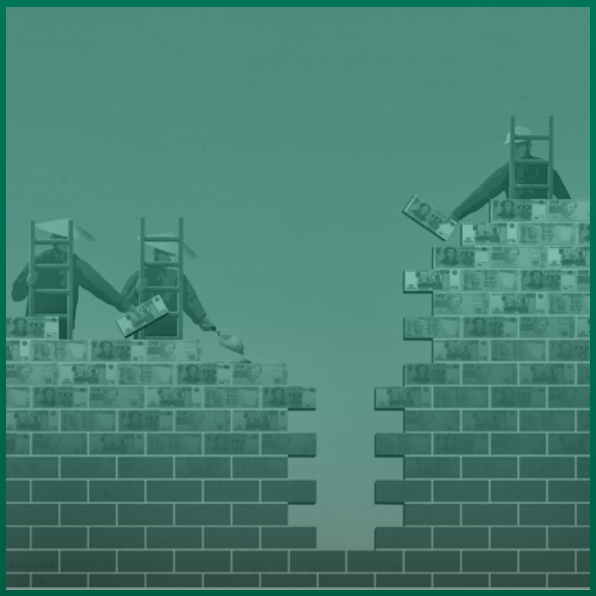

BRICs VERSUS MORTAR?

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EXECUTIVE SUMMARY

DESPITE the current worldwide lull in mergers and acquisitions, there's not much argument that emerging markets will remain a hotbed of M&A activity for some time to come. In the forefront of emerging-market M&A are the BRICs—Brazil, Russia, India, and China—which collectively account for 60 percent of total deal value in emerging-market M&A activity.

Within the BRICs, markets are growing, consumers are gaining purchasing power, and formerly protectionist economies are opening up to foreign investment. At the same time, newly confident and ambitious BRIC-based companies are racing to acquire assets in developed economies to achieve growth and advance their global aspirations. The sheer scale of economic activity ensures that the BRICs will continue to be a nexus for M&A.

This year's M&A report—the ninth from BCG highlighting surprising aspects of global M&A activity—turns the spotlight on the factors that make the difference between success and failure in deal making in emerging markets.

The global M&A market remains in a deep freeze, and emerging markets are feeling the chill.

- Following a weak 2011, global M&A activity declined by 13 percent in value and by 5 percent in the number of deals in 2012, dragged down by the aftermath of the euro crisis and ongoing financial-market volatility.

- The first half of 2013 showed little improvement, with deal quantity almost as low as it was after the bursting of the dot-com bubble in 2000–2001. At the same time, 2013 transaction values to date are high relative to those of 2012.

- The emerging markets, especially the BRIC countries, stand out as a relative bright spot. Although emerging-market M&A values and volumes declined in 2012, deals involving emerging-market countries now account for an increasing share of M&A activity.

- Today, one in every four M&A transactions involves an emerging-market company as buyer or seller. In 2004, emerging economies' share of the worldwide deal market was less than 10 percent.

Deal making is gravitating to those countries where personal and national wealth is increasing, the ranks of the middle class are swelling, and business is investing, expanding, and venturing into new markets.

- Emerging-market M&A tracks three broad investment themes: the search for the energy and natural resources that fuel today's economies, the opportunity to meet the surge of middle-class demand for consumer goods, and the need for technology and management know-how in order to catch up to developed economies.

- M&A activity in emerging markets yields strong results. From 1990 through 2012, deals involving at least one emerging-market company outperformed deals limited to developed economies, generating an average cumulative abnormal return (CAR) of 1.6 percent, compared with 0.9 percent for developed-country deals, in the seven-day window around the date of the deal announcement.

In emerging-market deal making, the keys to superior returns are learning from experience and managing complexity.

- Capital markets tend to react somewhat skeptically when acquirers from developed economies undertake deals involving emerging markets. But acquirers from developed economies that have done at least six emerging-market deals generate high returns.

- Successful acquirers in emerging markets, especially those from developed economies, reap superior returns by making transactions as simple and clear as possible. Acquirers from developed economies earn greater returns, at lower risk, on deals involving public companies than on deals involving privately held targets, which are less transparent.

- BCG's research shows that for developed-economy acquirers, the average CAR is 2.1 percent on public-to-public deals in emerging markets, compared with only –1.1 percent in all their other public-to-public deals. These findings run counter to much previous research on emerging markets.

Brazil remains an inbound acquirer's market.

- Inbound deals make up the majority of Brazilian cross-border transactions. Yet M&A in Brazil is far from easy for foreign investors, which since 1990 have generated average CARs that are less than half those earned by local dealmakers, on average.

- Nonetheless, inbound acquirers created more value than outbound acquirers from Brazil, which have posted an average CAR of –1.2 percent since 1990.

The Russian market rewards investors that take calculated risks, whether the deal is inbound, outbound, or local. In 2012, Russia joined the World Trade Organization, suggesting that the country will lower barriers to M&A in the years ahead.

- The focus of Russia's inbound M&A has shifted away from natural resources as consumer companies from developed economies claim an increasing share of inbound M&A activity.

- Although domestic deal-making in Russia dwarfed outbound M&A in 2012, many Russian companies pursued deals in developed economies, with a marked preference for North America over Europe.

India is active in cross-border M&A, with inbound and outbound transactions accounting for three-quarters of all Indian deal-making.

- The favorite targets of India's outbound investment are the U.S., with $13 billion in Indian capital since 1990, Nigeria with $11 billion, and the U.K. with $6 billion.

- Although Indian M&A of all sorts generates an average CAR that is about one-third lower than the average CAR for all deals excluding Indian transactions, outbound Indian M&A generates a significantly higher CAR than inbound M&A.

China's pivot from a low-cost, high-growth manufacturing center to the world's largest consumer economy has major implications for both inbound and outbound M&A.

- China's outbound investment is spurred by the need to secure the natural resources required for sustained economic development and by the desire to acquire technology and management know-how. The search for management know-how is emerging as a major motivation of outbound Chinese acquirers, possibly surpassing technology transfer.

- There are still abundant opportunities for acquirers from developed economies seeking to gain a foothold in the high-growth Chinese market. However, deal premiums are increasing as attractive targets grow scarcer, and observers say it is not unusual for acquirers to screen 100 or more potential candidates before they find a viable target.

Apart from the BRICs, seven countries—Egypt, Mexico, Nigeria, the Philippines, South Korea, Turkey, and Vietnam—appear poised to lead the next wave of emerging-market M&A.

- These "magnificent seven" countries have the potential to join the ranks of the world's largest economies. From 2009 through 2012, they recorded cumulative deal volumes ranging from $6.7 billion in Vietnam to $168.7 billion in the Philippines. And transaction volumes have been growing at high-double-digit rates.

- M&A deals involving the magnificent seven have consistently delivered above-average returns and are currently outperforming the developed-market benchmark by 0.6 percent. There is plenty of room for those returns to increase as these countries become a familiar presence in the global M&A market and as both inbound and outbound dealmakers gain experience from multiple transactions.

- The heavyweights among the seven countries are Mexico, South Korea, and Turkey. In the past four years alone, they have recorded a cumulative transaction volume of $300 billion, and those volumes are poised for continued explosive growth.

To create value from such a lively environment for cross-border M&A activity, today's corporate leaders must stick to a number of pivotal precepts.

- *Be prepared.* Begin due diligence early because limited transparency and often complex bureaucracies will make the process more time-consuming than in developed economies.

- *Be local.* The right advisors can make all the difference in emerging-market transactions. Consider venturing outside your usual circle of deal advisors and engaging a local team.

- *Think globally.* An advisor that combines a worldwide footprint with deep local expertise can help dealmakers overcome language barriers, make important contacts, and navigate bureaucratic and regulatory mazes while leveraging global networks and capabilities.

- *Cultivate key relationships.* The success of an emerging-market acquisition often depends on relationships with a handful of key executives at the target company. It's crucial to win their support and offer them compelling incentives to ensure their retention after the transaction's close.

- *Establish internal change-management teams.* Most emerging-market buyers are eager to acquire advanced management skills. Local managers of the target should support the new owners in this quest. This will help win the new owner's cooperation and facilitate the efficient transfer of knowledge and best practices.

- *Give emerging-market buyers plenty of lead-time.* If the ideal buyer of an asset is based in an emerging country, engage the potential buyer early in the sales process. Emerging-market dealmakers may not be familiar with European- and U.S.-style auctions and may struggle to adhere to tight timelines.

- *Consider joint ventures and alliances as alternative deal structures.* These give acquirers a chance to test the waters and gain a deeper understanding of the market. As their local expertise grows, acquirers can use these other deal structures as the launching pad for follow-up acquisitions.

- *Manage cultural differences proactively.* In some emerging markets, dealmakers tend to avoid negotiating deal terms and prefer to facilitate transactions through trust and personal relationships rather than complex legal documentation. Local advisors can help bridge cultural differences and facilitate the production of deal documentation.

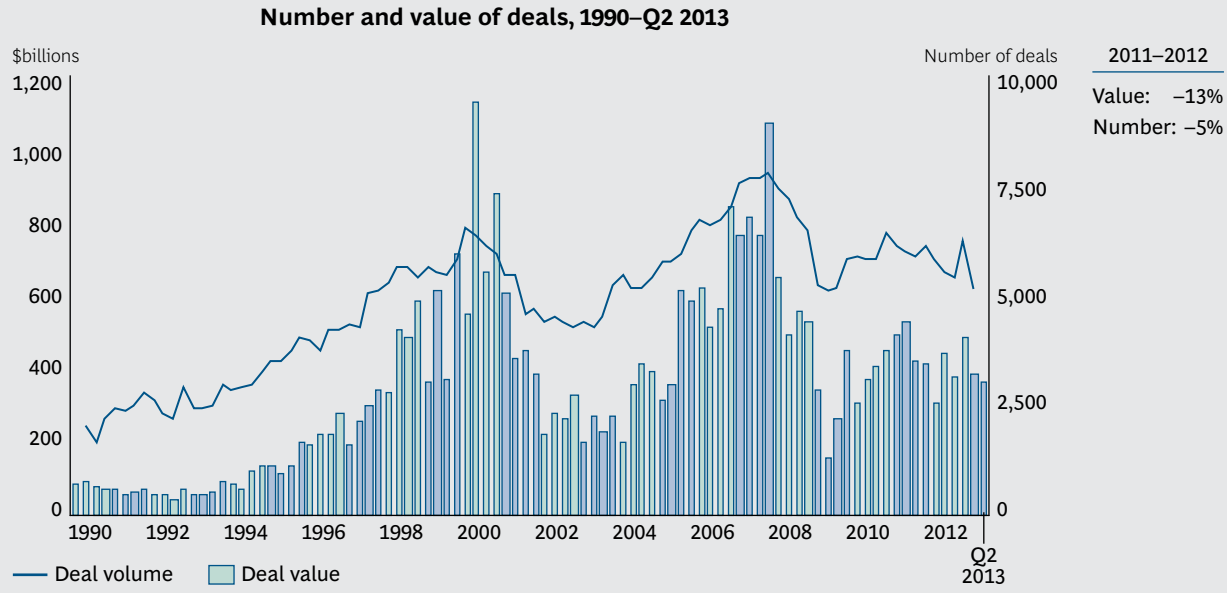
- *Keep it simple.* Go for public companies rather than mom-and-pop shops. Financial markets reward acquirers in emerging markets that keep things simple.

THE GLOBAL M&A MARKET REMAINS IN A DEEP FREEZE

FOLLOWING AN ALREADY WEAK year for mergers and acquisitions in 2011, deal-making activity in 2012 declined even further. Dragged down by the aftermath of the euro crisis, widespread erosion of consumer confidence, and ongoing financial-market volatility, worldwide M&A activity declined in 2012, with total deal value slipping 13 percent and the number of deals falling 5 percent. (See Exhibit 1.)

Analysis of more than 30,000 global transactions—BCG's ninth annual assessment of crucial M&A trends—reveals an M&A market that began 2012 on a low note. Deal-making activity in the first quarter of the year fell 26 percent, as measured by value, from the fourth quarter of 2011. The following quarters were somewhat stronger, but overall, 2012 can only be characterized as subdued, and the first half of 2013 showed little im-

EXHIBIT 1 | The Global M&A Market Remains in a Deep Freeze



Sources: BCG M&A Research Center; Thomson ONE Banker.
Note: Enterprise values include the net debt of target. Analysis based on a total of 457,684 completed M&A transactions with no transaction-size threshold and excluding repurchases, exchange offers, recapitalizations, and spinoffs.

provement. In terms of deal quantity, M&A activity in 2013 has been almost as low as the trough reached after the bursting of the dot-com bubble in 2000–2001. Still, 2013 transaction values are high relative to those of 2012, so it's too early to call the current year a bust.

The companies that did invest heavily in M&A in 2012 have little to celebrate. BCG's successive analyses of value creation through M&A show that when publicly listed companies acquire other publicly listed companies, the deal typically destroys value for the acquirer in both the short and the long run. It is not impossible to create value in public-to-public deals, but it is harder compared with other types of deals.[1]

Disappointing Results for Public-to-Public Deals

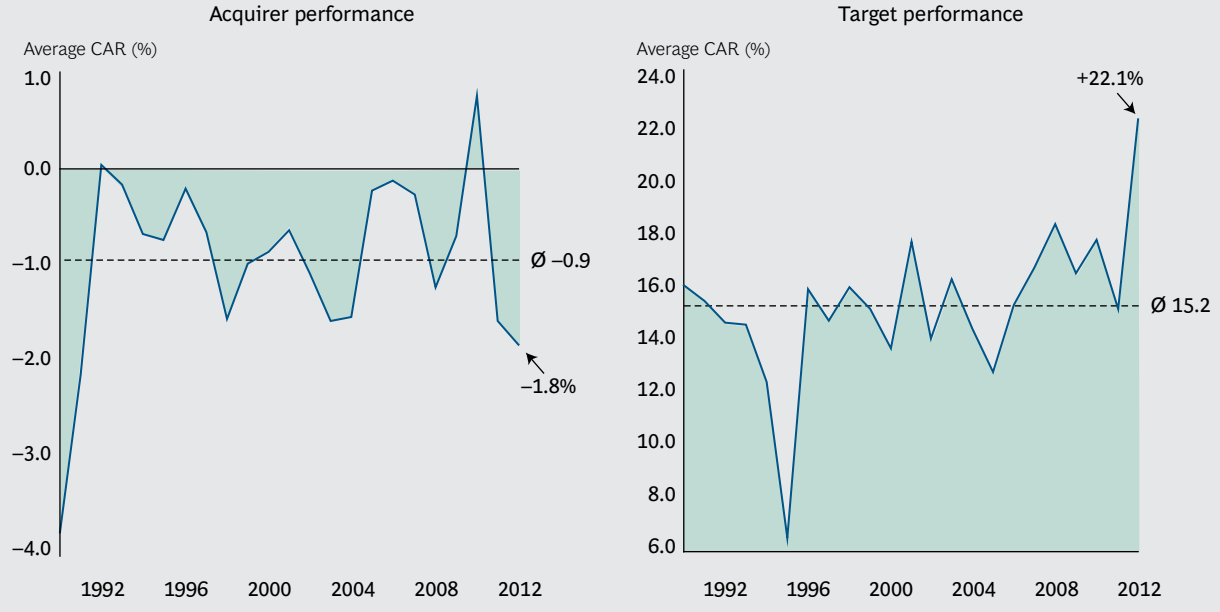
Reflecting the difficult economic environment and increased competition among international bidders, M&A returns for public-to-public acquisitions in 2012, as measured by average cumulative abnormal return (CAR), sank to –1.8 percent. (See Exhibit 2.) This return is slightly below the 2011 average of –1.6 percent and twice as low as the average since 1990 of –0.9 percent. In contrast to the poor showing of acquirers, the CAR of public targets reached a record high of 22.1 percent, well above the two-decade average of 15.2 percent.

The picture is different for deals in which public companies acquired private companies or subsidiaries of private companies. In 2012, the former subcategory created positive short-term shareholder returns, earning an average 1.3 percent CAR. That matches the long-term average of 1.3 percent since 1990. (See Exhibit 3.) Public companies buying subsidiaries of private companies showed roughly the same performance, posting an average CAR of 1.3 percent in 2012. That's a strong improvement over 2011 but still below the two-decade average of 1.8 percent.

Emerging Markets Claim a Growing Share of Deal Flow

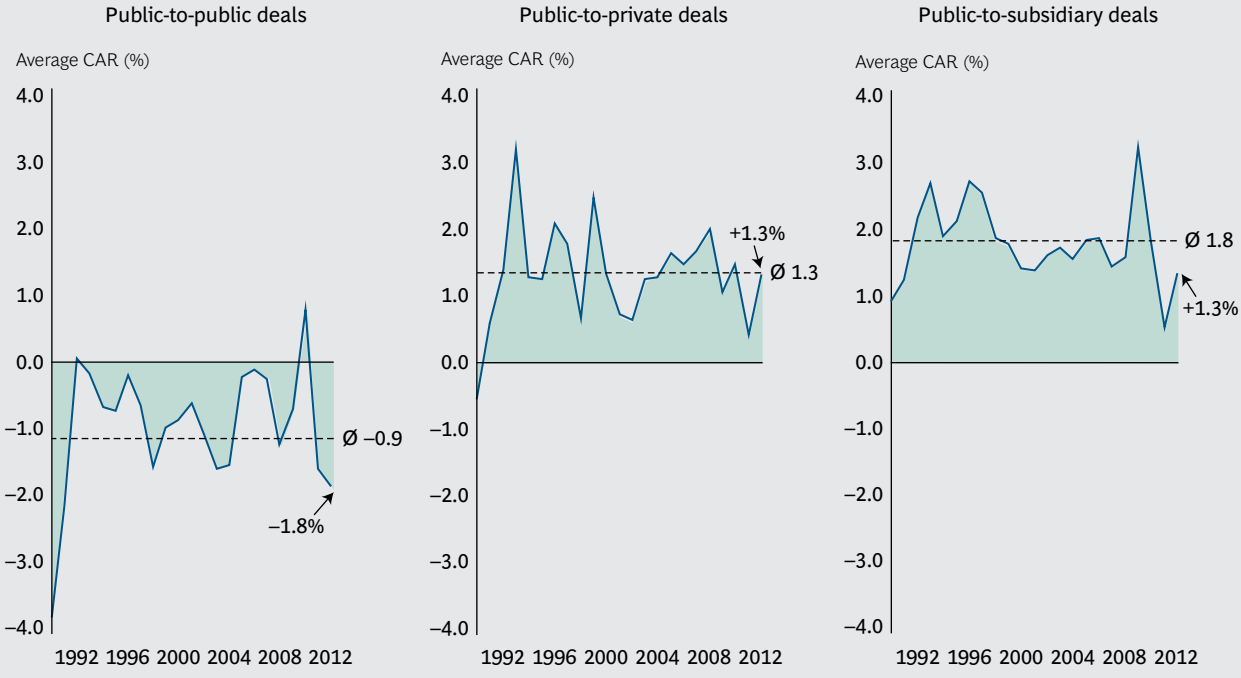
Amid the general gloom of the global M&A market, the emerging markets, especially the so-called BRIC countries of Brazil, Russia, India, and China, stand out as a bright spot. Although deal flow fell off even more sharply in emerging markets than worldwide, deals involving emerging-market countries continue to account for an increasing share of M&A activity. (See Exhibit 4.) Today, in fact, one in

EXHIBIT 2 | Public-to-Public Deals Posted Disappointing Returns in 2012



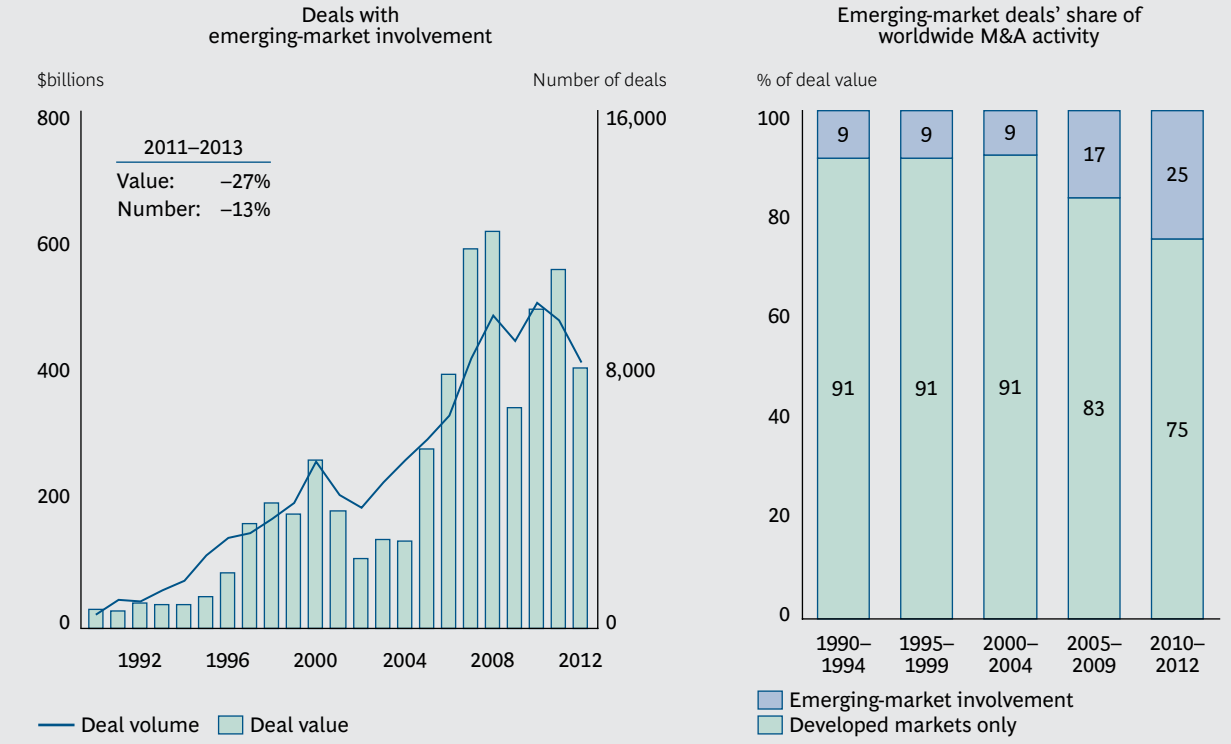
Sources: Thomson Reuters Datastream; Thomson Reuters Worldscope; BCG analysis.
Note: CAR = cumulative abnormal return calculated over a seven-day window centered around the transaction announcement date (+3/–3).

Exhibit 3 | Deals Involving Nonpublic Companies Earn Positive Returns for the Acquirer



Sources: Thomson Reuters Datastream; Thomson Reuters Worldscope; BCG analysis.
Note: CAR = cumulative abnormal return calculated over a seven-day window centered around the transaction announcement date (+3/–3).

Exhibit 4 | Emerging-Market Deals Declined in 2012 but Still Claim a Growing Share of M&A Activity



Sources: BCG M&A Research Center; Thomson ONE Banker.
Note: Analysis based on a total of 542,542 completed M&A transactions, including minority-share acquisitions or sales, with no transaction-size threshold; excludes repurchases, exchange offers, recapitalizations, and spinoffs.

every four M&A transactions involves an emerging-market company as buyer or seller.

We believe that the falloff in emerging-market M&A is a temporary deviation from the long-term trend, brought on by the continued economic weakness of the developed economies, slowing growth rates in the BRICs and other emerging markets, and continuing uncertainty about the direction of the global economy. As developed markets regain momentum and the BRICs adjust to the new normal of slower growth, emerging-market M&A will resume its upward trajectory. Indeed, the Chinese government's stated foreign-investment goals suggest strongly that the current lull is only temporary and that a surge in emerging-market M&A is not far off.

Key Investing Themes

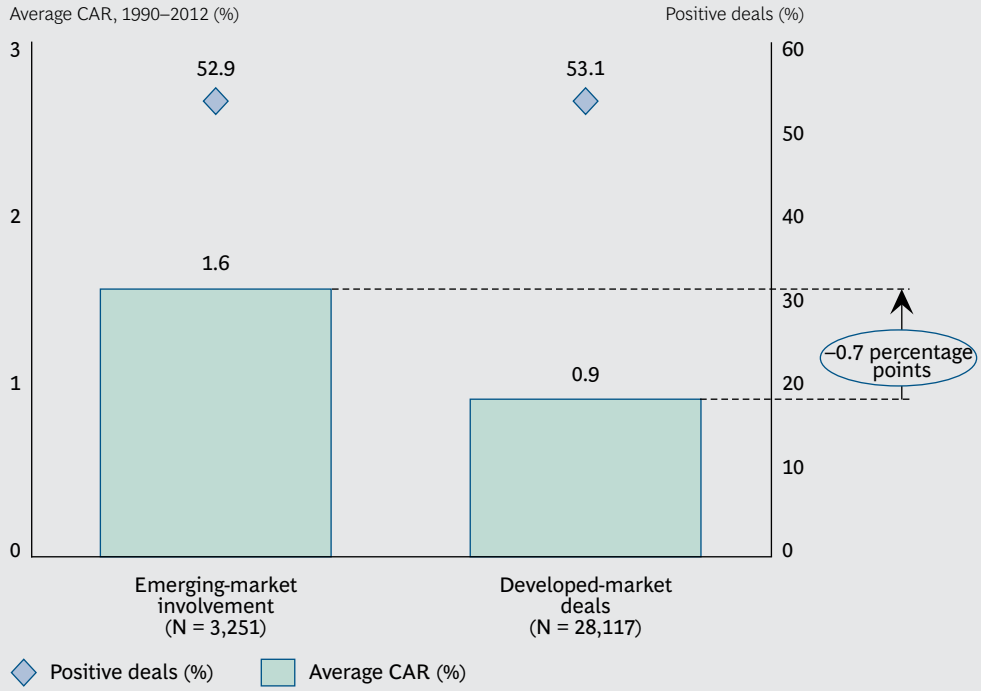
Several forces have converged to bring emerging-market M&A to greater prominence. One is the above-normal performance of transactions in these markets. Overall, deals involving at least one emerging-market company outperform deals limited to developed economies, generating an average CAR of 1.6 percent, compared with 0.9 percent for developed-country deals, in the seven-day window centered around the date of the deal announcement. (See Exhibit 5.)

A second force is the relatively robust economic performance of emerging markets, where personal and national wealth is increasing, the ranks of the middle class are swelling, and businesses are investing, expanding, and venturing into new markets. In particular, the rapid pace of economic development has spurred M&A that follows three broad investment themes.

- *Energy and Natural Resources.* The search for the industrial inputs that fuel today's economies, such as industrial metals and agricultural commodities, has motivated a large share of outbound M&A from the BRICs and other emerging markets, which are competing with one another to secure

EXHIBIT 5 | Emerging-Market Transactions Perform Above Normal

Performance of deals involving emerging-market versus developed-market companies



Sources: Thomson ONE Banker; BCG analysis.
Note: CAR = cumulative abnormal return calculated over a seven-day window centered around the transaction announcement date (+3/–3).

the resources essential to sustained economic advancement. As Zhou Zhongshu, chairman of China Minmetals, said in 2011, "For all kinds of metals, as long as it is rare in China, we aim to obtain it through outbound M&A."

Many emerging-market acquirers, such as India's GVK Power & Infrastructure, are state owned or state affiliated. GVK has invested heavily in coal and related assets in Australia as part of its drive to meet India's burgeoning demand for electricity. The cornerstone of GVK's energy deals was its $1.3 billion acquisition of a controlling stake in Australia's Hancock Coal in 2011. GVK supplemented that deal with the acquisition of railroad infrastructure to ship coal from Australia's Galilee Basin to the major Australian port of Newcastle.

Meanwhile, power generation and distribution companies in developed economies are doing inbound M&A in the BRICs and other emerging markets, acquiring generation and transmission assets in order to participate in those markets' fast-rising demand for electricity.

- *Consumer Goods.* Consumer goods companies from both developed economies and emerging markets are acquiring companies in the BRICs and other emerging markets to capture a share of burgeoning middle-class incomes. The rapid economic development of the emerging markets has accelerated the expansion of the middle class—the percentage of China's households classified as middle class, for example, has doubled since 2007—and the adoption of middle-class consumption habits. Turkish beverage company Anadolu Efes sought to capitalize on this demographic trend in 2012 when it acquired SABMiller's Russian and Ukrainian beer businesses for $1.9 billion. The deal enlarged the Turkish brewer's share of the world's third-largest beer market to 18 percent, making it Russia's second-largest brewer. The deal also gave Anadolu Efes entrée into the Russian market's premium and superpremium sectors, which are expected to grow rapidly as the country's middle class grows and its tastes become more sophisticated. "With an even more attractive product portfolio, we are better positioned to satisfy consumer expectations in the Russian beer market," CEO Alejandro Jimenez said after the acquisition.[2]

- *Technology and Management Know-how.* Increasingly confident and ambitious, the BRICs are racing to catch up with the developed economies in technology and global corporate best practices. China, especially, has made it a priority to quickly acquire the technological and management know-how necessary to compete on the global stage. Many Chinese outbound deals today are motivated by the desire to acquire a platform from which to launch global businesses, as well as the management skills to run them successfully.

Notes

1. To arrive at this conclusion, BCG performed standard event-study analysis on each deal in our database to calculate cumulative abnormal returns (CARs) over the seven-day window centered around the date the deal was announced. Short-term returns are not distorted by other events—a material advantage over other M&A metrics—and there is evidence that CAR is, on average, a reliable predictor of long-term success.
2. Anadolu Efes, annual report, 2011.

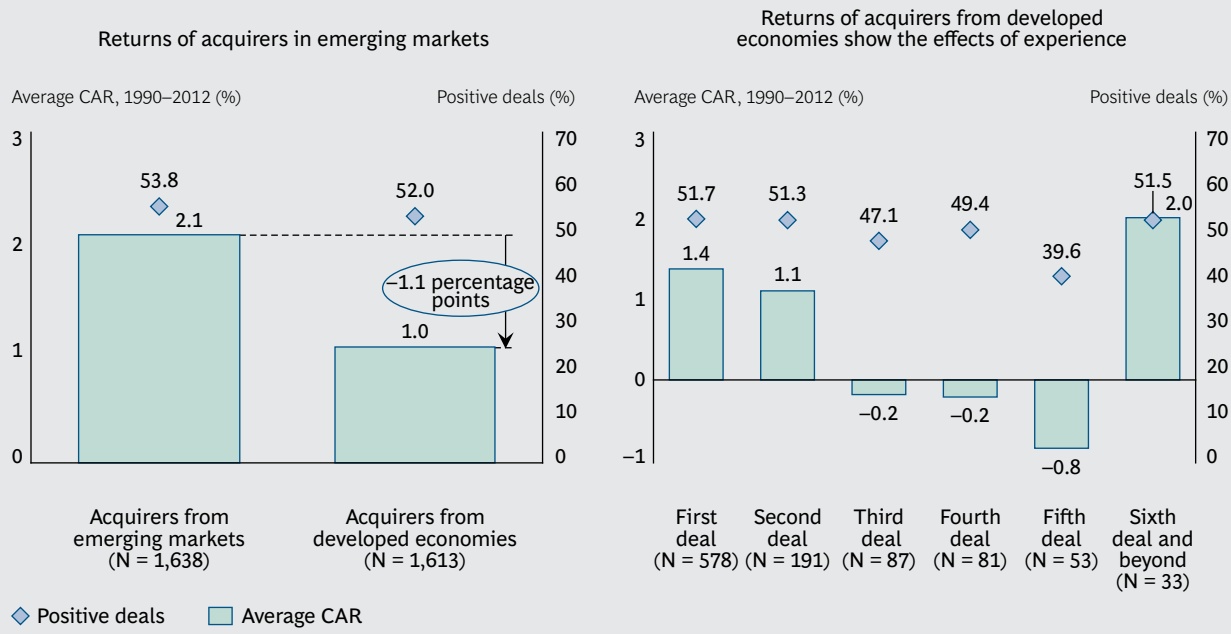
LEARNING FROM EXPERIENCE AND MANAGING COMPLEXITY

THE KEYS TO SUPERIOR RETURNS

THE BRICS AND OTHER emerging markets are likely to attract increasing attention from dealmakers in developed economies seeking opportunities for growth. But these would-be acquirers should be aware that the capital markets tend to react somewhat skeptically when acquirers from developed economies undertake deals involving emerging markets. Analysis of BCG's comprehensive database reveals that acquirers from developed economies generate an average CAR of 1.0 percent on emerging-market deals. Emerging-market acquirers generate an average return that is more than twice as high. (See Exhibit 6.)

The pronounced complexity of emerging-market deals appears to put developed-

EXHIBIT 6 | Typically, Only Local Players or Serial Acquirers Succeed in Emerging-Market M&A



Sources: Thomson ONE Banker; BCG analysis.
Note: CAR = cumulative abnormal return calculated over a seven-day window centered around the transaction announcement date (+3/–3).

country companies at a marked disadvantage to their local rivals, at least in the eyes of the markets. The greater familiarity of emerging-market-based acquirers with the cultures, languages, and markets of their targets translates into more successful deals.

Serial Acquirers Reap the Rewards of Experience

Experience is the key to overcoming the disadvantage faced by acquirers from developed economies. In fact, when such acquirers have done at least six emerging-market deals, they have performed almost as well as emerging-market acquirers, generating an average CAR of 2.0 percent, compared with 2.1 percent for their local rivals. Multiple acquirers with more than two but fewer than six acquisitions have generated lower or even negative average CARs.

Capital markets reward experience and favor simplicity and transparency.

There is no reason to think that doing six deals automatically endows an acquirer with the needed expertise. But the larger point is clear: the more deals a developed-economy acquirer does in emerging markets, the more it learns, and the more it learns, the better its chances of achieving recurring success.

In a previous report highlighting the benefits of experience, we noted that serial acquirers have the advantage over less experienced dealmakers when the deal in question is exceptionally complex (*How the Top Serial Acquirers Create Value: Does Practice Make Perfect?*, BCG Focus, April 2011). Serial acquirers in such situations learn valuable—and often painful—lessons from each successive transaction, which they can apply to subsequent deals.

The acquisition history of AES, a U.S.-based global, diversified power-generation and utility company, illustrates how experience in emerging markets pays off for acquirers from developed economies. Founded as an independent power company in 1981, when utility deregulation in the U.S. was just getting under way, AES has been an active acquirer in Latin America since 1997. The company has done seven deals in the region, accumulating generation plants and transmission systems in Argentina, Brazil, Chile, Colombia, Mexico, and Venezuela. AES has earned an average CAR of 3.0 percent on these transactions—three times the average CAR posted by developed-economy acquirers in emerging markets and nearly 1 percentage point higher than the average CAR of emerging-market acquirers.

The Virtue of Simplicity

Capital markets not only reward experience, they also favor simplicity and transparency, especially when evaluating emerging-market deals. By its very nature, M&A in emerging markets bristles with complexity. In many of those markets, the rule of law is not firmly established, regulatory barriers to foreign capital are high and sometimes ambiguous and arbitrarily enforced, and sellers tend to enjoy a distinct information advantage over acquirers.

Cultural differences add another layer of complexity. As Jens Uhlendorf, a transaction lawyer at Hogan Lovells with extensive experience in emerging-market transactions, said of China and India in particular, "Business relationships have historically been built on trust rather than on an elaborate contractual framework. In such countries, domestic sellers tend to avoid negotiating deal points that are likely to lead to controversy between the parties." (See the sidebar "The Lawyer's Perspective: A Conversation with Jens Uhlendorf.") Such cultural differences present a significant challenge to acquirers accustomed to using contracts to cover every possible contingency.

The capital markets recognize the challenges that developed-economy acquirers face and reward those that keep deals as simple as possible. New research from BCG focusing on acquirers from developed economies confirms that in emerging economies these acquirers earn higher returns, at lower risk,

THE LAWYER'S PERSPECTIVE: A CONVERSATION WITH JENS UHLENDORF

Seeking insight into the legal challenges of inbound and outbound M&A in the BRICs and other emerging markets, BCG spoke with Jens Uhlendorf, a partner in the Düsseldorf office of Hogan Lovells. Mr. Uhlendorf is an expert on international M&A and corporate reorganizations and has advised on numerous cross-border transactions. What follows is an edited transcript of our conversation.

What has been your experience with German and other European companies acquiring BRIC assets?

The economic success of BRIC and emerging-market countries has led to a significant increase in M&A activity in those regions, both in terms of numbers and value. As with the current M&A market in general, however, German and European M&A activity in emerging markets and the BRICs has been reduced as a consequence of the European financial crisis.

What are the key differences between M&A in developed economies and in the BRICs and other emerging markets?

Regulatory and legal obstacles in the BRICs and other emerging markets can lead to longer transaction processes. In addition, in some countries such as India, regulations are at times unclear, ambiguous, or inconsistent, and it is sometimes difficult to obtain clarification from the regulators.

Cultural differences can also have a considerable effect on M&A transactions. In China and India, for instance, business relationships have historically been built on trust rather than on an elaborate contractual framework. In such countries, domestic sellers tend to avoid negotiating deal points and drawing up detailed transaction documents that are likely to lead to controversy between the parties.

Are there significant differences among the legal environments in the BRICs and other emerging markets that are likely to affect M&A for acquirers?

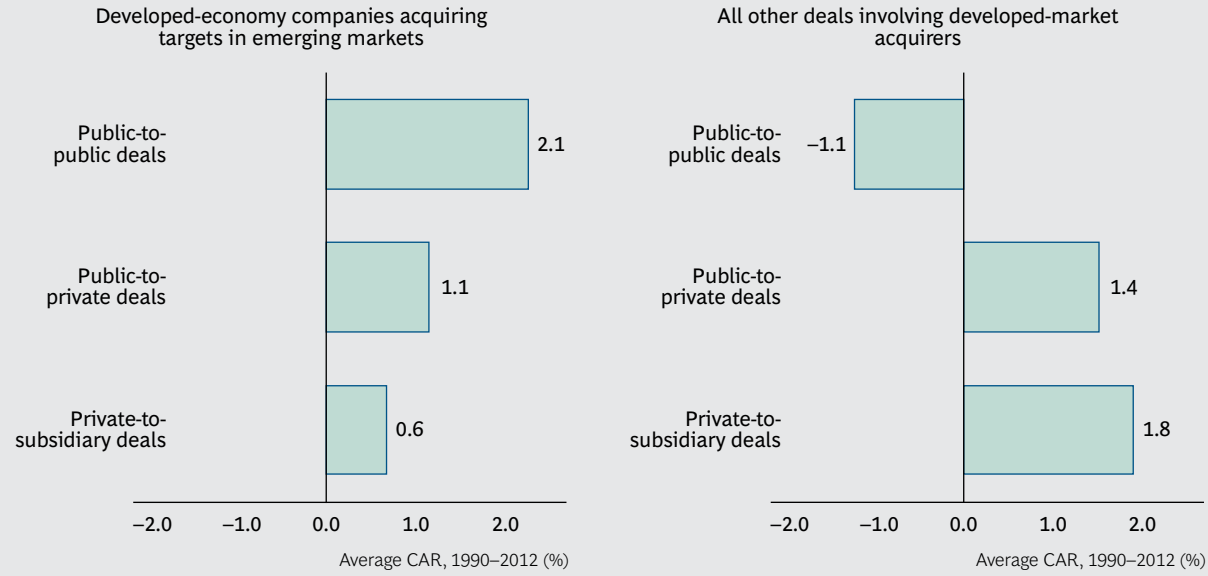
Due diligence on corporate governance is a key challenge for European investors in Brazil. A significant number of Brazilian companies, including large ones, are owned by industrialist families, and the quality of their corporate governance is high in some cases and less so in others. As a result, foreign investors must pay close attention to the adequacy of the target company's reporting and the strength of its internal controls. On the other hand, Russia is closer to Europe, and its traditions and its legal system are structurally similar to the systems in Germany and France.

What are the legal success factors and pitfalls for joint ventures and acquisitions in emerging markets?

Above all, European investors need to understand the complex regulatory framework in each emerging-market country. Moreover, European investors should spend as much time as they need to convince their counterparts to discuss and resolve difficult and complex issues prior to signing the deal. Finally, foreign investors would be wise to engage advisors with a network of experienced colleagues in the emerging-market country in question. These networks can be of immense help in bridging any cultural and legal gaps.

on public-to-public deals than on deals involving a privately held target. Moreover, for developed-economy acquirers, the average CAR on public-to-public, emerging-market deals is 2.1 percent, compared with –1.1 percent in all other public-to-public deals involving such acquirers. (See Exhibit 7.) This stands in sharp contrast to the capital markets' reaction to public-to-public deals in developed economies.

EXHIBIT 7 | Acquirers from Developed Economies Earn Higher Returns on Public-to-Public Deals



Sources: Thomson ONE Banker; BCG analysis.
Note: CAR = cumulative abnormal return calculated over a seven-day window centered around the transaction announcement date (+3/–3).

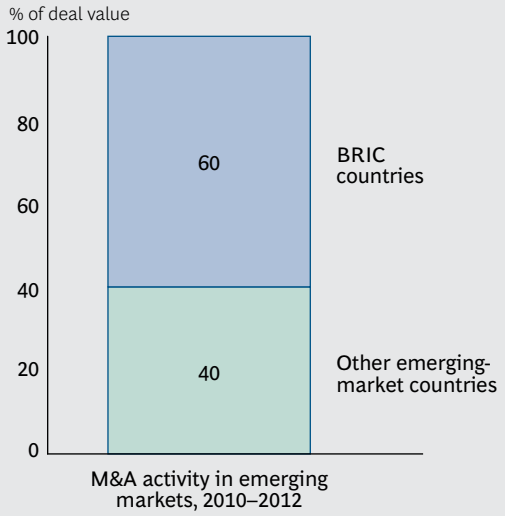
A TOUR OF THE BRIC COUNTRIES

THE EMERGING MARKETS ARE, of course, a highly heterogeneous group, and analysis of each one is beyond the scope of this report. Instead we will focus on the BRIC countries, which drive 60 percent of all emerging-market M&A activity, as measured by deal value. (See Exhibit 8.)

The BRICs are an increasingly important arena for M&A, for the simple reason that they are increasingly important to the global economy. These countries are home to 40 percent of the world's population, and over the past decade they have become a major driver of economic growth, with their share of global GDP climbing from 8 percent in 2000 to 25 percent in 2010. The sheer scale of economic activity ensures that the BRIC countries will remain a nexus for M&A for some time to come.

EXHIBIT 8 | Deals in Emerging Markets Are Mainly Driven by the BRIC Countries

60 percent of all emerging-market deals involve the BRICs



	Deal value (%)	Deal volume (%)
Brazil	26	9
Russia	17	46
India	11	13
China	47	32

Sources: BCG M&A Research Center; Thomson ONE Banker.
Note: Analysis based on 16,623 completed M&A transactions, including minority-share acquisitions or sales, with no transaction-size threshold; excludes repurchases, exchange offers, recapitalizations, and spinoffs.

Maps of the inbound and outbound investments of the BRIC countries since 1990 offer a glimpse of their investment strategies and priorities, as well as the strategies and priorities of the developed-economy acquirers flocking to their shores. (See Exhibits 9 and 10.) Clearly, inbound M&A is no longer motivated solely by dealmakers seeking cheap resources and labor. An increasing amount of inbound activity is aimed at establishing a foothold in the fast-growing consumer markets and financial systems of the BRICs.

It has not escaped the notice of acquirers from developed economies that per capita incomes have risen rapidly, with some year-to-year fluctuations, in each BRIC country. According to the latest data from the World Bank, per capita income in Brazil was $11,340 in 2012, up from $8,623 in 2008. Russia's climbed to $14,037 from $11,700, while India's improved to $1,489 from $1,042. China showed the most dramatic increase, with its income per capita rocketing to $6,091 in 2012 from $3,414 in 2008. The resulting increased purchasing power has, not surprisingly, caught the attention of consumer-facing companies in developed economies.

Below we examine each of the BRICs and the inbound and outbound M&A activity that typifies their investment environments.

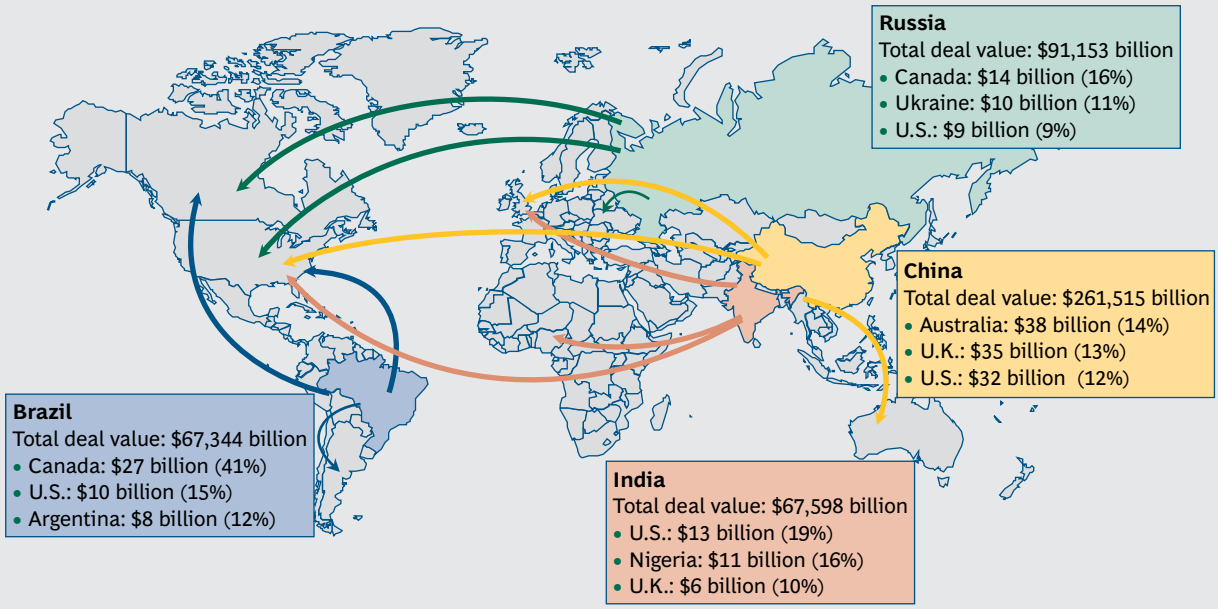
Brazil Looks to the North

Before 2001, Brazil was not widely recognized as a rising force in global business. Memories of the economic upheaval of the 1980s and '90s were still fresh, and there was little sign that Brazil was about to experience an epic growth spurt. But Brazil's economic strength became evident to everyone when Goldman Sachs economist Jim O'Neill coined the term "BRIC" a dozen years ago. A nation that not long before had been dogged by hyperinflation was now headed for a time when annual GDP growth would top 7.5 percent.

Since then, Brazil has burst onto the global business scene with energy and exuberance. None of this happened overnight, of course. Certainly, as a resource-rich nation, Brazil is well situated to capitalize on the global boom in commodities. But most observers credit the Plano Real, a far-reaching government program, with stabilizing the currency, enabling the redistribution of wealth, and

EXHIBIT 9 | Top Three Target Countries for BRIC Outbound Deals

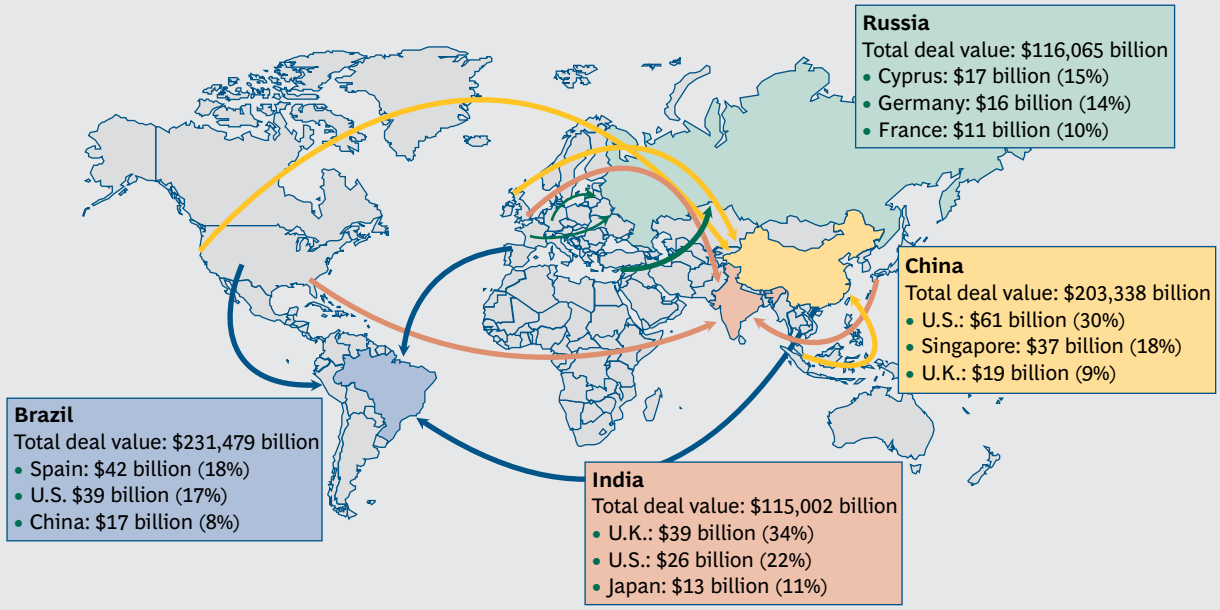
Cumulative deal value, 1990–2012



Sources: BCG M&A Research Center; Thomson ONE Banker.
Note: China includes Hong Kong.

EXHIBIT 10 | Top Three Acquirer Countries for BRIC Inbound Deals

Cumulative deal value, 1990–2012



Sources: BCG M&A Research Center; Thomson ONE Banker.
Note: China includes Hong Kong.

loosening credit. A stabilizing economy and the commodities boom encouraged some of Brazil's largest companies to seek overseas growth and at the same time opened the country to foreign investment.

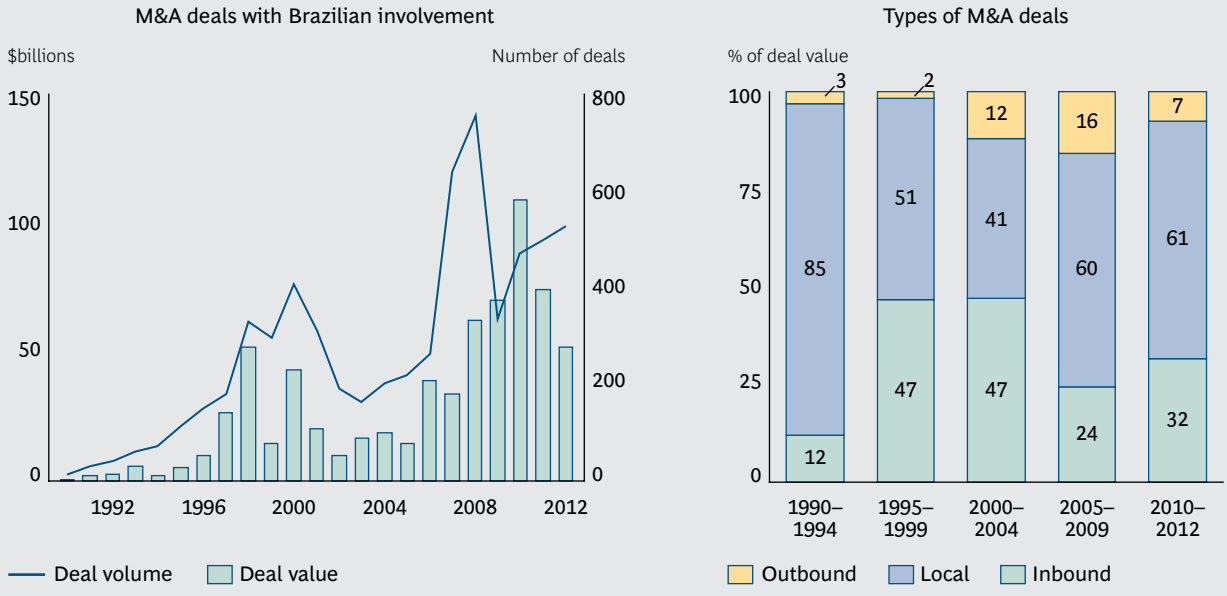
Nonetheless, Brazil remains risky territory for acquirers. In 2012, GDP grew at less than 1 percent. Brazil's exporters have been hard hit by an overvalued currency, and high interest rates are dampening the plans of local companies. While the country boasts a strong financial system and encourages foreign investment, it is also burdened with a complex tax system, high tax rates, inadequate infrastructure, and an erratic public-service sector. Moreover, family-owned or controlled companies are the leading form of business organization in Brazil, even among large listed companies. One recent OECD study revealed that 51.5 percent of the 200 largest listed companies are family controlled. "The quality of their corporate governance is high in some cases and less so in others," M&A lawyer Jens Uhlendorf told us. "As a result, foreign investors must pay close attention to the adequacy of the target company's reporting and the strength of its internal controls."

Despite the risks, Brazil has the largest volume of inbound transactions of all the BRICs. (See Exhibit 11.) Yet M&A in Brazil is far from easy for foreign investors, as the deal performance numbers indicate. Since 1990, foreign inbound acquirers have generated an average CAR that is less than half that earned by local dealmakers. (See Exhibit 12.) Nonetheless, since 1990, inbound acquirers have created more value than outbound acquirers from Brazil, which have posted an average CAR of –1.2 percent. Those results strongly suggest that Brazil remains an inbound acquirer's market.

Russia Seeks Technology, Resources—and Stability

For foreign dealmakers, Russia remains, in Winston Churchill's formulation, "a riddle wrapped in a mystery inside an enigma." The world's largest country in terms of land mass, Russia is rich in natural resources, yet its economic development remains fitful, with a middle class demanding more rapid improvement in living standards. Russia's government encourages foreign investment, yet seemingly does little to stem the widespread official corruption that frustrates

Exhibit 11 | Inbound Deals Drive Brazilian Cross-Border M&A

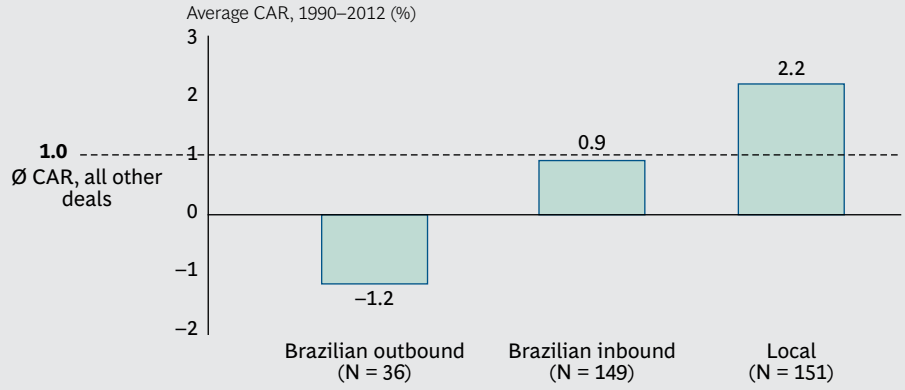


Sources: BCG M&A Research Center; Thomson ONE Banker.
Note: Analysis based on acquisitions in which Brazilian companies were involved: a total of 6,267 completed M&A transactions, including minority-share acquisitions or sales, with no transaction-size threshold; excludes repurchases, exchange offers, recapitalizations, and spinoffs.

dealmakers. It seeks foreign investment and expertise to develop the country's energy sector, yet it stood by while a consortium of Russian billionaires blocked BP's investment in Rosneft, a state-owned oil and gas producer, for several years.

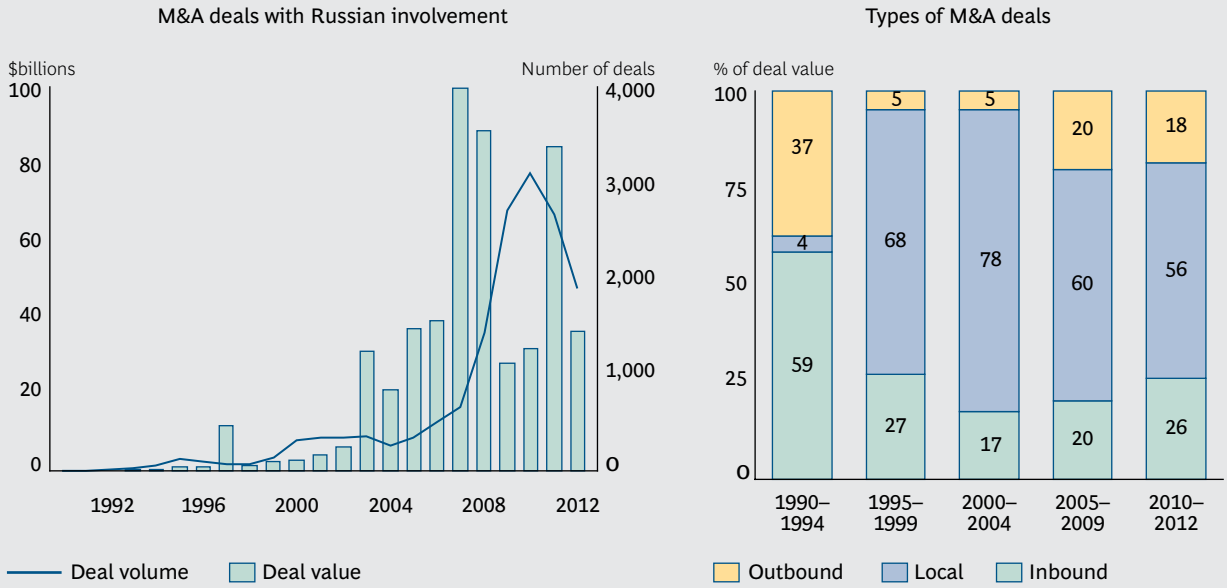
Despite such setbacks and obstacles, Russia remains a favorite destination of foreign dealmakers. It's not hard to see why. Its per capita GDP and private-consumption figures have risen steadily in recent years, to $14,211 and $6,994, respectively, while unemployment has fallen below 6 percent. And in 2012, Russia joined the World Trade Organization, suggesting to many investors that the country will lower barriers to M&A in the years ahead. Nonetheless, deal-making activity slowed in 2012, to a total of $36.5 billion, down from $84.3 billion the previous year. (See Exhibit 13.) Inbound investment fell by approximately two-thirds, to $8.7 billion, while outbound deal-making fell roughly 9 percent, to $8.5 billion.

Exhibit 12 | Brazilian Inbound and Local Deals Create Value, While Outbound Deals Are Unprofitable



Sources: Thomson ONE Banker; BCG analysis.
Note: CAR = cumulative abnormal return calculated over a seven-day window centered around the transaction announcement date (+3/–3).

EXHIBIT 13 | Activity Slowed in 2012, but Cross-Border M&A Increasingly Drives Russian Deal-Making



Sources: BCG M&A Research Center; Thomson ONE Banker.
Note: Analysis based on acquisitions in which Russian companies were involved: a total of 15,575 completed M&A transactions, including minority-share acquisitions or sales, with no transaction-size threshold; excludes repurchases, exchange offers, recapitalizations, and spinoffs.

Although domestic deal-making in Russia dwarfed outbound M&A in 2012, many Russian companies pursued deals in developed economies, with a marked preference for North America over Europe. "In the past, we have seen a couple of attempts where Russian enterprises tried to merge their assets with those of European companies," said Dirk Albersmeier, head of the German, Austrian, and Swiss M&A practice of J.P. Morgan, the investment-banking arm of JPMorgan Chase. "But because they had very high expectations regarding the valuation of their assets, only a few deals were executed. Today, we observe very little Russian interest in European assets." (See the sidebar "The Investment Banker's Perspective: A Conversation with Dirk Albersmeier.") The bulk of Russia's outbound investment has historically targeted the U.S. and Canada, as well as Ukraine.

Many outbound Russian deals are motivated by energy considerations and the desire to acquire valuable advanced technology. A consortium of Russian investors, for example, infused $20 million into Canada's Nesscap Energy in exchange for the right to manufacture the company's ultracapacitors, which have a variety of applications in the automotive and renewable-energy markets. Some of the funds also go toward establishing R&D centers in Russia and South Korea, signaling Russia's ambitions in the technology sector. In all, Russian enterprises have committed $14 billion to Canadian companies since 1990, accounting for 16 percent of total Russian outbound activity.

Russia's investments in the U.S. likewise show a strong technological bent. Rusnano, a government investment fund focused on technology and nanotechnology, has invested a total of $50 million in Selecta Biosciences and BIND Therapeutics (formerly BIND Biosciences), two early-stage biomedical companies. Selecta is an immunology specialist with a promising nicotine vaccine intended to promote smoking cessation and relapse prevention, while BIND is testing a number of targeted cancer treatments. As with the Nesscap deal, part of Rusnano's investment will fund the establishment of R&D and manufacturing centers in Russia.

The focus of Russia's inbound M&A—aside from investment originating from Cyprus, which is a special case (discussed in the sidebar "Russia's Cyprus Connection," below)—has shifted away from natural resources in recent years, as consumer goods companies

THE INVESTMENT BANKER'S PERSPECTIVE: A CONVERSATION WITH DIRK ALBERSMEIER

Seeking an experienced investment banker's views on M&A involving the BRIC countries, BCG spoke with Dirk Albersmeier, a managing director at J.P. Morgan, the investment-banking arm of JPMorgan Chase, and head of the company's German, Austrian, and Swiss M&A advisory business. What follows is an edited transcript of our conversation.

What is your experience with BRIC countries acquiring assets in Germany and elsewhere in Europe?

I have seen very limited activity by Brazil in Europe. There are enough domestic M&A opportunities in Brazil. The same applies to Russia. In the past, we have seen a couple of attempts where Russian enterprises tried to merge their assets with those of European companies, but because they had very high expectations regarding the valuation of their assets, only a few deals were executed. Today, we observe very little Russian interest in European assets. Indian outbound M&A activity can be summed up in one word: opportunistic. Cross-border M&A activities are limited to a small group of companies that are typically looking for low valuations. So there is very little deal flow. China is the most dynamic BRIC country when it comes to international M&A.

What do you see as the deal rationale for Chinese companies seeking stakes in European companies?

In Germany, we're seeing a new trend: the acquisition of a vehicle to establish a more international business. The Chinese are eager to grow their companies internationally, and German companies have proved to be the best practitioners in managing global businesses. Acquiring these skills is one of the main objectives of Chinese M&A in Germany and the rest of Europe. In fact, it's fair to say that the Chinese interest has shifted massively from technology to best-practice transfer.

How does the deal process change when Chinese acquirers are engaged?

One major difference is the auction process. Chinese companies have lengthy decision and approval processes, and as a result they have trouble succeeding within the European auction format. You have two choices if you would like to include a Chinese bidder in your sell-side process: make the process slow enough for them to cope with the pace, or preempt them up front with a premium price.

from developed economies have claimed an increasing share of inbound M&A activity. TPG Capital, a U.S. private-equity firm, for example, boosted its holdings in OOO Lenta, a hypermarket chain, to 43 percent in 2011, and brought in the European Bank for Reconstruction and Development as a coinvestor. U.K.-based Unilever recently acquired cosmetics maker Concern Kalina for $694 million, while The Walt Disney Company acquired Seven TV from its Russian owner, United Television Holding Russia, for $300 million. Disney intends to use the free broadcast channel to promote its other entertainment brands, including theme parks and movies.

Since 1990, the capital markets have treated inbound acquisitions in Russia far more favorably than they have outbound activity, awarding inbound deals an average CAR of 0.7 percent, compared with an average CAR

RUSSIA'S CYPRUS CONNECTION

Although Cyprus was listed as Russia's leading inbound investment source in 2012, the gross numbers do not reflect the true situation. Until the European Union's imposition of a 9 percent deposit tax on bank deposits in Cyprus—a condition of its 2012 bailout of the country—the island nation was a leading tax haven for Russian capital. Cyprus attained that status by offering favorable capital-gains and income-tax treatment for foreign investors. Thus, although $120 billion in Russian investment transactions appeared to originate from Cyprus in 2012, most of that money was, in fact, Russian capital routed through Cyprus as a tax minimization strategy. It's likely that Cyprus will slip quickly from the ranks of Russia's leading investment sources now that the EU has cracked down.

of –2.5 percent for outbound deals. (See Exhibit 14.) Both deal categories, however, create less value than M&A between two local players. Local deals generate an average CAR of 2.4 percent, which is itself a telling comment on the value of local deal savvy.

Whether the deal is inbound, outbound, or local, the Russian market rewards well-informed investors. Exhaustive due diligence is crucial to successful deal-making and risk management, of course, but it's just as important to follow up after the deal has closed. A strong team with good knowledge of local issues can facilitate post-transaction integration and cleanup and help management address any problems that arise after closing.

This recommendation applies with particular force to companies from developed economies that are considering acquisitions in Russia to achieve growth in end-customer demand. We believe that transactions targeting Russia's consumer markets will continue to make up a large share of inbound investment from developed economies, as the successful

EXHIBIT 14 | Capital Markets Reward Russian Inbound M&A, but Outbound Deals Are Struggling

Sources: Thomson ONE Banker; BCG analysis.
Note: CAR = cumulative abnormal return calculated over a seven-day window centered around the transaction announcement date (+3/–3).

transactions of Unilever, Disney, and TPG Capital encourage other developed-economy companies to jump in.

Some of those acquirers will likely be health care and pharmaceutical companies. The Russian government has targeted the pharmaceutical market for expansion in a bid to increase Russians' life expectancy. As a result, German pharmaceutical makers such as generic specialist Stada are working to build production facilities in Russia and forge joint development agreements with Russian drug makers, whose domestic market share the government wants to boost to 50 percent by 2020. Stada's CEO, Hartmut Retzlaf, expects the company's sales in Russia to exceed sales in its home market by 2015.

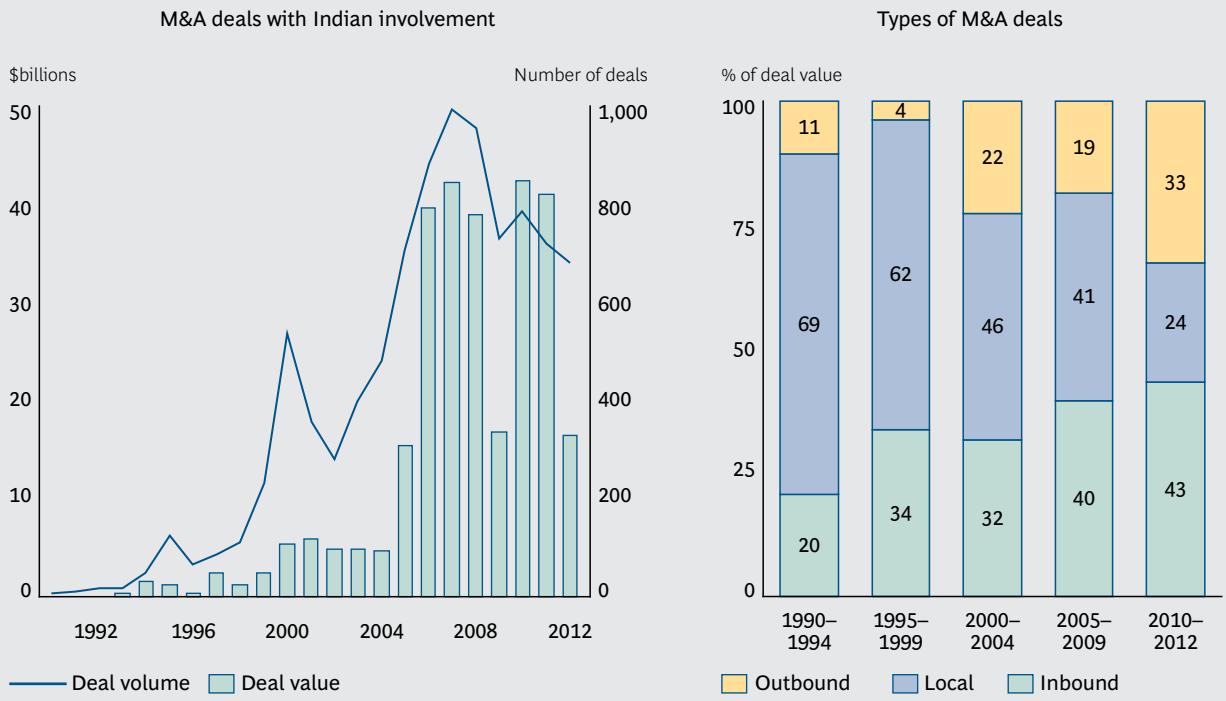
India Aims at Targets of Opportunity

When Tata Motors bought the storied Jaguar and Land Rover brands from Ford in 2008, many industry insiders and Wall Street observers predicted that the acquisition would fail for any number of reasons. History has proved those critics wrong. As shiny new Jaguar and Land Rover models roll off the company's assembly lines in Britain, as the new designs win plaudits from car enthusiasts, and as the division's sales and profits climb, Tata's purchase is evidence that Indian companies are very much a part of the global M&A game.

Tata's high-profile move was just one in a flurry of bold cross-border acquisitions by Indian companies during the first decade of the new millennium. Nine months into 2006, for instance, Indian businesses had already bought 115 overseas companies in that year alone—a sevenfold increase over 2000. Much of the decade's deal making was aimed at North America and Europe; the largest share was in the IT sector, where India Inc. had been making a name for itself.

India's businesses have hardly eased up on deal making since then. India is an active player in cross-border M&A, with inbound and outbound activity accounting for three-

EXHIBIT 15 | Cross-Border Deals Drive Indian M&A Activity



Sources: BCG M&A Research Center; Thomson ONE Banker.
Note: Analysis based on acquisitions in which Indian companies were involved: a total of 9,228 completed M&A transactions, including minority-share acquisitions or sales, with no transaction-size threshold; excludes repurchases, exchange offers, recapitalizations, and spinoffs.

quarters of all such Indian deal-making. (See Exhibit 15.) The favorite targets of India's outbound investment are the U.S., with $13 billion in Indian capital since 1990, Nigeria with $11 billion, and the U.K. with $6 billion. Indian companies have shown an eclectic bent in the U.S., acquiring landmark properties such as New York's Plaza Hotel as well as industrial companies such as the lighting and interior units of Visteon Corporation.

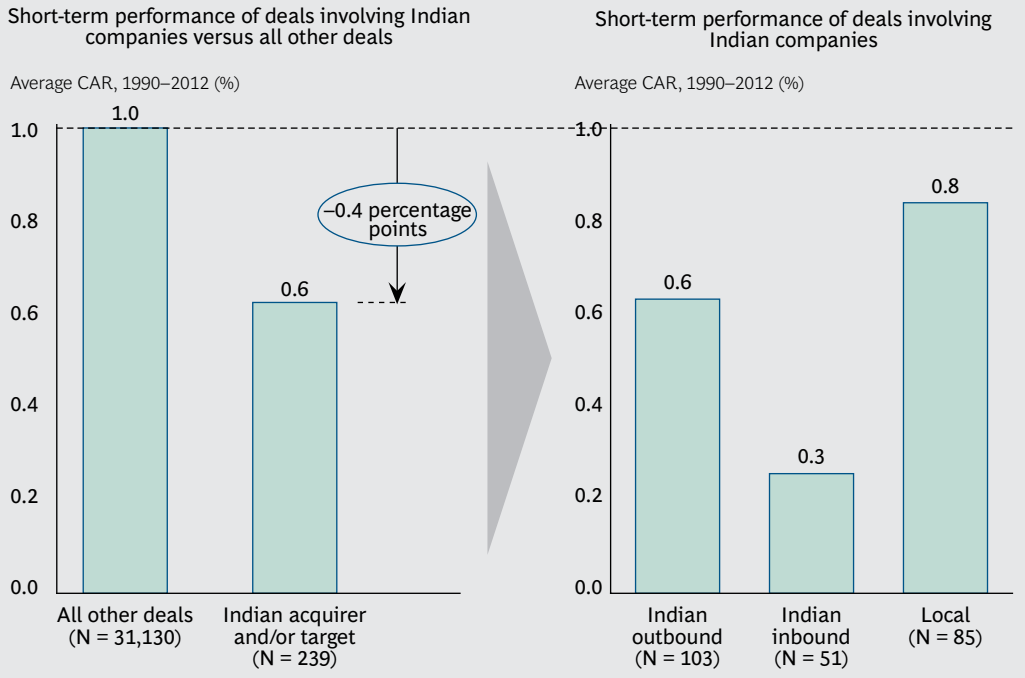
Such acquisitions typify outbound Indian deal-making, according to Dirk Albersmeier, the J.P. Morgan investment banker. "Indian outbound M&A activity can be summed up in one word: opportunistic," he said. "Cross-border M&A activities are limited to a small group of companies that are typically looking for low valuations."

Those companies have found the low valuations they sought, if the capital markets are any guide. Although Indian M&A of all sorts generates an average CAR well below the global benchmark, outbound Indian M&A since 1990 has generated a significantly higher CAR than inbound M&A. (See Exhibit 16.)

The Indian acquirers engaged in cross-border M&A range widely in their search for targets. In Nigeria, they focus primarily on the energy, telecommunications, and industrial sectors. India is Nigeria's second-largest customer for oil and its second-largest trading partner, in both categories trailing only the U.S. Among India's largest recent investments in Nigeria was Bharti Airtel's acquisition of local wireless operator Zain International (since renamed Bharti Airtel Nigeria). Bharti has continued to add to its holdings of the Nigerian unit's shares and now holds close to 80 percent of the country's leading wireless provider.

Inbound M&A activity, meanwhile, dropped sharply in 2012 as investment capital flowed elsewhere—to nations such as Chile, Turkey, Australia, and even the U. S. Inbound M&A in India rose from $10.8 billion in 2010 to $26.7 billion in 2011, before plunging to $5.9 billion last year.

Exhibit 16 | Indian Cross-Border and Local M&A Generates Positive but Below-Average Returns



Sources: Thomson ONE Banker; BCG analysis.
Note: CAR = cumulative abnormal return calculated over a seven-day window centered around the transaction announcement date (+3/–3).

It may take some time for inbound M&A to recover. The government launched a series of modest economic reforms in September 2012 to tackle the fiscal deficit and boost foreign investment. But protectionism remains part of India's economic legacy and regulatory mindset, and the belief that protectionism hinders investment is widespread in the business community.

Government policies aren't the only obstacle to deal making. Cultural differences also affect the M&A climate. Many Chinese and Indian dealmakers, for example, prefer not to negotiate deal points that are likely to be contentious, an approach that can lead to unforeseen questions and hard feelings if troubles arise after a deal closes. It's therefore critical for both parties to any cross-border deal to engage experienced local advisors who can help bridge the differences in negotiating styles, resolve disputes, and ensure that deal documentation covers all contingencies.

China Hunts for Management Know-How—and Access to the Global Business Arena

Nearly everyone who visits China returns from the trip impressed, if not downright overwhelmed, by the pace and scale of change there. Especially in the country's western and interior regions, new cities and manufacturing centers seem to spring up virtually overnight, roads and rail lines are connecting once-isolated areas, and every day vast numbers of migrant workers are settling in cities in search of economic opportunity. The upheaval and transformation are impressive, but in a way they mask what could well be the greatest change of all: China's pivot from a low-cost, high-growth manufacturing center to the world's largest consumer economy.

There is nothing random or unplanned about this shift in economic direction. It comes straight from the top of the Chinese government. In his November 2012 report to China's Communist Party conference, outgoing president Hu Jintao set out the government's priorities for the next ten years. At the top of the list was an unprecedented goal: doubling the per capita income of rural and urban residents by 2020. Never before had the government explicitly cited growth in per capita income as a goal of its economic-development program. This goal is in service of the party's overriding aim to double the country's 2010 GDP of $5.9 trillion by 2020. It's an audacious policy and not without significant risks. Much of China's economic expansion is debt financed, and Chinese financial regulators have struggled to rein in overaggressive lending.

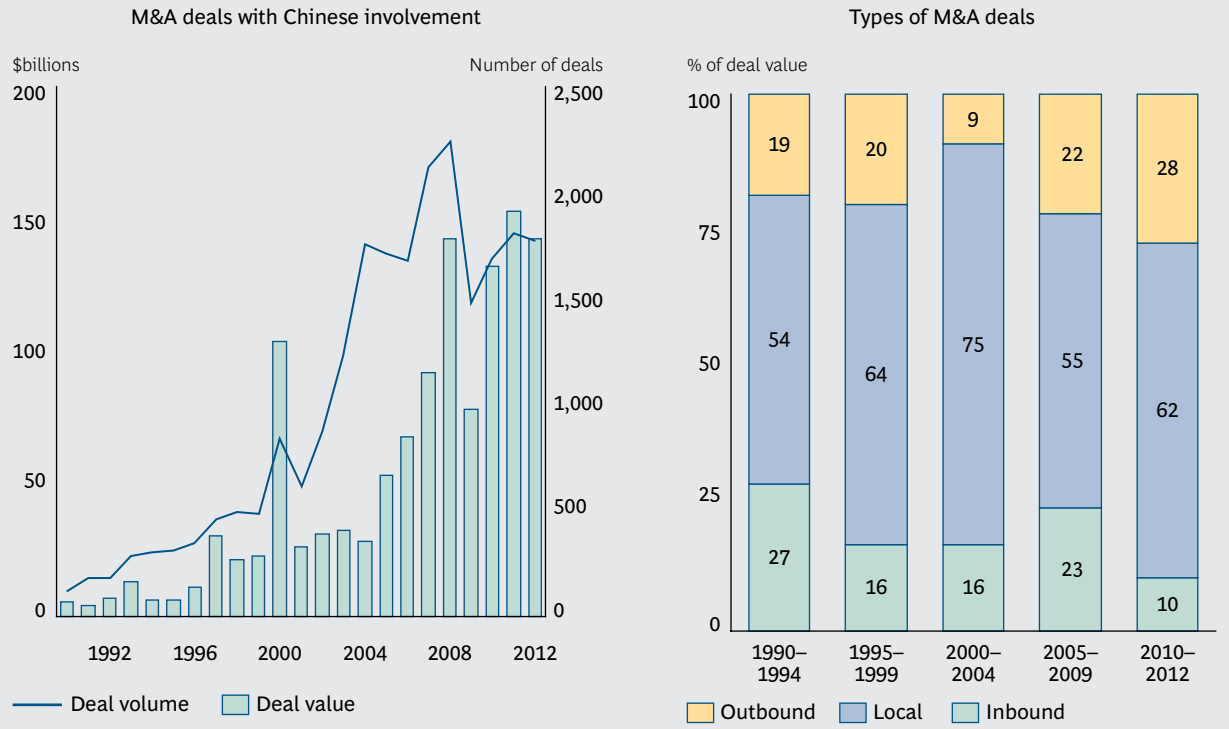
Both Chinese companies and would-be acquirers are eyeing the vast Chinese consumer market.

The path laid out by Chinese policymakers—which makes explicit a shift toward internal consumption that has been under way for several years—has major implications for both inbound and outbound M&A. No longer focused primarily on developing the country's export sector, both Chinese companies and would-be acquirers are eyeing the vast Chinese consumer market.

And no wonder. China, with a population of 1.3 billion, is projected to become the world's second-largest consumer economy by 2015, with the purchasing power to buy 14 percent of the world's products, according to the American Chamber of Commerce in Shanghai. And in a world where developed economies are growing sluggishly at best, China's targeted five-year economic growth rate of 7 percent is still among the world's highest. In short, sooner or later, businesses seeking growth will have to go to China.

At the same time, Chinese businesses are scouring the world for acquisition targets, and outbound M&A accounted for 28 percent of all Chinese deal making from 2010 through 2012, up from 22 percent in 2005 to 2009. (See Exhibit 17.) Although total outbound deal value, at $37.2 billion, fell 14 percent from 2010, China remains the most active outbound dealmaker of all the

EXHIBIT 17 | The Global Downturn Has Not Slowed Chinese M&A Activity, Especially Outbound Deals



Sources: BCG M&A Research Center; Thomson ONE Banker.
Note: Analysis based on acquisitions in which Chinese companies were involved: a total of 22,984 completed M&A transactions, including minority-share acquisitions or sales, with no transaction-size threshold; excludes repurchases, exchange offers, recapitalizations, and spinoffs.

BRICs, and this is a distinction that it seems eager to maintain. Inbound M&A accounted for deals valued at $10.3 billion, down 45 percent from 2011's total inbound value of $19 billion.

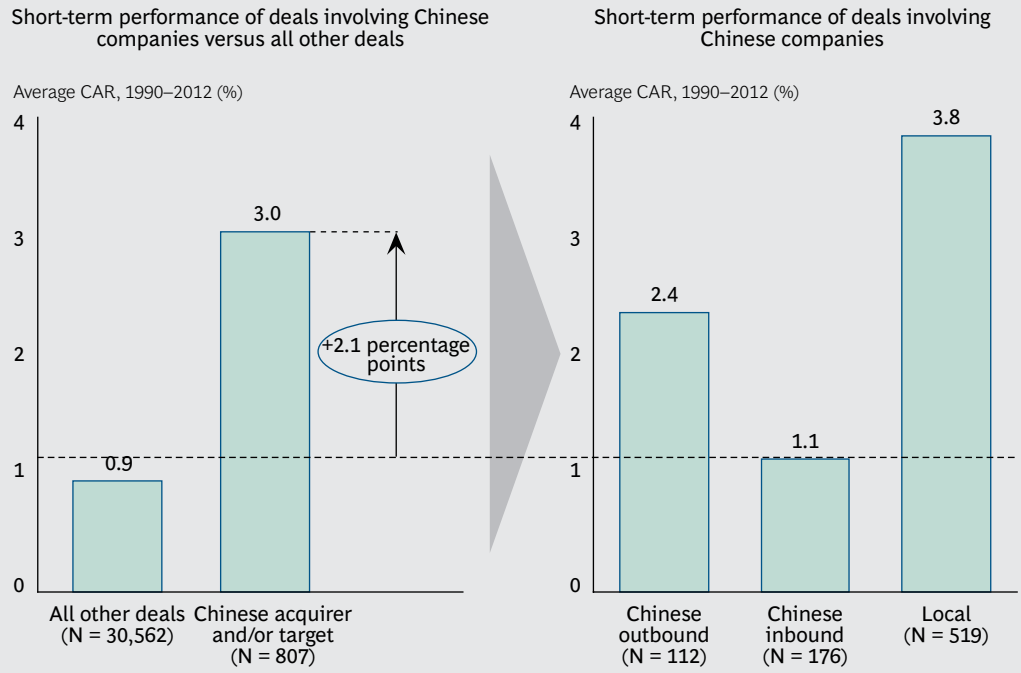
The excess of outbound over inbound deals is no accident—and it's a development that the capital markets applaud. The Chinese government's latest five-year plan calls for a total of $500 billion in outward direct investment through 2016, implying an annual growth rate of 17 percent. If outbound acquirers match the performance of earlier Chinese dealmakers, they can expect their deals to generate relatively high CARs. The average CAR for outbound deals from China is 2.4 percent, more than double the average for inbound acquisitions. Transactions between local companies outperform both categories, posting an average CAR of 3.8 percent. (See Exhibit 18.)

China's outbound investment is motivated both by the need to secure the natural resources required for sustained economic development and by the desire to acquire technology and management know-how from companies in developed economies. In fact, the search for management know-how is emerging as a major motivation of outbound Chinese acquirers, possibly surpassing technology transfer. "Chinese interest has shifted massively from technology to best-practice transfer," said J.P. Morgan investment banker Dirk Albersmeier.

Both motivations—locking in natural resources and acquiring technology and advanced management knowledge—are evident in some of China's most notable recent outbound deals. In the fourth quarter of 2011, for example, Sinopec paid $2.1 billion to acquire Canada's Daylight Energy, in the process gaining access to more than 121,000 hectares of hydrocarbon-rich land and the equivalent of more than 174,000 barrels of proven or probable oil reserves.

Sinopec didn't just acquire a significant holding of Canada's tar sands. The deal also gave

Exhibit 18 | Returns on Chinese M&A Are Exceptionally High, Especially for Outbound and Local Deals



Sources: Thomson ONE, BCG analysis.
Note: CAR = cumulative abnormal return calculated over a seven-day window centered around the transaction announcement date (+3/−3).

it access to the knowledge and technology needed to unlock natural-gas deposits trapped in shale rock. This is knowledge that Sinopec can turn to its advantage in its home market, since China's reserves of technically recoverable shale gas are an estimated 36.1 trillion cubic meters—more than those of the U.S. and Canada combined, according to the U.S. Energy Information Administration. So far, China—the world's largest energy consumer—has not exploited those reserves, but deals such as the Daylight acquisition, as well as linkups with ExxonMobil, Royal Dutch Shell, and Chevron, make clear that it means to learn how in a hurry.

Recent inbound deals, meanwhile, have targeted China's fast-growing consumer markets—especially those sectors that are poised for above-average growth. Consider the 2010 acquisition by Cardinal Health—the second-largest drug wholesaler in the U.S.—of Zuellig Pharma China for $470 million. The size of this transaction was unusually large; most inbound deals are closer to $50 million or less, reflecting both the scarcity of larger targets and the fact that the most attractive potential returns are found in companies in the earlier development stages. In other ways, though, it was typical of many inbound deals because it aimed to capitalize on China's changing demographics. China's population is aging as it grows more affluent, and health care is projected to grow rapidly as a share of total consumer outlays. By acquiring China's largest drug distributor (which does business in China as Yong Yu), Cardinal not only gained access to China's drug-distribution market, which the company expects will grow 20 percent per year through 2014; it also gained on-the-ground insight into China's health-care consumers, their buying patterns, and their product preferences.

Cardinal Health's acquisition of Zuellig was also atypical in that the U.S. company purchased 100 percent of Zuellig's shares, making the company what Chinese regulators classify as a wholly owned foreign enterprise. Although these entities account for a growing share of inbound M&A, the more typical transaction type is the joint venture, which in

many instances represents the most effective adaptation to China's idiosyncratic business and regulatory culture. (See the sidebar "Joint Ventures: A Popular Solution to the Chinese Puzzle.")

Even as China's outbound merger activity continues to outstrip inbound activity by a wide margin, opportunities remain for acquirers from developed economies seeking to gain a foothold in the high-growth Chinese market. But deal making in China is not for the impatient or the easily discouraged. Deal premiums are increasing as targets grow scarcer. Experienced dealmakers in the region say it is not unusual for acquirers to screen 100 or more potential candidates before they find a single viable target. As targets become smaller and competition among acquirers grows more intense, due diligence has become even more crucial than before. Due diligence should be conducted with the assistance of local advisors knowledgeable about market conditions and key players.

Deal-making executives should always be mindful of cultural differences that can influence the course and content of negotiations. Because of their deal-making priorities, Chinese acquirers often find themselves across the negotiating table from European and U.S. executives. Unlike the latter, many Chinese executives are unaccustomed to highly structured deal-making processes with rigorous time constraints. "Chinese companies have lengthy decision and approval processes,"

JOINT VENTURES
A Popular Solution to the Chinese Puzzle

Experienced dealmakers agree that the Chinese M&A market is different from all others. Restrictions on foreign ownership of Chinese assets, as well as limits on individual foreign investments, constrain inbound acquirers. In addition, many of the most attractive assets are in the hands of owners that are reluctant to relinquish control of them, or that insist on valuations that acquirers view as overstated or unrealistic. And even when owners are willing to sell, acquirers may lack familiarity with local market conditions and customer requirements and preferences.

In such a situation, joint ventures appear to many acquirers to be the best of both worlds. Properly structured, they enable acquirers to gain valuable local knowledge and access to new consumer markets and production and distribution systems. At the same time, the joint-venture structure often enables foreign acquirers to hold their investments below the threshold that triggers unwanted regulatory attention. The 2012 investor survey by the American Chamber of Commerce in China confirms the popularity of these entities. One-quarter of survey respondents reported that their parent companies had established one or more joint ventures in China.

Careful deal structure—and careful attention to setting goals and expectations—can mitigate many of the risks associated with joint ventures. Shanghai GM, the joint venture between SAIC and GM, has proved a long-running success because the two parties were careful to align their goals and expectations before closing the deal. Most important, they agreed on the objective of making the joint venture China's leading automotive OEM. It's no accident that their joint venture claimed the largest share of the passenger-car market in 2005 and has retained that distinction ever since.

What can companies from developed economies learn from the experiences, positive and negative, of those that have gone before them? In the course of its extensive experience with joint ventures, BCG has learned that there are three key success factors for such deals. It is important that all parties to the deal ensure that all contribute equally, recognize that alliances evolve over time and manage this change, and have a clear exit strategy.

said Albersmeier, “and as a result they have trouble succeeding within the European auction format. They are simply not able to quote in time.” Developed-economy companies dealing with a potential Chinese buyer should be prepared for protracted transaction cycles. They may need to structure negotiations to allow potential Chinese acquirers sufficient time to deliberate.

Internal preparation by the target asset is equally important. As we have noted, Chinese acquirers are seeking more than a collection of assets; they’re looking for a platform from which to launch global expansion. Local management should be aware of this motivation and, with appropriate incentives, support the aims of the new owner.

EMERGING THEMES AND RECOMMENDATIONS

WHAT CAN BE LEARNED from the BRICs? The first lesson is that M&A will go where the customers, technologies, or resources are. And that means that cross-border M&A, especially M&A focused on emerging markets, will make up an increasing share of deal-making activity. BCG has identified seven emerging-market countries—Egypt, Mexico, Nigeria, the Philippines, South Korea, Turkey, and Vietnam—that we believe will play a growing role in the M&A market. They have recorded consistent growth in deal flow in the past several years, and deals involving those countries have earned attractive returns. Along with the BRICs, these "magnificent seven" countries have the potential to join the ranks of the world's largest economies.

Their investment potential is as impressive as their economic growth rates. Our analysis revealed that the cumulative deal volumes of the magnificent seven from 2009 through 2012 were significant—ranging from $6.7 billion in Vietnam to $168.7 billion in the Philippines. What's more, those volumes have been growing at high-double-digit rates, led by Nigeria, where M&A volume has increased at a 96 percent compound annual rate—in other words, virtually doubling each year. (See Exhibit 19.)

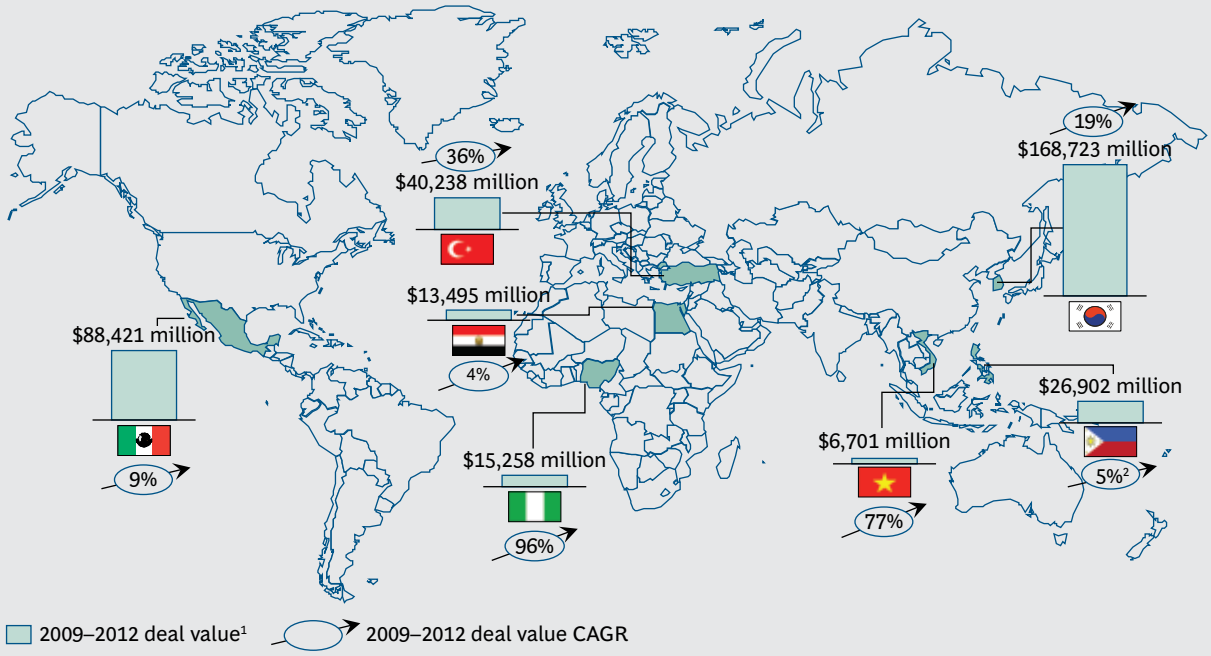
It's not just the growth in deal flow that should catch the attention of dealmakers. M&A deals involving the magnificent seven have consistently delivered above-average returns and are currently outperforming the developed-market benchmark by 0.6 percent. (See Exhibit 20.) There is plenty of room for those returns to increase as these countries become a familiar presence in the global M&A market and both inbound and outbound dealmakers gain experience from multiple transactions.

The three largest economies among the magnificent seven—Mexico, South Korea, and Turkey—are also the countries that, alongside the BRICs, are driving emerging-market M&A, and their presence in the M&A market will only increase. In the past four years alone, Mexico, South Korea, and Turkey have recorded a cumulative transaction volume of $300 billion, and those volumes are poised for continued explosive growth. The numbers alone make these evolving challengers worth watching. Keep them in mind when thinking globally.

For the time being, it's likely that the BRICs will remain a hotbed of M&A activity for some time to come. Within the BRIC countries, markets are growing, consumers are gaining purchasing power, and formerly protectionist economies are inviting foreign investment. At the same time, newly confident and ambitious BRIC-based companies are racing to acquire assets in developed econo-

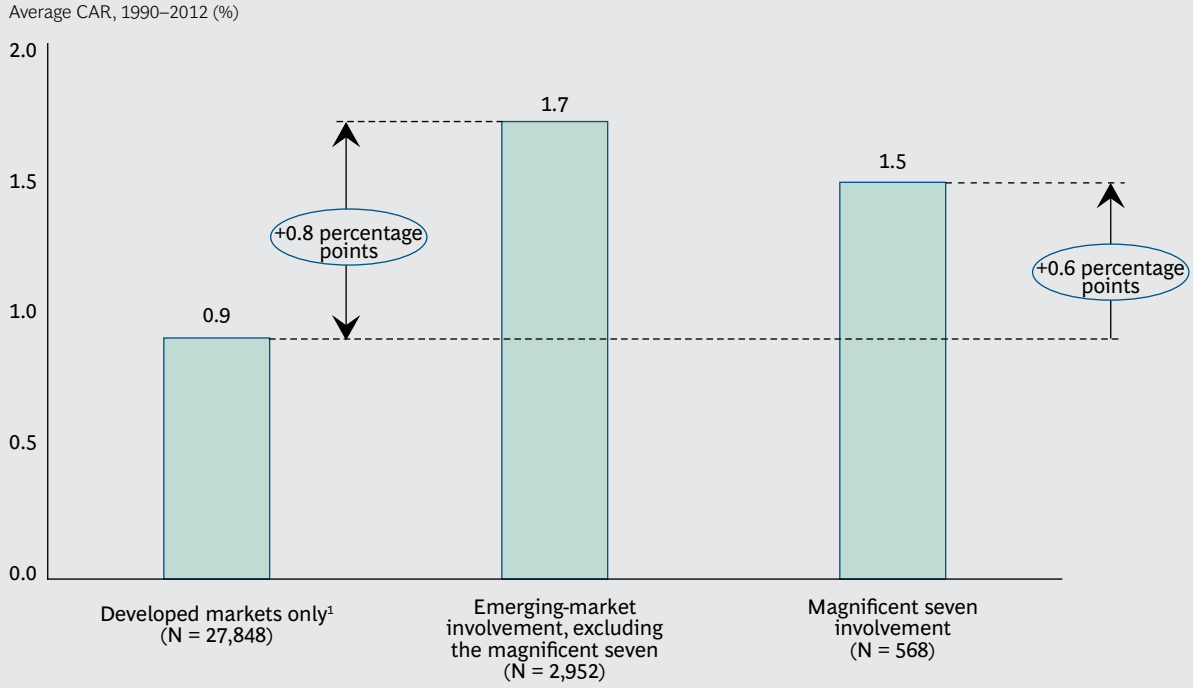
Exhibit 19 | Seven Countries Could Be the Next Drivers of Emerging-Market M&A

Egypt, Mexico, Nigeria, the Philippines, South Korea, Turkey, and Vietnam are recording consistent growth in deal value



Sources: Thomson ONE Banker; BCG analysis.
[1]Sum of deal values, including all transactions (inbound, outbound, and local) in which the respective countries were involved.
[2]CAGR, 2010–2012; 2009 was an outlier.

Exhibit 20 | Deals Involving the "Magnificent Seven" Are Producing Attractive Returns



Sources: Thomson ONE Banker; BCG analysis.
Note: CAR = cumulative abnormal return calculated over a seven-day window centered around the transaction announcement date (+3/–3).
[1]Deals with developed-market acquirer and target, excluding South Korea.

mies to achieve growth and advance their global aspirations. These circumstances have combined to create a lively environment for cross-border M&A activity. To create value from such transactions, however, today's corporate leaders must keep in mind the following basic precepts:

- *Be prepared.* Begin due diligence early because limited transparency and often complex bureaucracies will make the process more time consuming than in developed economies. Approach the foreign management as early as possible so that buyer and seller develop a shared understanding of one another's business. Make an early start on planning for the postmerger integration.

- *Be local…* The right advisors can make all the difference in emerging-market transactions. Consider venturing outside your usual circle of deal advisors and engaging a local team. Local insights, market knowledge, and takeover know-how are key success factors in emerging-market M&A.

- *…but think globally.* A company that combines an international footprint with deep local expertise can help dealmakers overcome language barriers, understand local industries, navigate bureaucratic and regulatory mazes, and develop important relationships with local business owners and decisionmakers.

- *Cultivate key relationships early in the deal process.* The success of an emerging-market acquisition often depends on relationships with a handful of key executives at the target company. It's crucial to win their support and offer them compelling incentives to ensure their retention after the transaction's close.

- *Establish internal change-management teams.* Most emerging-market buyers are eager to acquire advanced management skills. Local management of the target should support the new owner in this quest. Doing so will win the new owner's cooperation and facilitate the efficient transfer of knowledge and best practices.

- *Approach potential emerging-market buyers early on.* If the ideal buyer of an asset is based in an emerging country, consider engaging the potential buyer early in the sales process—possibly even before the auction process gets under way. Be aware that emerging-market dealmakers may not be familiar with European- and U.S.-style auctions and may struggle to adhere to tight timelines.

- *Weigh different entry options.* Consider joint ventures and alliances as alternative deal structures. They give acquirers a chance to test the waters and gain a deeper understanding of the market. As their local expertise grows, acquirers can use these other deal structures as the launching pad for follow-up acquisitions.

- *Manage cultural differences proactively.* In some emerging markets, dealmakers tend to avoid negotiating deal terms, preferring to facilitate transactions through trust and personal relationships rather than complex legal documentation. Local advisors familiar with the business culture and management style of both parties can foster understanding between the two sides and facilitate the production of documentation.

- *Keep it simple.* Go for public companies rather than mom-and-pop shops. Try to avoid adding complexity to an already complicated situation. Financial markets reward acquirers in emerging markets that remember to keep things simple.

APPENDIX

SELECTED TRANSACTIONS, 2012 AND 2013

Private-Equity Transactions

2013 EQUISTONE PARAGON PRINT & PACKAGING Strategic advisor to the seller **Not disclosed** BCG	**2013** EXPLORER Investments PROBOS Strategic advisor to the seller **€75M** BCG	**2013** Permira PHARMAQ Strategic advisor to the buyer **€250M** BCG	**2012** Italyi Investment S.A ivsgroup Strategic advisor to the buyer **€220M** BCG	**2012** Montagu private equity The University of Law Strategic advisor to the buyer **€243M** BCG
2012 Montagu private equity CAP Strategic advisor to the buyer **€215M** BCG	**2012** ALTOR EQUITY PARTNERS meyn Strategic advisor to the seller **Not disclosed** BCG	**2012** BainCapital PRIVATE EQUITY bravida Strategic advisor to the buyer **€669M** BCG	**2012** VTB Capital BURGER KING Russia Strategic advisor to the buyer **€37M** BCG	**2012** Bridgepoint COMPAGNIE DU PONANT Strategic advisor to the buyer **Not disclosed** BCG
2012 KKR WMF Strategic advisor to the buyer **€550M** BCG	**2012** Bridgepoint aenova Strategic advisor to the seller **Not disclosed** BCG	**2012** BC Partners aenova Strategic advisor to the buyer **Not disclosed** BCG	**2012** HERKULES CAPITAL ESPRESSO HOUSE Strategic advisor to the buyer **€95M** BCG	**2012** PAI partners MARCOLIN EYEWEAR Strategic advisor to the buyer **€268M** BCG

2012
Advent International
DOUGLAS HOLDING
Strategic advisor to the buyer
€1,641M
BCG

2012
Investment Partners
VEMEDIA
Strategic advisor to the buyer
€136M
BCG

2012
BC Partners
TEMMLER Your Product's Best Friend
Strategic advisor to the buyer
€114M
BCG

2012
OAKTREE
PANRICO
ARTIACH
Strategic advisor to the seller
€73M
BCG

2012
icg
ATPI
Strategic advisor to the buyer
Not disclosed
BCG

2012
Blackstone
PAI partners
UB
KP SNACKS
Strategic advisor to the seller
€615M
BCG

2012
CapMan
ACONA
Strategic advisor to the buyer
Not disclosed
BCG

2012
Triton
Strategic advisor to the buyer
Not disclosed
BCG

2012
SPONSOR CAPITAL
barona
Strategic advisor to the seller
Not disclosed
BCG

2012
NPM CAPITAL
VSI your bar
Strategic advisor to the buyer
Not disclosed
BCG

2012
ROARK CAPITAL GROUP
Massage Envy SPA
Strategic advisor to the buyer
Not disclosed
BCG

2012
GENERAL ATLANTIC
TORY BURCH
Strategic advisor to the seller
Not disclosed
BCG

2012
Blackstone
GCA SERVICES GROUP
Strategic advisor to the buyer
Not disclosed
BCG

2012
THE CARLYLE GROUP
gettyimages
Strategic advisor to the buyer
$3,300M
BCG

2012
VMG
BabyGanics
Strategic advisor to the buyer
Not disclosed
BCG

Corporate Transactions

2013
Pfizer
zoetis
Strategic advisor to the seller
Not available
BCG

2013
nkt cables
ERICSSON Power Cables
Strategic advisor to the buyer
€29M
BCG

2012
Galeries Lafayette
MONOPRIX
Strategic advisor to the seller
€1,175M
BCG

2012
B&C INDUSTRIE HOLDING
DORR
Strategic advisor to the seller
€80M
BCG

2012
DOVER
Anthony
Strategic advisor to the buyer
$603M
BCG

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