SKOLKOVO
Moscow School of Management

GLOBAL EXPANSION OF EMERGING MULTINATIONALS: POST-CRISIS ADJUSTMENT

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AFTER A DECADE OF RAPID GROWTH,

multinational companies from emerging markets are passing through a period of change and uncertainty. What are the impacts of the economic slowdown on the expansion, performance and role of emerging multinationals? The following will review Russian and Chinese companies' expansion abroad and how the current crisis has impacted international acquisitions and investments. Are the major companies in these countries taking advantage of the current situation and expanding internationally? Are they busy with domestic consolidation instead? Or, on the contrary, are they in need of selling overseas units? Both cross-border acquisitions and greenfield projects are examined.

EMERGING MULTINATIONALS ON THE RISE

Foreign direct investment (FDI) outflows from emerging countries have increased at an impressive pace during the 2000s, reaching $253 billion per year by 2007. Multinational companies from India, Russia and China have been the leading players in this process; they have given a new contour to the global investment map. According to MOFCOM[1], by the end of 2007, nearly 7,000 Chinese entities had established more than 10,000 overseas enterprises, covering 173 countries and territories; the accumulated outward FDI net stock reached almost $118 billion, among which the non-financial sector accounted for 85.8%. The direct investment stock of Russian organisations abroad, while smaller at $32 billion as of the end of 2008, has also rapidly become substantial. Overall, the number one dealmaker among emerging markets buying into developed economies during the last 5 years has been India, which made 393 acquisitions abroad. Russia comes second with 121, followed closely by China, which made 108 acquisitions[2].

In the 2000s, both Russian and Chinese policymakers have started to encourage outward investment.

Outward FDI from China has been largely driven by government policies and the dynamics of China's domestic institutional environment over the past few decades. As shown in Figure 1, there was no significant change in outbound FDI volumes between 1990 and 2000. However, with depleting natural resources and an excess of domestic production over the past few years, the government has liberalised the regulations that govern outward FDI activities and has streamlined the bureaucratic procedures for global expansion. Since 2001, the government has begun initiating a variety of support mechanisms for Chinese enterprises seeking to invest overseas as part of its 'going abroad' and 'national champion' strategies. Such strategies have resulted in a substantial rise in outward FDI from Chinese enterprises, primarily state-owned, but also from the private sector.

1/ Statistical Bulletin of China's Outward Foreign Direct Investment (Ministry of Commerce of the People's Republic of China, 2008)
2/ Emerging markets continue to narrow the M&A gap (KPMG, 2009)

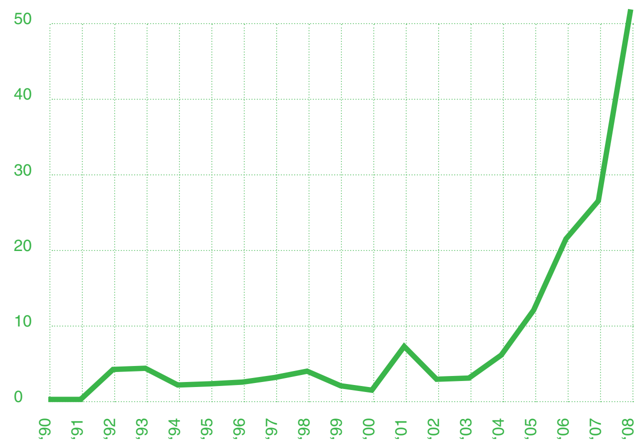
The Russian government has also begun to view outward investment more favourably since the early 2000s. In contrast to a previously strong stand against "the flight of capital", state leaders have come to show public support for companies investing abroad and, at one time, even considered establishing an agency to promote and support such projects. Like China, Russia has seen rapid growth of outward investment in the last few years. However, the outward FDI of Russian multinationals in geographic and industrial terms differs significantly from that of the Chinese.

A survey conducted by SKOLKOVO[3] in 2008 found that Russia's top 25 multinationals – ranked by foreign assets – had, at the end of 2007, US$90 billion in assets abroad and about US$220bn in foreign sales (including exports), and employed nearly 140,000 people in other countries. Foreign assets had increased fourfold since 2004, and employment abroad had tripled. Russian multinationals were comparable to their counterparts in other BRIC countries by their foreign assets and growth rates. They lagged significantly behind the world's biggest multinationals – those from developed countries – but they were growing much faster.

The United Nations Conference on Trade and Development (UNCTAD) has included in its list of 100 top multinationals from developing countries* nine Chinese groups that together account for about 54 billion in foreign assets and employ nearly 80,000 people abroad. Predictably, most of them are state-owned enterprises. That is not the case in Russia, where the expansion trend has been led mostly by private corporations.

According to official statistics on FDI **destinations,** 10 key areas had attracted 86% of total China's outbound direct investment by the end of 2007; Hong Kong alone accounting for over 58% (Table 1). The concentration is also obvious in Russia, where the top 10 destinations accounted for 95% of outward FDI in 2008. Predictably, the world's leading economies such as the United States feature on the lists, as do immedi-

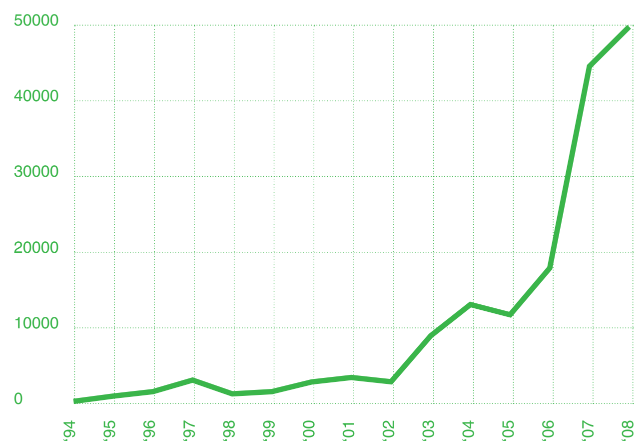
FIGURE 1/ Spectacular growth in outward investment from China 1990-2008



China's outward FDI, $ billions

Data source: MOFCOM

FIGURE 2/ FDI of Russian non-financial companies



$ billions

Data source: Central Bank

[3] Emerging Russian Multinationals: Achievements and Challenges (Moscow School of Management SKOLKOVO, 2008)
[4] World Investment Report. Transnational Corporations and the Infrastructure Challenge (United Nations Conference on Trade and Development, 2008)

Europe is the main investment destination for Russian companies, while Chinese corporations focus on Asia/Pacific; the US attracts both.

ate neighbours and trade partners of each investing country.

However, the prominent positions on those lists of countries such as the British Virgin Islands (identified by the UK National Audit Office as the "world leader in provision of offshore companies")[5] underscore the limitations of official FDI statistics[6]. In order to get a better understanding of where Chinese and Russian FDI actually goes and what really drives it, it is necessary to look at the alternative sources of data available on international investment projects. For instance, the aforementioned survey by SKOLKOVO has shown that over half of the foreign assets of Russia's global players were concentrated in Europe (CIS not included).

The expansion of Russian and Chinese companies abroad in terms of greenfield, current and co-location projects is presented in Table 3. It is clear that the primary destination for Russian **greenfield projects** has been the other CIS nations, although China and Germany also appear. For Chinese companies, by contrast, the USA, India and Russia feature as the most popular destinations. The business area most represented in Russian projects is that of sales and marketing, although in 2005 this was manufacturing. The picture is inverse for Chinese investments, with manufacturing clearly superseding marketing after 2005.

The industries most active in expanding abroad have proved very different in the two countries (Table 3). In Russia, the leader was the natural resources sector, amounting to 15 - 18% of total activity. This is consistent with the findings of the SKOLKOVO ranking[7], where three oil and gas companies – Lukoil, Gazprom, TNK-BP, – and nine metals and mining firms, led by Norilsk Nickel, together accounted for 80% of the total foreign assets of the top 25. In China, on the other hand, it was first the communications sector, which took the

TABLE 1/ FDI from China in 2007

Rank	Country (Region)	Investment stock (billion USD)	Share of total
1	Hong Kong SAR	68.78	58.3%
2	Cayman Islands	16.81	14.3%
3	British Virgin Islands	6.63	5.6%
4	United States	1.88	1.6%
5	Australia	1.44	1.2%
6	Singapore	1.44	1.2%
7	Russia	1.42	1.2%
8	Canada	1.25	1.1%
9	Korea	1.21	1.0%
10	Pakistan	1.07	0.9%
	Total	**117.92**	**86.5%**

Data source: MOFCOM

5/ Managing Risk in the Overseas Territories (Report by the Comptroller and Auditor General, 2007)
6/ See, for instance, Ben Aris, A Row Over Russia's FDI Figures (Business New Europe, 2006), and Thorsten Nessmann and Daria Orlova, Russia's outward investment (Deutsche Bank Research, 2008)
7/ Companies in the financial services were not included in the SKOLKOVO ranking due to concerns related to methodology.

lead and then more recently the metals industry. The international investment boom in the finance sector prior to the crisis is visible for both countries.

The greenfield investment abroad of Russian companies has been increasing at a rate of approximately 10% per year from 2005-2008, both in the number of deals and in the number of companies participating. Chinese greenfield projects on foreign soil began from a similar level, but their number has grown considerably faster. This growth rate is related to a faster economic growth in China itself and to a more active state involvement, and also with strategic motivations, discussed later in this report. During the first quarter of 2009, however, the slowdown in FDI is apparent, as only 2 Russian and 8 Chinese companies were active, with a total of 16 deals[8]. To obtain a more comprehensive picture of the expansion of Chinese and Russian companies abroad, cross-border mergers and acquisitions (M&A) also need to be examined.

Russian companies participated in 213 outbound transactions between the beginning of 2005 and the end of 2008, spending a total of €38.5bn. Of this total, industrials accounted for approximately 35% of the deal value and 30% of the number of deals; energy, mining and utilities accounted for 30% of deal value and 15% of the number of deals; hi-tech, media and telecoms accounted for 11% of deal value and 21% of the number of deals. Deal sizes have been fairly constant during 2005-2008, with the proportion of deals valued under €500mn making up around 70% of the total volume. Figure 3 illustrates cross-border M&A activity of Russian companies from 2005 to 2008.

For Chinese companies making acquisitions, 2008 has definitely been a record year. According to Thomson Reuters, Chinese multinationals spent over $46 billion abroad in 2008 alone, a 64.4% growth from 2007. PricewaterhouseCoopers issued a lower estimation of $30 billion and a 35% growth, with mining and financial services as the leading sectors.

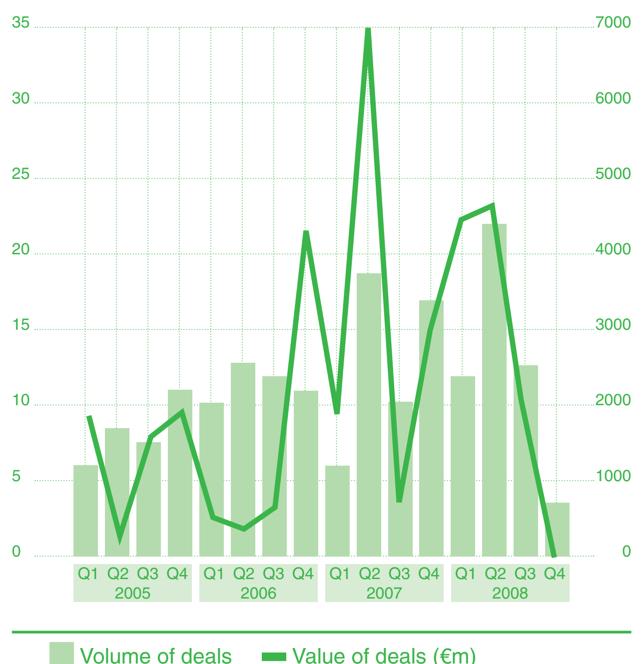
[8]/ FDI Markets database

TABLE 2/ FDI from Russia in 2008

Country (Region)	Investment stock (million USD)			Share of total
	direct	portfolio	other	
Cyprus	9994	115	5570	31.1%
Netherlands	9787	40	1392	30.5%
British Virgin Islands	1453	1163	3789	4.5%
United States	4669	-	785	14.5%
Germany	513	0	2311	1.6%
Switzerland	1189	0.1	1588	3.7%
Belarus	1323	0.1	182	4.1%
Ukraine	123	463	512	0.4%
United Kingdom	730	20	123	2.3%
Armenia	676	0	1	2.1%
Total	**32108**	**2823**	**18828**	**94.9%**

Data source: Rosstat

FIGURE 3/ Outbound M&A trends in Russia



Data source: Mergermarket.com

TABLE 3/ Greenfield investment from Russia and China

	Russia	China
2005	• The leading sector was coal, oil and natural gas, which accounted for 18% of projects. • The leading business activity was manufacturing, which accounted for 28% of projects. • The top three destination markets for inward investment were Ukraine, Estonia and Belarus, attracting 25%, 5% and 4% of investment projects respectively.	• The leading sector was communications, which accounted for 26% of projects. • The leading business activity was sales, marketing and & support, which accounted for 34% of projects. • The top three destination markets for inward investment were Russia, the USA and India, attracting 10%, 7% and 7% of investment projects respectively.
2006	• The leading sector was financial services, which accounted for 23% of projects. • The leading business activity was sales, marketing and & support, which accounted for 30% of projects. • The top three destination markets for inward investment were Ukraine, China and Kazakhstan, attracting 9%, 8% and 6% of investment projects respectively.	• The leading sector was communications, which accounted for 14% of projects. • The leading business activity was Manufacturing, which accounted for 40% of projects. • The top three destination markets for inward investment were the USA, India and Russia, attracting 11%, 8% and 6% of investment projects respectively.
2007	• The leading sector was coal, oil and natural gas, which accounted for 18% of projects. • The leading business activity was sales, marketing and & support, which accounted for 30% of projects. • The top three destination markets for inward investment were Ukraine, Germany and Kazakhstan, attracting 10%, 6% and 6% of investment projects respectively.	• The leading sector was financial services, which accounted for 13% of projects. • The leading business activity was manufacturing, which accounted for 41% of projects. • The top three destination markets for inward investment were the UK, the USA and Hong Kong, attracting 15%, 7% and 5% of investment projects respectively.
2008	• The leading sector was coal, oil and natural gas, which accounted for 15% of projects. • The leading business activity was sales, marketing and & support, which accounted for 36% of projects. • The top three destination markets for inward investment were Kazakhstan, Ukraine and Armenia, attracting 7%, 6% and 5% of investment projects respectively.	• The leading sector was metals, which accounted for 13% of projects. • The leading business activity was manufacturing, which accounted for 30% of projects. • The top three destination markets for inward investment were the USA, Vietnam and India, each attracting 6% of investment projects.

Data source: FDi Markets

TABLE 4/ Greenfield investment from Russia and China

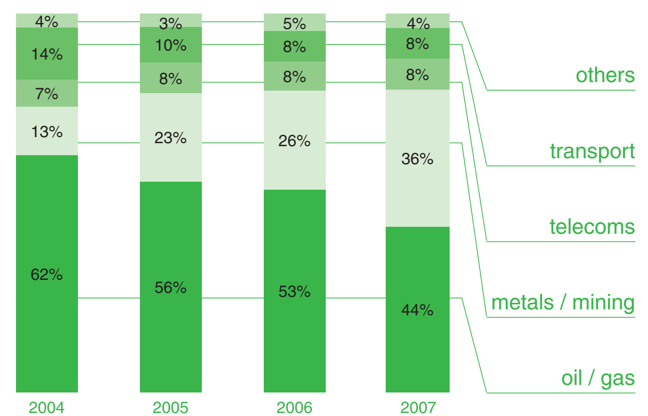
	Russia						China					
	2005	2006	2007	2008	1Q 2009	CAGR 2005-8	2005	2006	2007	2008	1Q 2009	CAGR 2005-8
№ of Companies	74	74	82	99	2	10.2%	74	86	138	153	8	27.4%
№ of Deals	139	155	135	188	6	10.6%	140	133	202	240	10	19.7%

Data source: FDi Markets

INDUSTRY-SPECIFIC STRATEGIC MOTIVATIONS

FDI in general and Russian/Chinese outward direct investment in particular include a wide variety of projects – not only in terms of scale, industry and organisational and legal structure, but also in terms of strategic significance to the acquirer. In a very general sense, it is customary to distinguish market seeking, resource seeking, efficiency seeking (including, in particular, scale seeking), and strategic asset seeking international investment[9]. On a macro level, these motivations are influenced by country-specific competitive advantages. On a micro level, these same motivations are, to a large degree, derived from the profit drivers (to the extent that the management is aware of them) and therefore from the structure of a particular industry.

FIGURE 4/ Russia's top multinationals by industry, 2004-2007



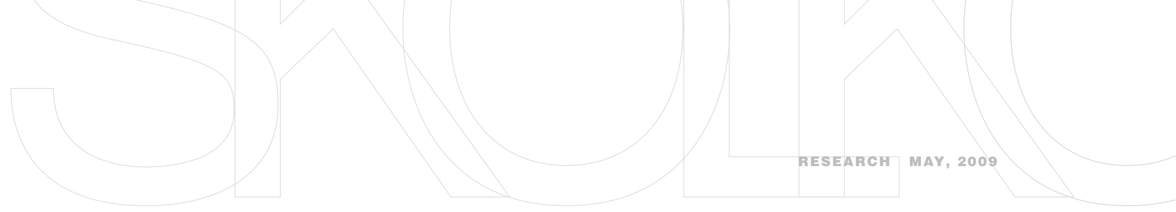
Data source: SKOLKOVO rating of Russian multinationals

According to the 2008 SKOLKOVO report, corroborated by other sources (see Table 3), the biggest Russian multinationals were in extractive industries. However, the dominance of oil/gas conglomerates in the transnationalisation process was clearly decreasing: in 2004, they accounted for as much as 63% of the top 25's aggregate foreign assets, compared to 44% in 2007 (Figure 4). Telecoms, shipping and manufacturing were also significant. Keeping in mind that the bulk of Russian outward direct investment is still made in a handful of major industries, we can pinpoint a few characteristic strategies based on both country-specific and industry-specific factors.

Downstream integration is characteristic of large Russian mining and energy corporations, both government-controlled and private. Companies such as Lukoil, Gazprom, Inter RAO or Novolipetsk Steel have been using the country's natural resource endowments to build a strong presence on foreign markets. Throughout the 2000s, they have been buying and building refining, rolling, transportation and distribution assets in their key destination markets. Combining market seeking and strategic asset seeking, this strategy enables them to appropriate more value-adding activities and often push up their market share.

Vertical integration is also a defining characteristic for the leading Russian multinationals in the metal/mining sector, such as Norilsk Nickel, Severstal or Rusal. However, rather than focusing on complementing their Russian upstream assets with downstream facilities in target markets, they have bought up a wide range of mines and smelters throughout the globe.

[9]/ See, for instance, John Dunning, Location and the Multinational Enterprise: A Neglected Factor? (JIBS, 1998)



Within a few years, these groups broke into the peloton of the world's largest miners, thanks to a series of large acquisitions. While this trend has been part of a powerful global consolidation process, its motives and rationales are not clear-cut. Typically, the deals were justified as **scale-seeking expansion.** In principle, that may include economies in consolidated purchasing; more effective resource reallocation within the group in a volatile market; optimization of administrative costs; economies of scope derived from a fuller product range; consolidating sufficient cash flows to afford new large-scale investment projects; and last but not least, access to cheaper capital. In practice, however, most of these benefits (possibly with the exception of lower financing costs) are hard to realise and not always sufficient to offset the cost of the deal. The contagious "eat or be eaten" logic is probably part of the motivations at work in this industry.

Russian natural resource companies invest abroad to control the whole value chain and to get direct access to clients.

Market-seeking **expansion into emerging markets** is typical of leading Russian companies working on consumer markets, such as telecommunications, retail, food products, entertainment or media. These companies operate in fiercely competitive markets, and as penetration increases and competitors move along the learning curve, the profitability of their core operations can decrease quite dramatically. Geographic expansion gives them access to less crowded markets, and sometimes economies of scale as well. Understandably, the companies which find the extra costs of cross-border transactions acceptable are usually nationwide players, who are already present in the most promising regions within the country. They typically start by entering neighbouring markets, leveraging their know-how in relatively familiar environments. The largest and most successful, like the telecom operator VympelCom, are now starting to invest in Southeast Asia, and some have even ventured as far as Latin America.

A very different strategy was pursued by companies mostly in manufacturing industries, such as GAZ Group (automotive), CTP, Rostselmash (both agricultural equipment), TransmashHolding (railway equipment) etc. This strategic asset seeking strategy, which can be described as product-line import, consists of purchasing a relatively smaller, but technically modern manufacturer in a developed country and localising the production of its main line of ma-

Chinese and Russian manufacturers purchase ready-to-market product lines in developed countries.

chines in Russia. The purpose is, on the one hand, to bridge quickly the technological gap between Russian manufacturers and their Western competitors, and, on the other hand, to benefit from lower costs and dynamic demand in Russia.

Typically, the plan is to start by importing products from the acquired plant to test demand and train potential clients, then to start production from imported parts (considerably reducing import taxation), and then finally localise most of the value chain as suppliers adapt. None of that means, of course, that the acquired company should necessarily discontinue production or sales in the existing markets; on the contrary, the new owners tend to do their best to keep and expand the existing operations, if at all possible. While this particular strategy is most characteristic of engineering and vehicle production, it is also found in other industries where technology is both crucial and transferrable. One example is Kalina, a Russian cosmetics company that acquired the German Dr.Scheller in 2005 and is now making and selling its products in Russia.

Product-line import and similar varieties of **strategic asset seeking** are also characteristic of many Chinese companies, active in a wide array of manufacturing industries. This stems directly from the overall advantages and disadvantages of the Chinese economy compared to developed economies, its major trading partners - growing demand, much lower labour costs, and insufficient capabilities in advanced technology and design. Companies investing in such strategic assets are typically privately owned, with a production base in China and growing domestic sales.

For instance, Dishang Group is a private Shandong Province-based company that specialises in garment manufacturing and international trade. During the past two years, Dishang initiated three cross-border acquisitions; its targets were located in Germany, France, and Korea. According to our interview with the CEO, the main purpose of these acquisitions was to obtain world-famous brands and superior design capabilities. He pointed out that "Chinese garment manufacturers are now very good at production; what we lack are world-class brands and design competency. Through these cross-border acquisitions, we can generate a good synergy: by promoting these premium brands in China, we can upgrade our firm image and increase our profitability."

Another example is Huawei Technologies, now a major global telecommunications manufacturer, with sales over $23.3 billion in 2008. In order to maintain its technological edge, Huawei has established five oversea R&D centres located in four different countries. Thanks to a strong base of technological know-how, Huawei is now enjoying a high sales growth (50% in 2007, 46% in 2008 and 30% expected in 2009).

Huawei also presents an example of **market-seeking** international

expansion. Leveraging their high costs at home, Chinese manufacturing companies have become very successful exporters; and while most of them still let clients or resellers handle all the downstream activities outside of the country, some have taken control of these operations and invested considerably in market seeking expansion. In the most advanced cases, this goes considerably beyond sales offices. For instance, as of 2007, Haier Group, the world's fourth largest white goods manufacturer, had 24 of its 29 manufacturing plants and 5 of its 8 design centres overseas. Such extensive market-seeking expansion is especially characteristic for electronics manufacturers.

Chinese "power builders" pursue national interests in extractive and infrastructural projects across the world.

Most of the largest Chinese multinationals, however, are in resource sectors such as oil and mining. This includes China National Petroleum, China National Offshore Oil, Aluminum Corporation of China, Baoshan Steel, China Petrochemical, parts of Sinochem and others. Unlike Russian multinationals from extractive industries, however, they are importers rather exporters, and most of their outward investment is **resource-seeking.** The major purpose of this group's international activity is to access strategic natural resources (e.g., oil fields and mines) to guarantee national safety. For instance, China National Petroleum started its international operations in 1999 when it set up its first overseas oil field in Sudan. Since then, it has completed more than 30 developmental projects in other countries. These companies are typically government-owned, reflecting the government's emphasis on acquiring strategic resources abroad.

A related group among the largest Chinese multinationals is government-controlled infrastructure companies. Active in transportation and communications (over 10% of China's outward FDI stock), as well as utilities and construction, these groups play an active role in the aforementioned resource projects. This includes direct support, but also projects meant to enhance relationships with developing host countries and promote national image. For instance, COSCO Group is a company that provides global shipment services. Currently, it has set up about 400 subsidiaries in more than 50 countries. Ships and containers with the conspicuous "COSCO" logo shuttle among 1,300 ports in more than 160 countries and regions around the world. China Railway Construction Corporation (CRCC), another state-owned entity, took an active role in undertaking construction projects in African countries such as Libia, Algeria and Nigeria over the last several decades to support the government policy of assisting African infrastructure construction.

It is clear from the above that two factors are strongly linked to the strategic motivations of emerging multinationals and play a large role in determining their expansion paths: ownership status (government control vs. private ownership) and market positioning (domestic market vs. foreign markets as primary targets). This relationship can be illustrated by sorting most multinationals from Russia and China into four uneven broad groups, as in Table 5.

We have dubbed government-owned companies targeting the markets of other countries 'power builders'. Not unlike their privately owned counterparts, they are, of course, to a great extent driven by commercial motivations, pursuing attractive markets. However, their market-seeking activity is also very sensitive politically, both at home (as a matter of national pride) and abroad (often as reason for concern). They are both powerful builders – in the sense that some of them are able to complete huge infrastructural projects, including international ones – and builders of power for their governments on the international arena.

TABLE 5/ Four groups of Russian and Chinese multinationals

		Targetmarket	
		Domestic	International
Owner	Government	**Resource seekers** Sinopec, CNPC, ARMZ	**'Power builders'** Gazprom, COSCO, CRCC
	Private	**Strategic asset seekers** GAZ, Kalina, Dishang	**Market seekers** Huawei, Haier, VympelCom

Data source: SKOLKOVO

ADJUSTMENT TO CRISIS

In 2008, the growth in international investment witnessed a dramatic reversal, when world FDI flows fell by 21% compared to the previous year's record high of $1.8 trillion[10]. The United Nations Conference on Trade and Development (UNCTAD) expects a further decline in FDI during 2009. The fall in global FDI stems from two major elements affecting both domestic and international investment:

1) The capability of firms to invest has been reduced by a fall in access to financial resources, both internally – due to a decline in operating cash flows – and externally – due to lower availability and higher cost of finance.

2) The propensity to invest has been affected negatively by economic prospects, although lower asset prices have partly counterbalanced this influence.

The situation at the beginning of 2009, where a high level of risk perception is causing companies to considerably curtail their costs and investment programs so as to become more resilient to any further deterioration of the business environment has compounded the abovementioned factors. Particularly affected has been cross-border M&A, which has not only plunged but has also taken the form of an upsurge in divestments and restructurings. International greenfield investments have been less impacted thus far, but could be increasingly affected in 2009 as projects are being cancelled or postponed[11].

Cheaper assets attract interest, but most companies cannot afford new investments.

The impact of the crisis on FDI has differed depending on the region and sector involved. In terms of industry, FDI flows to financial services, the automotive sector, construction, intermediate goods and some consumption goods have been the most severely affected thus far[12]. While developing economies have been less affected in 2008 than the developed nations in terms of FDI flows, the situation could reverse itself in 2009. A few emerging market countries, such as China and Russia, have stockpiled considerable sums during the good times and are now equipped to take advantage of the depreciated assets[13].

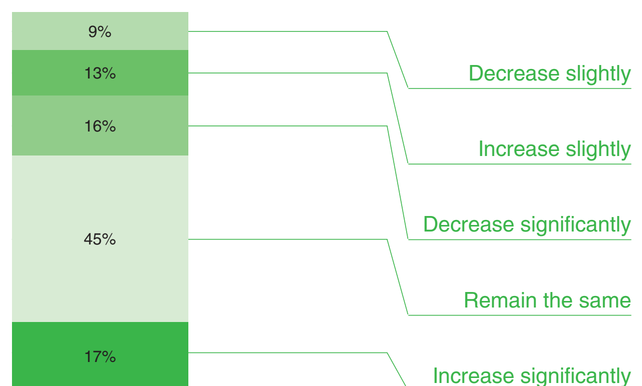
Indeed, the number of M&A deals involving buyers from the emerging markets buying into the developed economies has been holding up better in the face of the credit crisis than vice versa. According to KPMG, the second half of 2008 saw a 28% decline in the number of emerging-to-devel-

[10]/ End of the Boom (Vedomosti, 2009)
[11]/ Assessing the impact of the current financial and economic crisis on global FDI flows (UNCTAD, 2009)
[12]/ Ibidem
[13]/ Deal Drivers Russia (CMS/Mergermarket, 2009)

oped deals, compared to a 37% decline in developed-to-emerging deals. However, Ian Gomes, Chairman of KPMG's High Growth Markets practice for KPMG in the UK, cautions against the assumption that this trend will continue: "Many companies are now switching focus back to their domestic market. In the case of China, they are even being actively urged to do so by their own government. Therefore, there is a good chance that future deal activity may be restricted to mainly domestic deals." Furthermore, he states that "Buyers in the emerging markets are proving unwilling to buy into severely ailing, even dying businesses, no matter how much of a bargain they would appear to represent."

2009 is certainly going to be a difficult year, although some see acquisitions, including international ones, as a way to deal with the difficulties. A study conducted by Mergermarket that polled 100 M&A and corporate finance professionals in Russia shows that most (51%) expect M&A activity to increase in 2009, with the majority (80%) citing the financial services industry as the primary area of deal-making and Europe (cited by 57% of respondents) as the main target region [14]. Respondents of a September survey by Remark [15] expected China to take a greater share of M&A activity into other parts of Asia over the next year, and 64% of respondents throughout Asia mentioned China when asked from which Asian country the most cross-border buyers will emerge. A similar survey in China and Hong Kong in December [16] showed that most finance professionals did not expect a downturn in outbound acquisitions there (Figure 5).

FIGURE 5/ What do you expect will happen to the next level of Chinese outbound M&A activity over the next 12 months?



Data source: Remark

Despite this attitude, deals are not as big or as numerous as they used to be – and for a reason. Natalia Orlova, Chief Economist of Russia's Alfa Bank, summarises the situation as follows: "On the buy-side there is very little capital to make acquisitions, and the main source of money is from the [Russian] state. Companies are suffering from the withdrawal of loans and a lack of demand. Only companies with the support of the state are in a position to consolidate." [17] The sell-side, meanwhile, has the same situation – only the big, state-supported, financial institutions are likely to be in a position to consolidate, and a number of smaller players have already folded or sold considerable stakes to outside investors.

[14] Deal Drivers Russia (CMS/Mergermarket, 2009)
[15] Asia Pacific's New Corporate Landscape: Asia Outbound M&A (KPMG, 2009)
[16] Reaching Beyond the Great Wall (RBS/Mergermarket, 2009)
[17] Russia-Focused Cross-Border M&A (PBN, 2009)

Aggressive scale-seeking Russian miners have been hit hardest by the crisis.

Indeed, the expansion of Russian multinationals has been considerably stifled by the lack of external financing. But overall the effect of the crisis has been very uneven, depending on the strategic type of outward investment.

The most severely affected are probably those companies which have been engaging in aggressive **scale-seeking expansion** (see above), in particular in the metals/mining sector – like Rusal or Norilsk Nickel. Participating in the consolidation race, they and their shareholders had accumulated considerable debts, and the current financing, more expensive and less accessible, is putting them in a difficult situation. At the same time, a severe fall in metals prices has cut their operating cash flows dramatically. They are now forced to close down money-losing overseas operations, like in the case of Rusal or Norilsk Nickel, which has announced the discharge of about 1500 employees from its foreign units. Capital expenditures are being "reduced to critical committed amounts", according to a Norilsk Nickel presentation. Their shareholders have been trying to sell interests in some of the non-core businesses, both at home and abroad, to decrease overall consolidated leverage. For example, Oleg Deripaska's debt-ridden holding Basel has been forced to sell its stakes in Magna, the international automotive company, and in Holcim, the construction group. Currently, these companies rely on emergency loans from Russian state banks to keep afloat, large chunks of their shares are pledged, and the government has a significant say in the management. While they have so far resisted the threat of disintegration, and are still demonstrating global ambitions, they are unlikely to be able to finance any new expansion project in the near future.

The situation is somewhat different for those companies – like Lukoil, for instance – that had focused primarily on **downstream integration**. They are usually less indebted, and their moves into more value-added products (and services) may have made them somewhat less exposed to the volatility of commodity prices. In terms of capability to invest, they are therefore in a better position. By December, Lukoil had closed a deal, financed by a consortium of international banks, to purchase Sicilian refinery assets for €1.3 billion. By 3 February, Gazprom had completed a deal to purchase a controlling stake in Serbia's oil company NIS. State-controlled 'power builders' in the energy sector, such as Gazprom, Rosneft and InterRAO, are not only pushing on with previously planned international investments, but are also negotiating new projects in remote regions of Latin America, Africa and Southeast Asia. The gas monopoly's revised budget for 2009 includes investments in Vietnam, India and Turkmenistan.

Projects to introduce new product lines to emerging markets are losing appeal amid lower and more price-conscious demand.

The expansion of Russian companies into the emerging markets is slowing, but not stopping. The focus seems to be on further greenfield investment rather than acquisitions, which have become difficult to finance. VympelCom, for instance, is continuing to advance in Vietnam and Cambodia, although consideration of any new M&A projects is frozen for the time being. Eldorado, the electronic retailer, opened two new hypermarkets in Ukraine in December, and is planning to open a dozen more this year.

Product-line import initiated by Russian groups, however, are for the most part in a much worse position following the crisis. Several adverse factors are at work: decreased demand in both Western and CIS markets undercuts revenue of existing production facilities; dwindling investment programmes threaten localisation plans; and clients' preferences switch towards cheaper models rather than fancy advanced ones. Those companies that have already launched production of new ranges in Russia are tending to get rid of Western assets. This Kalina did, selling the industrial property in Germany to continue producing its Dr.Scheller cosmetics in Russia. Amtel, the tyre producer, is desperately trying to sell its plant in the Netherlands. GAZ, one of Russia's largest automotive groups (and Amtel's largest customers), is considering selling or closing LDV, purchased back in 2006, after the British government refused to bail it out. GAZ has announced that its next minivan model will be a "more economical" one, and will not be based on the design by LDV, as previously thought. The alternative to selling the western plants is bankruptcy, which already happened last year to FTD Fahrzeugtechnik Dessau GmbH, previously owned by the Russian TransmashHolding. Some companies are counting on the government to support the implementation of new products with technological advantages. That seems to work for Rostselmash, which is relying on agricultural stimulus measures to start locally producing a tractor by Buhler, the Canadian company that Rostselmash has recently taken over.

Chinese multinationals in general seem to weather the downturn better. Despite the global economic recession and the sharp fall of world FDI, Chinese outward investment continued to grow strongly in 2008, doubling from 2007 to reach $52 billion. Despite overall Chinese M&A falling 74% in the first quarter of 2009, outbound activity was comparable to the record-breaking Q1 2008 – at least in volume, of not in the number of deals. This momentum is expected to continue throughout 2009 given the relaxation of China's governmental restrictions on outward investment.

55% of those deals (by volume) occurred in the energy/mining/utilities sector [18]. Thanks to the Chinese government's strong financial position and its willingness to invest abroad, state-owned natural resource seeking giants are continuing to explore opportunities worldwide – all the more since prices decreased. China's mining giant Aluminum Corporation of China (Chinalco) recently announced its plan to make a cash injection of $19.5 billion into Rio Tinto, one of the leaders in the industry. Zhu Zhongshu, President of China Minmetals Corp., noted that "New opportunities for overseas investment and acquisitions are emerging as many international mining companies hit by the financial crisis see their market values shrinking." Reportedly, the SASAC (the State-owned Assets Supervision and Administrative Commission) recently selected ten enterprises to support in their drive to acquire international assets.

Consumer companies from both countries push on with greenfield investments into other emerging markets.

Outward **market seeking investment** by Chinese companies is also continuing rather actively. Not unlike their Russian counterparts, they tend to focus more on greenfield investment and on emerging markets now that demand in mature ones is severely dampened. "Even if asset prices fall to a low level", Yang Yuanqing, CEO of Lenovo Group, said recently, "now is not a good opportunity to do M&A". The company has rearranged its geographic structure to focus more on such countries as Brazil and India. Similarly, ZhuJiang Piano Group has shifted its promotion attention to emerging markets such as Brazil, Russia, and Southeast Asia, maintaining a growth rate of 25% in emerging markets. Another example is Chery Automobile Corp, a privately owned company in Anhui, China, which has signed contracts to build new factories in Thailand and Argentina within the past six months. Developed countries are not abandoned either: Chery claimed that it would enter the North American market in 2009, given its good sales in Europe in 2008. Chongqing Lifan Group, a major Chinese motorcycle manufacturer, also claimed that it would set up more foreign production bases in 2009, and that Europe and North America would become the main target for promotion this year.

Strategic asset investment investment by Chinese groups, on the other hand, is much more focused on mergers and acquisitions and on developed markets, where most sophisticated technologies and design solutions are available. As for Russian firms, 'product-line import' deals continued well into 2008, - as in the case of construction equipment manufacturer Zoomlion that bought 100% of Italy's CIFA, - but these now seem much less advantageous in a weaker market.

18/ Greater China M&A roundup for Q1 2009 (Mergermarket, 2009)

PROSPECTS AND CHALLENGES

Clearly, the combination of critical capabilities acquired abroad and other advantages at home can bring significant competitive edge to emerging-market enterprises pursuing globalization strategy. It is evident that both Chinese and Russian firms are acquiring knowledge and learning new skills, extending their managerial capabilities, building global brand names and enhancing their global competitive advantages through cross-border investment activities. Due to the global financial crisis, there is an immediate opportunity to acquire potentially interesting international assets for a much lower price. For example, Russia's Mechel is in the process of buying the US company Bluestone Coal for $425 million plus about $200 million worth of Mechel's preferred stock, while the initial price in last year's negotiations was close to $4 billion. The ability of Russian and Chinese companies to press on with international investment, taking advantage of such opportunities, will depend on whether they can deal with key challenges exacerbated by the current crisis.

The most obvious of such challenges is investment project financing. In the words of the Chairman of KPMG's High Growth Markets practice Ian Gomes, "Full-blown cross-border deal activity may only restart once liquidity starts to flow again." The **financing** challenge is especially ominous for highly leveraged private companies, while government-owned ones are in a better position to use state banks or capital infusions if funds are unavailable on the market.

For both natural resource and strategic resource seeking investment, and especially for state-owned groups, protectionism is one of the main challenges. Despite the need for incoming capital, in most countries political resistance to acquisitions by Chinese or Russian companies is unabated. For instance, China Minmetals' bid to buy OZ Minerals has been blocked on security grounds by the Australian antitrust authority. Rumors of Gazprom and/or Lukoil negotiating a deal to buy part of Repsol caused a major stir in Spain's political circles, including a very angry parliamentary speech by the opposition leader. Another example of troubles that authorities can cause investors is the recent reopening by Switzerland's Ministry of Finance of the case against Russian billionaire Viktor Vekselberg for alleged violation of disclosure rules during the acquisition of equipment maker Sulzer. The legal move occurred less than two days before a general shareholders meeting in which Mr. Vekselberg's representatives replaced Sulzer's CEO.

The **protectionism** factor may become even more important now that the state is taking a more active role in the international expansion not only from China, but also from Russia. Examples of strategically important foreign assets passing from private to state hands include 49% of the Hungarian airline Malev (now managed by VEB, the state development bank) and 25% of the Kazakhstan uranium mines (now managed by Rosatom, the state nuclear corporation). If the authorities and the public in host states come to see all investors from China and/or Russia as potentially representing their respective governments, it may prompt further restrictions on inbound investment.

Finally, another challenge for both Russian and Chinese enterprises is that the governments may adjust their **policies** and frameworks depending on the balance of payments. Recent liberalization measures could be easily reversed if Russia's foreign exchange reserves fall sharply or the growth in China's reserves falls below a politically acceptable threshold. In this case, political leaders may change their attitude towards capital leaving the country, no matter which economic benefits specific firms might enjoy based on their globalization strategies.

Protectionism is increasingly a challenge now that emerging countries' governments are among the few players with cash.

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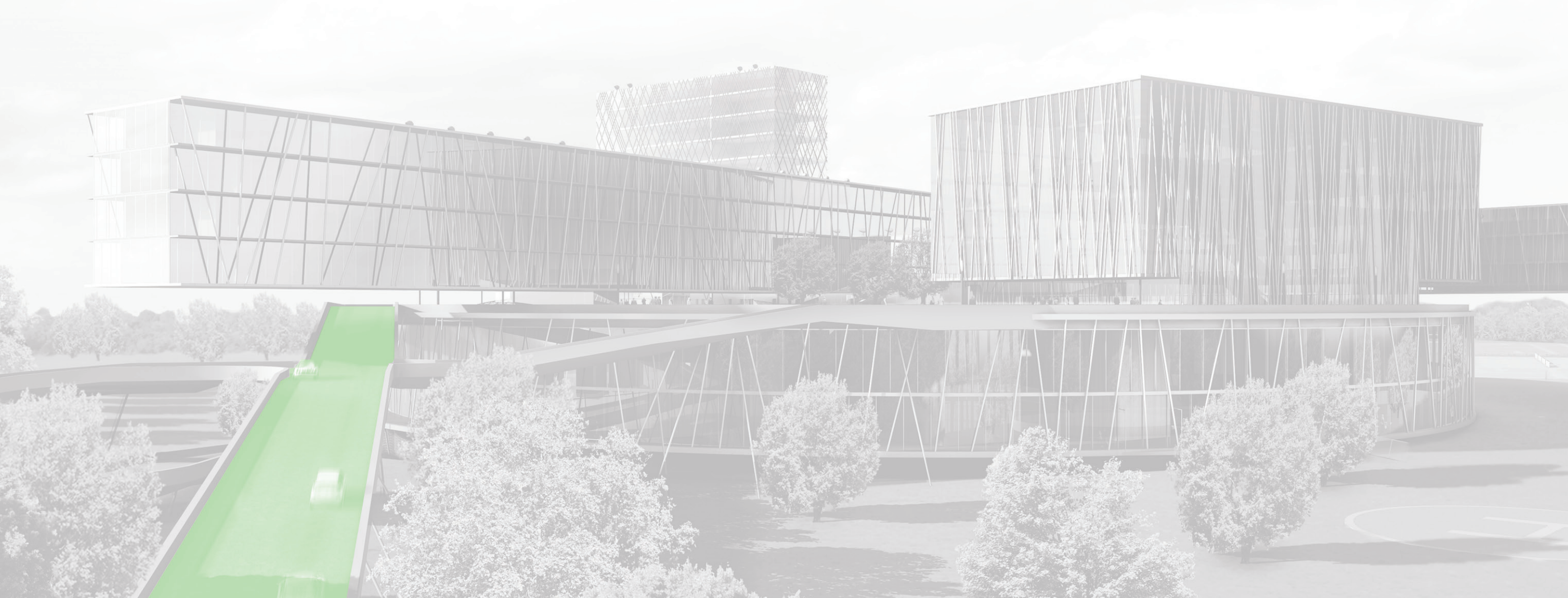

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