Internationalisation strategies of emerging markets firms

Rosa Caiazza

Department of Management, Parthenope University of Naples, Naples, Italy
Email: rosa.caiazza@uniparthenope.it

Abstract: Starting from existing mergers and acquisitions (M&A) trend and managerial literature we evidence new challenges for internationalisation strategies. Our conceptual paper aims to evidence several aspects to discuss more deeply in future papers on M&A process and internationalisation strategies. First, we evidence challenges due to cultural diversity in multipolar strategies. Second, we evidence how these challenges require firms to re-evaluate their strategies in a multipolar world. Finally, we propose a new model of performance evaluation of M&A.

Keywords: internationalisation strategies; emerging markets firms; mergers and acquisitions; performance evaluation; cultural diversity.


Biographical notes: Rosa Caiazza is Professor of Management at the Parthenope University of Naples, Italy. She is an advisory board member of Academy of Management Perspectives, Corporate Governance, International Journal of Comparative Management and several other A ranked journals. She was a Visiting Researcher at the Wharton University of Philadelphia (USA) and Université Libre de Bruxelles (Belgium). She is an author of several articles published in top-tier academic journals on interlocking directorates and M&A. She was a Chairman of many academic conferences and workshops on M&A. She had Emerald Literati Network Awards for Excellence. Her main research topics are corporate and business strategies, internationalisation, cross-cultural management, M&A and corporate governance.

1 Global trends

The complex strategy of internationalisation has interested researchers of management alike for several decades. Mergers and acquisitions (hereafter, M&As) have long been the most popular way to implement such strategy. The popularity of this strategy increased tremendously since the ‘90s (Bertrand and Zitouna, 2008).

Researchers of management have studied several M&A waves over the last century and developed many theories about their causes and effects (Shimizu et al., 2004).
The first M&A wave began in 1897 and involved horizontal consolidation. The idea was to create a monopoly and use its cost and price advantages. This worked until the Sherman Act (1904) that prohibited the anticompetitive activities of firms.

The second M&A wave began in 1916 and involved vertical integration and some of the car companies today was the product of this period’s activity. The idea was to improve the efficiency of firms. It ended in 1929 with the great depression.

The third M&A wave began in 1960 and it where conglomerates took over. The idea was to increase world trade and economic growth. It ended in 1970 when many of the expected returns didn’t come to fruition (Zhu and Huang, 2007).

The fourth M&A wave began in 1980 and was caused financial innovation and the creation of the European Union. The financial innovation was the junk bond and leverage buyout. It ended in 1989 due to the savings and loan crisis and the early 1990s recession.

The fifth M&A wave began in 1993 and the catalysts were high stock prices and dot com delusion. It ended in 2000 with the dot com bubble and the early 2000s recession.

The sixth M&A wave began in 2003 and was due to globalisation, cheap credit and in some countries the desire to create national champions to show off to the world. It ended in 2007 with higher interest rates and the US sub-prime mortgage crisis.

Understanding history can help us identify main challenges of this new wave of M&A. Currently the world is in the middle of a seventh wave (see Figure 1). Since 2007, new pole of economic power rose leading the value of mergers and acquisitions at 1.200 billion US dollars in 2016.

Figure 1 Seventh merger wave (see online version for colours)

Source: http://mergers.whitecase.com

Indeed, market capacity for M&A is predicted to rise in the next future, driven by healthy bottom lines and large corporate balance sheets. This evidences that the risk aversion that led organic growth of firms since the 2007 crisis is going to be dissipating and M&As are now selected again for accessing new regions, products and know-how. Acquirers across the globe leveraged strategic combinations to expand both their geographic reach and innovation capabilities.

Cross-border transactions remain a feature of the M&A market in 2017, as companies continue to look to new market to expand geographic reach and innovation capabilities.
Between 1997 and 2017 companies based in emerging economies engaged in outbound cross-border M&A had increased to $2 trillion. A significant number of cross-border M&As is occurring in which a firm from an emerging-economy acquires a developed-economy firm (Caiazza et al., 2017).

The development of emerging-market firms into a potent force for globalisation in their own right has important implications for cross-border capital formation, technology diffusion and commercial activities. A number of innovative and dynamic emerging-market firms are on a path toward dominating their global industrial sectors (Bouwman et al., 2003).

A notable development has been the gradual emergence of cross-border M&A, as preferred alternative to joint ventures and overseas subsidiaries, in internationalisation strategies. These new trends inherent within the competitive environment are forcing businesses to re-evaluate their strategic behaviour and re-think those factors affecting each stage of M&A.

2 General framework

Since 2007 the world is moving into an era characterised by multiple centres of economic power. The multi-polar world requires corresponding multi-polar strategies for facing the new challenges. Companies have understood that this volatile era in terms of market growth world is the new standard. In such an environment, it may not be possible to rely only on organic growth to deliver consistent financial results. Nevertheless, M&A, both national and cross-national, remains crucial for companies seeking change. In such multipolar world, firms need to transform more radically and much faster than is possible organically.

Thus, firms implementing multi-polar strategies through cross-border M&A are more able to compete with everyone for everything (Caiazza and Simoni, 2015). Consequently, while in the past only developed economies were making outbound M&A investment, the flows are now becoming larger, more numerous and multi-directional.

These aspects have, thus, affected the 2016 M&A volume in both developed and developing countries. According to data on 2017 M&A Report in the USA deal volume in 2016 decreased of 9%, in Europe improved for the third consecutive year and in the Asia-Pacific region declined for the second consecutive year (Bothwick and Leibowitz, 2017).

A surge in China outbound deal volumes contributed to overall cross-border M&A growth, as Chinese companies sought attractive opportunities abroad. China outbound activity into the USA and EMEA increased by 471% and 252% year-over-year, respectively (UNCTAD, 2017).

Latin America, the Africa and Middle East regions are jointly the biggest climbers in terms of predicted appetite, up 7% almost completely because of rising market capitalisations. The emergence of acquirers from South-America, Asia and Eastern Europe are radically reshaping the economic geography.

Considering this new scenario we expect in the next future emerging market firms will be engaged more and more in multipolar strategies through cross-border M&A. This trend raises an interesting question regarding the challenges that influence cross border deals and their effects (Simoni and Caiazza, 2013). This question is increasingly pertinent
as government regulators grapple with the dramatic rise in M&A investment by firms in emerging markets. Consequently, it is likely to evidence challenges that drive this future trend at the aim to help firms successfully balance opportunities and risk rising from a rapidly changing environment.

Macroeconomic trends and structural cross-national differences in capital, labour, natural resources, culture, legal systems and accounting rules between the home and the host countries affect cross border M&A in many ways. However, the relevance of these elements depends on industry and firms’ resources, competences, experiences and strategic intents (see Table 1).

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<th>Table 1</th>
<th>Factors affecting cross border M&amp;As</th>
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<td>Exchange rate</td>
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<td>Market size and growth</td>
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<td></td>
<td>Labor cost</td>
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<td>Skills and talent</td>
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<td>Technological intensity</td>
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<td>Strategic intent</td>
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For creating value a number of key activities have to be reconsidered in the acquisition process, mainly because 21st century pressures have reduced time to think, increasing exposure to risk. New global flow in cross-border M&A evidences challenges of differences in multiple legal and regulatory regimes that require compliance with different rules. Differences of value, religion and behaviour impose a careful reconsideration of the way in which the M&A process is implemented.

### 3 New perspective of analysis

The complexity of cross border M&A process under current pressures imposes acquirers to be able to revise the target selection. The nature of the buyers and their strategic priorities creates the potential need to acquire another firm. Corporate buyers pursuing multipolar strategies through M&A continue to compete against private equity firms (Morosini et al., 1998; Caiazza and Dauber, 2015).
Corporate buyers from emerging countries pursue their strategy based on improving their competitive positioning (Simoni and Caiazza, 2012a, 2012b). Thus for such corporate, a deal making decision has to strengthen their basis of competition by improving technologies, brand, market and capabilities. In fact, the decision of emerging market firms to expand participation into developed markets can be dependent on their ability to improve technologies, to leverage price differentials between the two markets, achieve competences, etc. (Caiazza et al., 2013). Some acquisitions are intended to transfer intellectual capital, access markets or build capabilities that improve overall competitiveness. As such, it is possible to categorise them as knowledge, market and structure-oriented M&A (Harzing and Sorge, 2003).

To create sustainable value through M&A, emerging markets firms must choose a developed market target that supports the specific strategy. It is often customary to engage international transaction advisors including investment banks (Deutsche Bank, Citigroup, etc.), accounting firms (Deloitte & Touche, PwC, etc.) and/or consulting firms (Boston Consulting, McKinsey & Company, Booz & Company, etc.) in the process of target selection and due diligence.

Cultural due diligence is the critical step to quantify the strategic value of a potential transaction considering cultural clash and differences between two firms. It is an important step in the pre-closing phase that helps acquirers to take critical people decisions at the time the deal is announced or shortly thereafter.

The transaction advisor’s role in cross-border M&A becomes fundamental to the success of the deal and must identify the transaction price and future synergies resulting from the deal.

The ability to integrate developed and emerging market companies is generally ranked as the most important factor influencing M&A success (Quah and Young, 2005). This is made significantly more difficult when the countries are culturally distant. Integration challenges resulting from national differences between emerging and developed countries firms are high-risk issues (Walsh, 1988). In such transactions, cultural differences are a significant source of risk and a potential obstacle to realising integration benefits (Terjesen and Elam, 2009). It can affect synergy realisation and shareholder value, increasing the likelihood of incompatible management styles leading to acculturative stress, implementation problems, and lower performance.

Standard integration tends to focus on integration structure and alignment of the management to leadership of acquirer. In such case senior leaders design the entire organisation with little input from others. However a broadly inclusive process of cultural integration has to consider value and principles of multiple management levels. Aligning the top team around cultural choices is a critical standard integration intervention. Tailored cultural interventions address the specific findings of the outside-in analysis and focus on changing targeted behaviours.

Thinking about cultural conflicts and opportunities in terms of management practices makes culture easier to define, identify, and tackle. Managers should avail themselves of tools that can help perform these tasks, whether an outside-in analysis that surfaces cultural issues even before deal close. Every integration action, from announcement to combination, has impact on corporate culture and therefore M&A value (Haleblian et al., 2012; Caiazza, 2016a, 2016b).

Cultural integration is about aligning the right behaviours with the desired results. This aim can be achieved having a relentless focus on delivering M&A value, enhancing
business performance and rewarding enabling behaviours. A successful M&A integration that puts the right leadership, processes, systems, metrics and incentives in place creates culture as an outcome (Tsai and Eisingerich, 2010). A common misconception during M&A integration is that in order to integrate well, one needs to address the culture.

4 Conclusions and discussions

Some new research questions are emerging in cross border M&A studies. Chinese, Indian and Russian companies have been prolific in venturing outside their domestic markets to do deals, demonstrating that they are well-managed, efficient and globally competitive. Which internationalisation models these firms adopt?

Terrorism, political instability, corruption, kidnapping creates opportunities for those willing to take calculated risks in some areas of Africa, Latin America, the Middle East and parts of Asia and Eastern Europe. However, in many markets risk and insurance reviews are excluded from a bidder’s due diligence. This can be a dangerous oversight, as dealmakers may underestimate the liabilities and risks they inherit and overestimate the insurance assets of the target company. Have new acquirers’ different motivations?

The process of merging of two firms implies merging of structures, systems and processes. However, human integration turns two firms a unique entity. People who work for firms at all the level, in fact, represent the firms’ culture. Dealmakers must pay close attention to human capital issues in every phase of the M&A process to assure that it create value. How the whole integration process can be re-thought on the base of human resources?

Most of financial literature evaluates M&A performances using abnormal return analysis. However, the long-term success of cross border M&A is better evaluate on the base of the achieved strategic intents. Which are the long-term models to evaluate cross border M&A performances?

References


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