Strategic Importance of Cross-Border Acquisitions for Emerging Market Multinationals

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Abstract Business environment has changed significantly during the last two decades under a rapid globalization. The growing number and power of multinationals from emerging markets is one of the most prominent results of these changes. From niche players in the global market or regional competitors in similar emerging markets, they became multinationals that are challenging world leaders, even in high intensive industries. As late followers in the global market, these companies are faced up with competition gap. Therefore, they use cross-border acquisitions to obtain strategic resources necessary to compete in the global market (technology, brands, marketing knowledge, etc.). They combine the obtained resources with their own cost advantage to reshuffle competition in the industry. To preserve targets' strategic resources, these multinationals retain the top management and give them great autonomy. Through this approach, the risk of acquisition failure is reduced, regardless of the fact that some cost synergies are not achieved. Two case studies, Lenovo and Tata Motors, from China and India, the major emerging markets, are used to show how emerging market multinationals rewrite motives and strategies for cross-border acquisitions.

1 Introduction

For more than two decades, economic liberalization and accelerated development of technology have been the drivers of increasing business globalization. One of the most important results of globalization is a greater role of emerging markets in global economy. Emerging markets have strengthened their ties with the world economy and became its most vibrant part. Growing economic power of emerging

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Table 1 Number of multinationals from China, India, the USA, and Japan in Fortune 500

	2008	2009	2010	2011	2012	2013	2014
China	29	37	46	61	73	89	95
India	7	7	8	8	8	8	8
USA	153	140	139	133	132	132	128
Japan	64	68	71	68	68	62	57

Source: Fortune Global 500 Database (2014)

markets is reflected in rising foreign direct investment (FDI) outflow which soared from more than USD 127 billion in 2004 (less than 14 % of the global FDI outflow) to more than USD 553 billion in 2013 (around 40 % of the global FDI outflow) (World Investment Report Database, 2014). Consequently, the number and power of emerging market multinationals (EMM) is rising. Table 1 shows the number of multinationals from China and India, as the leading emerging markets, and the USA and Japan, as the most significant developed countries, in Fortune 500 list.

During the analyzed period, the number of multinationals from China rapidly increased, the number of Indian companies was low and steady, and the multinationals from the USA and Japan significantly declined in number. Such trends brought EMM into focus of academic research (Chattopadhyay, Batra, & Ozsomer, 2012; Khana & Palepu, 2010; Ramamurti, 2012; Rugman, 2009).

Companies from emerging markets were considered to be producers of standardized products only, unable to develop any radical innovation (Vernon, 1966). Nowadays, this opinion is mostly abandoned and considered outdated due to rising power of some EMM (Lenovo, Haier, Tata, Infosys, Embraer, Huawei, Lukoil, Rusal, Cemex, etc.). Some researchers, nevertheless, argue that EMM can develop only gradual innovations due to inefficient institutions and specific social and cultural relationships (Abrami, Kirby, & McFarlan, 2014).

Internationalization of EMM is strongly affected by three determinants: (1) these multinationals usually lack superior technology and management knowledge, (2) governments encourage global expansion, and (3) frequent use of cross-border acquisitions (Peng, 2012). This chapter deals with these determinants, giving special focus to cross-border acquisitions. Theoretical arguments and results of the earlier research on aims of cross-border acquisitions made by EMM and management of acquisition process are supported by two case studies, Lenovo and Tata. These two companies made several cross-border acquisitions in the last decade that reshaped their global market position. They applied specific approach to integration of targets, giving them great autonomy, which enabled acquirers to obtain strategic resources and achieve full-scale synergy.

2 Determinants and Strategic Goals Behind Cross-Border Acquisitions Made by EMM

Growing power of EMM brings up the question whether traditional theories of multinationals can explain their internationalization paths. These theories point out that the multinationals possess some strategic resources, which are source of competitive advantage, and try to exploit them abroad (Dunning, 2000; Rugman & Verbeke, 2003; Verbeke, 2008). These strategic resources are usually intangible and cannot be subject to market transactions. Due to imperfections in the market of intangible resources, companies invest abroad to exploit additionally these sources of competitive advantage (Caves, 1980; Krugman & Obstfeld, 2003). However, EMM do not entirely fit in these theories. They lack cutting-edge technology, marketing and management skills, and globally recognized brands. Some researchers therefore argue that EMM base their competitive advantage primarily on the country of origin's specific advantage (surplus of low-cost labor force, cheap natural resources, huge and growing domestic demand, government incentives, etc.) (Rugman, 2009).

However, their competitive advantage lies in much more than mere capability to produce low-cost and poor-quality products. These companies expand their business activities simultaneously to developed and to emerging markets (Guillen & Garcia-Canal, 2009). In developing markets, they make use of their ability to do business under undeveloped formal institutions, unpredictable actions of informal institutions, weak legal protection, undeveloped infrastructure, and a broad base of poor customers (Yadong, Sun, & Lu Wang, 2011). In these markets, EMM are generally positioned as producers able to service the bottom of the pyramid (Prahald & Hammond, 2002) since they are familiar with the limited purchasing power of the customers and their specific needs.

EMM expansion into developed markets is driven by different motives. They penetrate into these markets primarily to learn new skills and to leverage the skills they already possess (Mathews, 2006), which enable them to develop new strategic resources. Strategic resources can be developed internally, through cooperation with strategic partners or via cross-border acquisitions (Barney & Tong, 2006). To boost their own competitiveness, EMM purchase the lacking market-based resources (technology solutions, components, hiring individuals with specific skills, etc.) and combine them with their own capabilities (additional services, low-cost manufacturing, designer skills, etc.) (Barnard, 2010). Besides hiring a number of managers who worked for Microsoft, Google, and Motorola, Xiaomi, the leader in Chinese smartphone market, hired Hugo Barra, the former vice president of Google, with the aim of developing a global strategy.

EMM's networking capabilities enable them to identify strategic partners and their strategic resources and to determine how to acquire them and finally how to adapt them to local conditions (Yadong et al., 2011). The obtained resources are used to improve own capabilities and expand abroad. This path sometimes goes from OEM, over ODM, to OBM (Ramamurti, 2012). Galanz is a good example of a

company that has successfully passed these stages, now taking more than 50 % share in global sales of microwave ovens, either under its own or the strategic partners' brands. However, by using this strategy, companies run the risk of being stuck in the position of a subcontractor to global MNC, such as the case of some Chinese auto companies, with no prospects of establishing a global marketing position.

Besides the competitive forces in industry (Porter, 2008) and the available resources (Barney, 1991), institutional environment is another factor determining business decisions of a company (Peng, Wang, & Jiang, 2008). Therefore, the role of international acquisitions in EMM expansion can be properly understood only within the institutional context in which these companies operate. Institutions can affect cross-border acquisitions undertaken by EMM in two ways—indirectly, through inefficient institutions and, directly, through purposeful action of state authorities. Inefficient capital market (banks make soft loans to potential outward investors, inefficient internal capital market inside conglomerates, and family firms have access to cheap capital from family members) enables EMM to undertake acquisitions involving high risk and to pay higher premium than their competitors (Buckley et al., 2007).

In some emerging markets, governments directly stimulate cross-border acquisitions that could bring about strategic resources. This policy is carried out in the form of promotional measures and direct financial support (Yadong, Qiuzhi, & Binjie, 2010). Therefore, companies from emerging markets who are trying to acquire companies from developed economies are often considered to be representatives of government rather than business interests. Consequently, this can be a big obstacle to acquisitions in industries that developed countries consider strategically important (Bremmer, 2014). Thus, in 2009, General Motors, being in bankruptcy and under government control at the time, decided to break off the lengthy negotiations on sale of its troubled subsidiary Opel to auto parts producer Magna, although the financial offer was very attractive. Magna established partnership with Russian state-owned bank Sberbank and Russian vehicle manufacturer OAO Gaz Group to try to acquire Opel. Therefore, the US authorities estimated that through this acquisition, Russian companies would come into possession of cutting-edge technology and well-known brand, which would significantly impede the operations of American companies in strategically important auto industry.

For only one decade, from 2004 to 2013, the value of cross-border acquisitions made by companies from developing and transition countries increased from something over USD 30 billion, or about 15 % of the value of global acquisitions, to more than USD 186 billion, or 53 % of the global value (World Investment Report Database, 2014). Interestingly, one acquisition carried out in 2013 made a considerable impact of the total value of cross-border acquisitions made by emerging market companies in this year. This acquisition worth USD 54 billion was made by Russian state-owned company Rosneft who acquired TNK-BP. During the last decade, cross-border acquisitions made by EMM increased both in value and in number. From 2004 to 2013, the number of these acquisitions grew from 1,257, or about 16 % of global deals, to 1,807, which accounts for 21 % of global deals

(World Investment Report Database, 2014). The importance of cross-border acquisitions to EMM expansion is best depicted by the fact that in China (Li, Li, & Shapiro, 2012) and India (Ray & Gubbi, 2009), they became the most frequently applied investment strategy for penetration into foreign markets.

Previous studies have shown that the companies lacking cutting-edge technology opt for cross-border acquisitions rather than green field investments (Shimizu, Hitt, Vaidyanath, & Pisano, 2004). Cross-border acquisitions are, therefore, the predominant type of investment strategy applied by the EMM. Through cross-border acquisitions, EMM obtain the lacking cutting-edge technology and other intangible strategic resources needed to reinvent their business model (Christensen, Alton, Rising, & Waldeck, 2011). However, this type of acquisition involves considerable risks, such as how to identify the appropriate target and how to integrate it. Investors from developed countries believe that the acquisitions aiming at reinvention of the business model are too risky and destroy the value of the owners (Beishaar, Knight, & Van Wassenaer, 2001). However, some studies have shown that acquisitions made by EMM contribute to value creation for shareholders (Gubbi, Aulakh, Ray, Sarkar, & Chitoor, 2010; Ray & Gubbi, 2009). High degree of success of cross-border acquisitions from emerging markets is attributed to complementarity of target's and investor's resources. Targets provide EMM with access to developed markets and more affluent customers, implying much higher profit margins, and with advanced technology, globally recognized brands, and superior management competencies (Kale, 2009). On the other hand, target gains access to the acquirer's low-cost advantage, to additional cheap capital, and to large and growing demand in emerging markets (Knoerich, 2010). When Chinese car producer Geely acquired Volvo, it gained the access to cutting-edge technology and marketing knowledge. Simultaneously, Volvo was provided with fresh capital and access to fast-growing Chinese market, which turned from a marginal to the largest single market for Volvo only 4 years after the acquisition.

Acquisition of strategic resources from abroad enables EMM to offer cutting-edge technology products, variety, and customization at minimum price premiums (Williamson, 2010). Additionally, acquired competencies enable EMM to launch internally developed innovations that then become acceptable in developed markets (Govindarajan & Ramamurti, 2011).

3 Integration Options and Value Creation for EMM in Cross-Border Acquisitions

It has been reported that more than two-thirds of large M&A deals fail to create value for shareholders. The propensity for mergers and acquisitions' failure to meet anticipated financial and strategic objectives is corroborated by numerous studies which indicate that the rate of M&A failure ranges from 55 % to 70 % (Lodorfos & Boateng, 2006). Despite of the high failure rate, mergers and acquisitions are very

popular choice for strategy implementation by multinationals. Absence of synergy realization between companies involved in the transaction is often attributed to the mistakes in the integration process. Therefore, integration process is one of the major determinants for the success of the acquisition in creating value.

Value creation often depends on the transfer of strategic capabilities between the acquirer and the target. The extent of the integration depends upon the degree of the strategic interdependence between the two firms as a precondition for capability transfer and value creation. The timing of integration also depends on the type of capability being shared or transferred. Rationalization of operating capacity is often done much faster than the transfer of functional and management skills. The strategic value creation logic behind the acquisition dictates the extent to which the capabilities of the two companies need to be merged within single organizational structure or maintained within single boundaries of the companies (Sudarsanam, 2010). According to Marks and Mirvis (2010), companies involved in a transaction need a high-level vision of the end state before agreeing on a deal. That way, decisions about how to put different functions together can be weighed against the desired end state. There are several organizational and cultural end states that can help managers to think through their integration options. These integration options include preservation, absorption, reverse takeover, the best of both, and transformation. Preservation relates to the case where acquired company faces only modest degree of integration and retains its ways of doing business. This end state is desirable in diversified companies that promote cultural pluralism among business units and in acquisitions where the intent is to secure and build on human and social capital. To succeed, the acquirer's management has to protect the boundary of the acquired company, limit intrusions, and minimize conformance to its rules and systems (Marks & Mirvis, 2010). Absorption refers to the situation where the acquired company is completely absorbed by an acquirer and assimilated into its culture. In reverse takeover, the acquirer wants to adopt the ways of doing business of the acquired company. Besides, in that situation, the acquired company dictates the terms of the combination and effects cultural change in the acquirer. Achieving synergy between companies through their partial or full integration is characteristic of the best of both integration approaches. Geographical expansions or roll-ups in fragmented industries often seek this end state. In this integration approach, financial and operational synergies are achieved by consolidation implying reductions in workforce. The optimal result is full cultural integration which means the blending of both companies' policies and practices. Transformation implies that both the acquirer and acquired company undergo fundamental change following their combination. This end state is desired when an industry is radically evolving or emerging. Synergies are not simply realized from reorganizing the businesses but from reinventing the company. This is the trickiest of all integration options and requires a significant investment and inventive management. Existing practices and routines must be abandoned and new ones discovered and developed (Marks & Mirvis, 2010).

Acknowledging the importance of integration process, emerging multinationals take special care when integrating acquired targets. Instead of rushing to integrate

acquired companies and thus try to generate instant growth, EMM allow their acquisitions to continue operating independently, focusing on strategic reasons of the acquisition, almost like there was no change in ownership, e.g., they usually decide on preservation approach. Preservation approach or partnering approach as Kale, Singh, and Raman (2009) call it entails keeping acquisition structurally separate and maintaining its own identity and organization. The acquirers retain senior executives, particularly the CEOs of the acquired companies, and give them same power and autonomy they used to have adding just few executives of their own. They aim for synergies in few areas having in mind that realizing synergies is not disruptive for acquired company's business. In essence, EMM treat the acquired company as it would treat partner in strategic alliance (Kale et al., 2009). The main reason for giving the acquired company such autonomy lies in the basic goals behind the acquisition. EMM's aim is to obtain new technologies, brands, and customers in foreign markets while focusing on long-term goals. On the contrary, the main goal of many acquisitions is to reduce costs and make quick benefits from disposing overlapping assets, focusing on short-term objectives. Clear long-term vision, identifying its weaknesses and targeting only companies whose purchase would offset those weaknesses, is the main reason for M&A success of India's Hindalco which became one of the largest manufacturers of aluminum in the world (Kumar, 2009). After acquiring companies, EMM try to score quick wins in combined raw material purchases by setting up combined teams to coordinate buying with overseas acquisitions. High degree of operational autonomy minimizes the poor performance after the acquisition since acquirers often make bad decisions because they do not understand the acquisition's business. It can also help to prevent decision-making paralysis which can occur when managers do not understand the acquirers' expectations. If emerging multinationals decide to place one of their senior executives in the acquired company, their job is not to oversee CEOs, but they act as bridges between the acquirer and acquired company. That was the case when Ülker acquired Godiva. In order for partnering approach to work and create value, it is extremely important that emerging multinationals communicate values, ethics, and business philosophies immediately after the takeover. Structural separation and operational autonomy deliver results only when the acquired company understands the acquirer's values (Kale et al., 2009). The partnering approach when integrating acquired targets was successfully used by Lenovo and Tata Motors.

4 Becoming Technology Giant Through Cross-Border Acquisitions: Case Study of Lenovo

Lenovo is the leading Chinese company in technology intensive industries. This company ranks on Fortune 500 list, with operating income of USD 39 billion and market capitalization of USD 16 billion in 2013 (Fortune Global 500 Database,

2014). In the same year, the company was the leading PC seller. By 2005, Lenovo focused its business efforts on PC production and sale in growing domestic market and neighboring emerging markets. Consequently, its brand was not recognizable in developed countries. During this period, the company employed the late follower strategy and cooperation with multinationals from developed countries. Through strategic partnerships with HP, IBM, and AST, Lenovo acquired new competencies, especially in the area of distribution (Biediger et al., 2005).

However, the company soon came under pressure from foreign competitors in domestic market. To withstand these pressures, Lenovo needed strategic resources, but it was expensive and time-consuming to develop them internally. Therefore, the company decided to acquire IBM's PC division, including the line for laptops and tablets. They purchased this division for USD 1.25 billion and paid off USD 500 million of IBM's debt (IBM, 2005). The Chinese government provided a part of the funds for this acquisition and gave Lenovo privileged access to local education market and domestic public procurement, which significantly facilitates the process of acquisition (Deng, 2009). Via this acquisition Lenovo acquired technology solutions, recognizable brand, marketing and management knowledge, and a network of strategic relationships with other multinationals developed by IBM.

The PC industry was recognized as Lenovo's core business, so it intensified its business efforts to significantly improve its position in the industry. Valuable experience in acquisition management led to new acquisitions in the industry (Collins, Holcomb, Trevis, Hitt, & Lester, 2009). Thus, in 2011, Lenovo acquired German electronics manufacturer Medion, thanks to which the company now controls more than 14 % of the German market (New York Times, 2011). Lenovo had its own subsidiary in Brazil, but the internal resources were not sufficient to achieve strong business performance. Therefore, Lenovo acquired Brazilian electronic producer CCE in 2012. Through this acquisition, Lenovo obtained local marketing knowledge needed to operate in the specific business environment and soon became the third best PC company in Brazil (Reuters, 2012). For the purpose of geographic diversification, Lenovo had long been considering how to enhance its position in Japanese PC market. Finally, in 2011, the company united its business operations in Japan with Japanese company NEC, the leader in this market. Lenovo has 51 % stake in this joint venture controlling 25 % of the market. Synergy effects are expected in the field of R&D, supply chain, service, product, sales and marketing, and information system (Lenovo, 2011).

Lenovo's "protect and attack" strategy implies protection of core business and expansion into complementary industries, often through international acquisitions (Yuanqing, 2014). Lenovo seeks to acquire complementary technologies and capabilities abroad and improve performance of target using strong cash flow from domestic market (Ramamurti, 2012). In 2014, Lenovo bought IBM's server business. Through this acquisition, Lenovo entered into a complementary branch and gained access to technology solutions and market with higher profit margins than in the core business. Furthermore, it allowed the company to establish strategic relationship with Intel, the largest manufacturer of processors (Lenovo, 2014). In

2008, Lenovo sold its smartphone division with the aim of focusing on PC business. However, by the end of 2009, the company repurchased it, with the intention to strengthen it through a big acquisition. In 2013, Lenovo tried to acquire Blackberry, which was on the brink of bankruptcy, but the Canadian government blocked the deal on the grounds that it could pose a threat to national security. As early as 2014, Lenovo acquired Google's Motorola Mobility division for USD 2.9 billion (Forbes, 2014). Lenovo thus got access to the necessary patents and acquired the brand with strong reputation in the markets of the USA and Latin America.

After the acquisition of IBM's PC division, Lenovo set up its headquarters in the USA, in addition to its headquarters in China (Deng, 2009), with the aim of making use of the US country-specific advantage and giving the target a high degree of autonomy. After the acquisition was made, Lenovo decided to introduce English as the official language and retained the CEO of IBM division Steve Ward in his position for the next 2 years to gain the trust of American employees (Financial Times, 2010), although this slowed down the integration. Similar approach is applied in the integration of Motorola Mobility which will keep a high degree of autonomy and its own brand. To preserve the trust of employees, customers, and suppliers, Lenovo adheres to the principle that no expatriates are hired after the acquisition (only 50 out of 54,000 employees are expatriates) (Yuanqing, 2014).

5 Grand Entrance into the Global Market via Cross-Border Acquisitions: Case Study of Tata Motors

Tata Motors is the largest producer of motor vehicles in India. In 2013, Tata Motors was ranked on Fortune Global 500 list, with total revenues of USD 38.5 billion and USD 2.3 billion of profits (Fortune Global 500 Database, 2014). Earlier, Tata was known as a manufacturer of cheap and poor-quality vehicles for the domestic market. However, in the past 10 years, the company carried out two acquisitions that have completely reshaped its position in the global market.

In 2004, Tata Motors outbid eight other companies and purchased bankrupt Daewoo Commercial Vehicles for USD 160 million. This was the first cross-border acquisition carried out by an Indian auto company. Although being relatively small, this acquisition brought about significant synergy effects. These two companies have complementary product lines, and Tata's reputation has been significantly enhanced through this acquisition. Furthermore, Tata mastered the technologies for production of large trucks. Few years after the acquisition, Daewoo Commercial Vehicles "was in the black" again. The success of this acquisition is largely attributed to the specific approach to integration of the target company, best described in Tata Motors CEO's statement given after the acquisition: "Tata Motors will operate Daewoo as Korean company, managed by Koreans, but it will work as a part of a global alliance with its Indian counterpart" (Kale & Singh, 2012).

In June 2008, Tata Motors acquired Jaguar Land Rover, troubled British subsidiary of American Ford, for USD 2.3 billion (BBC, 2008). To finance this acquisition and provide additional working capital, Tata borrowed about USD 3 billion. However, under the global financial crisis that began at the end of 2008, the sale of Tata Motors and Jaguar Land Rover plunged, so the investor was placed under financial pressure. At the last moment, state-owned State Bank of India helped the company by granting it a loan worth USD 885 million with favorable financing conditions (Financial Times, 2009). This acquisition enabled Tata Motors to enter into the premium segment and diversify its sales. Additionally, the company shed the negative image of the country of origin, gained access to Jaguar Land Rover's distribution channels, and finally acquired technical know-how, especially in the areas of engineering (Chattopadhyay et al., 2012).

Although many were skeptical about this acquisition, it proved successful. Jaguar Land Rover's revenues in 2013 totaled GBP 19.4 billion, an increase of almost 23 % relative to the preceding year. In the same year, profit before tax amounted to GBP 2.5 billion and was 49 % higher than in the preceding year (Tata Motors, 2014). The success largely came from the experience in management of cross-border acquisitions gained through acquisition of Daewoo Trucks. As in the previous acquisition, Tata left day-to-day management of Jaguar Land Rover to British managers, strengthening thus the motivation of the employees and managers in Great Britain (New York Times, 2012).

These two case studies have shown that EMM undertake cross-border acquisitions to obtain strategic resources needed to reinvent their business model; that they carry out cross-border acquisition with certain degree of support from the home country government; and that gradual integration of target accompanied by greater autonomy given to its management has a positive impact on absorption of strategic resources and post-acquisition business performance.

6 Conclusion

In turbulent business environment of twenty-first century, organizations are forced to use different growth strategies in order to successfully position themselves with respect to competition and to preserve and increase their profit margins. Globalization pressures created large number of EMM which constantly seek for growth and try to obtain strategic resources needed to challenge world's leading corporations. Therefore, the main goal of this chapter was the analysis of the strategic importance of cross-border acquisitions for EMM. Systematic research indicates that the greatest danger for value creation that should come out M&A comes after two companies try to integrate operations, and M&A literature indicates that there has been intense interest in examining integration aspects of M&A in order to explain the high rate of M&A failures. Out of the available integration approaches, EMM usually decide for preservation approach (e.g., partnering approach) when it comes to integrating acquired company. By adopting this approach, EMM agree

that their acquisitions stay autonomous in operations and concentrate on the strategic perspectives of the acquisition. High degree of autonomy is consequently related with the strategic intent by the acquirers. The successful acquisition by adopting preservation approach means that they also retain top management of the acquired companies and give them equivalent power and independence they used to have and adding only limited number of new executives. Focusing on complimentary targets, EMM purchase the lacking market-based resources (technology solutions, components, hiring individuals with specific skills, etc.) while focusing on long-term goals. The obtained resources are used to improve own capabilities and expand abroad. By analyzing case studies of Lenovo and Tata Motors, it can be concluded that cross-border acquisitions can be successfully used by EMM to gain strategic resources needed in order to strengthen their position in the world market. Both Lenovo and Tata Motors provided their acquired companies with high degree of autonomy enabling them to avoid all possible pitfalls of integration process and resulting in better performance in the post-acquisition period.

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