

KEY CONSIDERATIONS WHEN DOING DEALS IN EMERGING MARKETS



Emerging markets are increasingly attractive candidates for investment due to higher rates of gross domestic product growth and, in many countries, emerging mass consumer classes. However, emerging-market mergers and acquisitions (M&A) deals present very different challenges than developed-market buyers are accustomed to. This guide explores some of the less obvious challenges that a buyer may face and provides some key considerations to keep in mind when doing deals in emerging markets.

EXPECT THE UNEXPECTED

Transactions in developed markets typically involve a target business that utilizes fairly standard governance and commercial documents that are supported by a well-understood body of law and business operations on which due diligence can be conducted with a reasonable degree of confidence. Negotiated deal terms tend to fall within a well-defined band of publicly reported market terms reflecting many deals. Once a deal is struck, the parties will have a reasonably clear understanding of what regulatory approvals will be required, the process for obtaining those approvals, and how regulators are likely to respond to the transaction.

In emerging markets, only some – and often none – of that is true. Corporate governance laws and practices are constantly evolving, basic diligence information can be extremely difficult to come by, there is often no established market for peer transactions, and government regulators can feel like third or fourth (even fifth or sixth) parties when negotiating a transaction. As a result, it is critical for both the deal team and their executive leadership to expect the unexpected to arise and be comfortable addressing issues of first impression.

DEAL TEAM ALIGNMENT

Most serial acquirors are excellent at preparing executive or board briefing documents outlining the strategic and economic rationale for exploring a transaction. In our experience, the most successful emerging-market buyers go beyond strategy and economics to directly address and align on a range of fundamental points that provide a framework for addressing unexpected issues. Key topics on which alignment should be reached include:

- **Deal Objectives.** As with a domestic transaction, each party to the deal needs to understand the relative importance of key deal objectives, such as maximizing economic value, maximizing closing certainty, minimizing post-closing

financial risk, and closing on a particular timeline. The balance of these objectives will determine how a team approaches particular issues. The more clarity there is on this balance, the more efficiently a deal can be executed.

- **Stakeholders.** In emerging markets, it is critical to understand who the key nonparty stakeholders are in a transaction, what their primary concerns are, and how their concerns will be addressed. These stakeholders could include work councils, unions, minority investors, suppliers, major customers, local partners, and regulatory and governmental authorities.
- **Operational Risk Tolerance.** Emerging-market operations often give rise to very different issues than companies face in their domestic markets. For instance, in many emerging markets, it is extremely common for there to be large numbers of small-dollar consumer and employment claims. In others, it is common to identify unclear chains of title to material real estate. And in many emerging markets, protection payments to criminal organizations are simply a fact of life. A deal team that has considered how to respond if these types of issues are identified – and perhaps has even aligned with executive management – will be far better equipped to address such issues if they arise during diligence.
- **Nonoperational Risk Tolerance.** Nonoperational risks can be even more disruptive if they arise unexpectedly. For instance, it is not uncommon to discover that the owner of a counterparty is on a politically exposed persons list, to encounter local stakeholders using civil or criminal charges to extract economic benefit from a transaction, to face unexpected governmental interference, or to have to address hostile local press. It is far better to be prepared for these types of issues in advance, rather than having to use crisis management strategies when they arise unexpectedly.

DEAL TEAM STRUCTURE

A typical domestic M&A transaction will be led by an in-house corporate development team, in-house M&A counsel, often an investment banker brought on board early in a transaction to assist in valuing and (if selling) marketing the business, and outside counsel brought in once a deal seems more certain. Internal specialists and other third parties are typically not engaged until much further into the diligence process. Because of the complexity and need to learn local markets, emerging-market transactions require a different approach.

Internally, the core deal team will often need to be expanded beyond corporate development staff to include tax and treasury teams to assess capital and structural requirements and key funds flow issues. Externally, it is essential to identify an advisory team composed of bankers, accountants, global and local counsel, and potentially local strategic advisors that collectively have deep emerging-market transactions experience, as well as expertise on local legal requirements, business practices, and stakeholder engagement strategies.

Although every company is different, our most active emerging-market investors tend to develop long-term relationships with one or two global investment banks and law firms that learn the objectives and risk tolerance of their clients, and they rely heavily on those advisors to identify appropriate local teams in new countries. Identifying and retaining local advisors as early as possible can be critical to, and even determinative of, a deal's success – particularly given that, in many jurisdictions, there are only one or two firms capable of providing the type of support required by a multinational investor.



EXECUTION MECHANICS

It goes without saying that deal mechanics vary significantly from country to country. However, the fundamental issues those mechanics must address are generally consistent across the world. We advise deal parties to have their local advisors tackle these issues as early as possible in a transaction. Examples include:

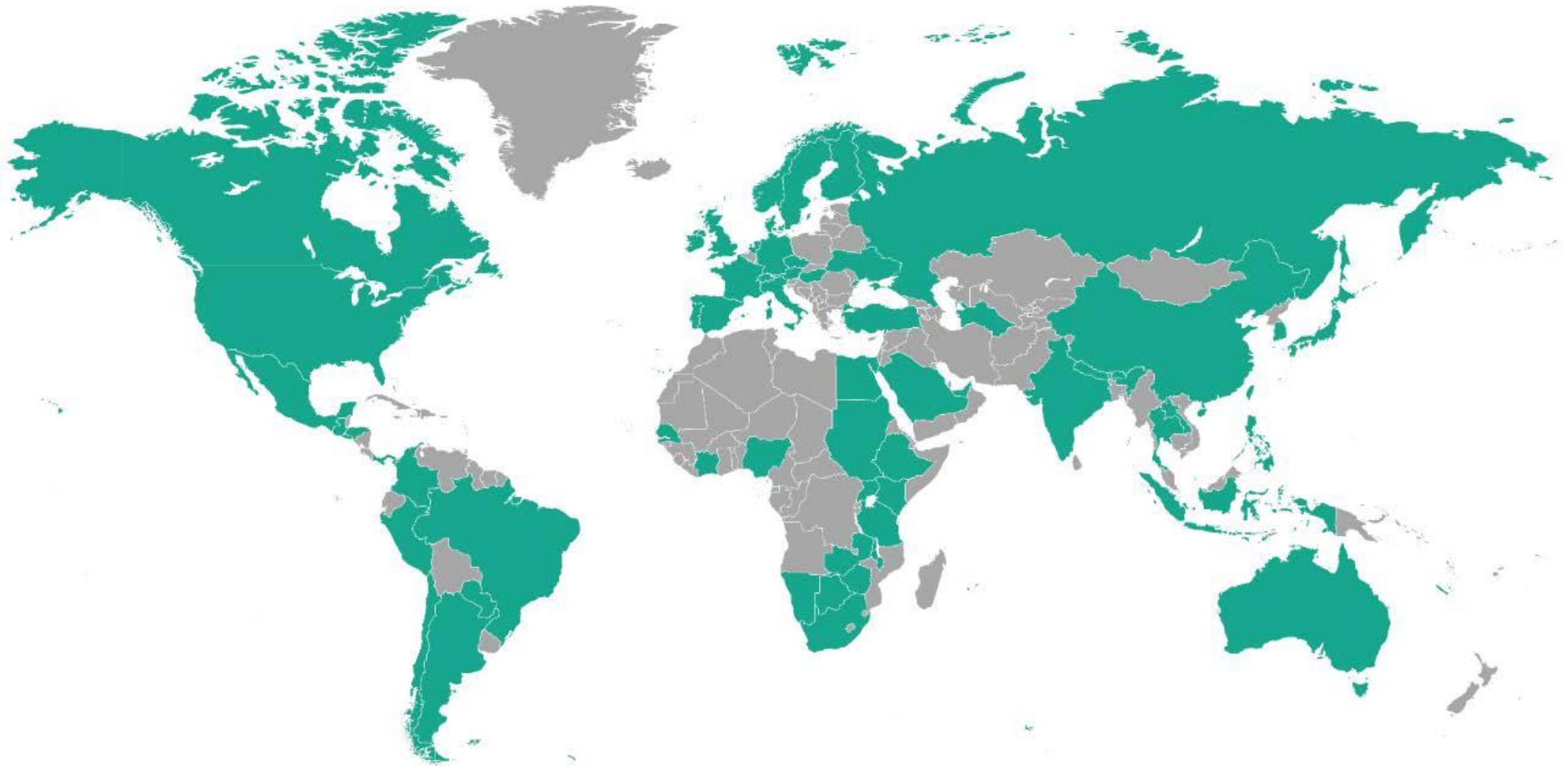
- **Transaction Structure.** Available transaction structures (e.g., stock purchase, asset sale, merger, or “hive out”), as well as any filing requirements, foreign ownership restrictions, taxes, and financing restrictions
- **Government and Regulatory Approvals.** Process for obtaining approvals, including what information is required, timelines, fees, remedies, foreign exchange restrictions, antitrust/competition approvals, foreign investment approvals, stock exchange requirements, asset ownership restrictions (e.g., limitations on noncitizens owning land or other types of protected assets), other approvals, and public disclosure requirements
- **Shareholder and Third-Party Approvals.** Requirements for board and shareholder approvals, statutory preemptive rights, third-party consents, and employee consultation requirements
- **Transaction Terms.** Customary transaction terms, purchase price adjustments, vendor due diligence, representations and warranties, indemnifications, escrow accounts, availability of representation and warranty insurance, closing conditions, cost-bearing for filings and taxes, and governing law and dispute resolution forums
- **Employees.** Employee transfer mechanisms, consent requirements, employee leasing agreements, transfer to third-party employers, historic employee liabilities, visa/work permit transfers, and change of control implications
- **Enforceability and Formalities.** Prohibitions on governing law, enforceability of foreign judgments, signing requirements, authentication of signatures, digital signatures, power of attorney, and other formalities
- **Entity Formation.** Process for forming a company, shareholder and ownership restrictions, director requirements, changing officers and directors, establishing a bank account, and other pre-transaction actions

The process of completing an M&A transaction is not dramatically different in emerging markets than in the United States, United Kingdom, European Union, or other developed jurisdictions. The main differences arise from the complexity of navigating the business, legal, and governmental environments in unfamiliar jurisdictions. Aligning on the fundamental purpose of the transaction, building the right team to execute it, and learning as much as possible about the local environment as early as possible in the transaction are the keys to setting a transaction up for success.



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