Mid-market perspectives

Foreign direct investment– A bright spot for mid-market enterprise growth

As the U.S. economy remains sluggish, many mid-sized companies with revenues ranging from $50 million to $1 billion are searching for new ways to drive revenue, trim costs and capture more value. Many are taking a hard look at foreign direct investments as a way to reach their long-term growth goals.

Historically, a significant amount of cross-border merger and acquisition activity has taken place among larger multinationals in developed countries. That pattern has changed in recent years with increasing activity in emerging markets, particularly the BRIC countries – China, India, Brazil, and Russia. China and India continue to post the fastest GDP growth rates among major economies. Brazil and Russia also offer significant growth opportunities for many businesses, along with more overlooked areas, such as sub-Saharan Africa and some other South American economies, such as Peru, Colombia, and Chile.

Recognizing the benefits that the investment brings, the governments of some emerging countries are taking steps to create a more welcoming environment for foreign direct investment. Many mid-market business leaders now see an open window of opportunity.

Why global expansion?

Gone are the days when mid-market companies were considered too small to play on the global stage. Indeed, many are perfectly positioned for cross-border moves to meet their long-term business goals. Often more agile, more focused and more decisive than their larger counterparts, certain mid-market companies don't experience the intense quarterly stakeholder pressures that large, public companies face. Mid-market companies are typically more focused on cash flow than stock price, seeking transformational deals that will drive enterprise value over the long term. Also, they are more likely to be interested in replicating their local successes internationally, rather than simply diversifying their portfolio of products or services.

Three of the broad trends driving mid-market companies' interest in cross-border activity are:

Pressure for growth: Deloitte's 2011 study of 527 mid-market companies shows that half of the respondents currently earn at least some revenues overseas.[1] In three years' time, respondents expect that number to climb to 65 percent, with more than 10 percent saying overseas revenues will exceed domestic revenues. Asia-Pacific countries, including China and India, are expected to be attractive growth targets over the next three years for 17 percent of respondents, while 10 percent expect to focus on Latin America, including Brazil and Mexico. While the destinations vary, the message is the same: many mid-market companies expect their share of revenues from overseas to grow.

Need for improved performance: In addition to providing new sources of income, many emerging markets continue to provide viable alternatives for improving operating efficiencies, cutting costs and increasing productivity. This is driven by massive amounts of skilled and unskilled labor, favorable tax policies and abundant raw materials.

Access to global talent: Globalization means a greater share of the mid-market workforce is located overseas. In 2007, 61 percent of the mid-market survey respondents had no overseas workers. By 2014, this number is expected to drop to 43 percent – for two reasons. On one hand, companies are looking for lower-cost talent to drive productivity and performance gains. On the other hand, the domestic supply of talent in some critical segments is simply not sufficient to meet demand. Companies are often looking at both ends of the talent spectrum when they consider cross-border investments.

Challenges ahead

For senior executives of mid-sized companies, the prospect of looking overseas for new opportunities brings special challenges that larger companies may not face.

[1]Deloitte, *Mid-market Perspectives: 2011 Report on America's Economic Engine*, April 2011.

Many mid-market companies run lean, and often don't have the in-house resources to assess and execute cross-border deals effectively. Leaders should ensure they have support from experienced professionals who can provide information to help them realistically assess the return they can expect from a transaction.

Choosing M&A targets that match the company's growth goals requires a careful strategy that's reinforced with thorough target screening, focused due diligence and detailed integration planning. Even in countries where foreign investment rules are being relaxed, governments are prone to make sudden shifts in policy. In many emerging markets, policies and regulations that are relevant to foreign acquirers and investors — ownership limits, bidding rules, local-competition rules — continue to be unpredictable. Leaders can provide information to mitigate these uncertainties by understanding the intricacies of new markets before entering them and by understanding how government policies operate in principle and in practice.

Leaders of mid-market companies should understand host-country laws, regulations, political environment and culture to educate themselves on the economic viability of a particular transaction. For example, leaders should learn up front if the country permits — in law and in practice — the financial and ownership structure they desire for the transaction. On the back end, leaders must determine whether, after the close of a transaction, the acquired business will thrive given the host country policies towards tax, competition, labor, and other business fundamentals. And, of course, realizing the potential value of their investment relies on following through with effective and efficient planning and implementation.

For example, a company may believe it can improve the performance of an acquired business by applying its domestic experience. In some cases, though, domestic experience won't translate into an emerging market without significant retooling. Expected benefits of new markets, synergies and cost savings should be assessed with an experienced eye.

How foreign direct investments can pay off

Leaders of mid-market companies may judge the success of cross-border investments the same way they evaluate other investments: by measuring the impact on the bottom line. In many cases, mid-market companies find that expanding through acquisitions carries less risk and quicker returns than organic growth. It's sometimes easier in these emerging countries to buy a business that's up and running – with existing market share, infrastructure and local management – than trying to build an organization from the ground up.

But growth and synergies are not the only reasons to do cross-border deals. Instead of exporting knowledge and culture into acquired foreign businesses, some mid-market companies are importing knowledge and creativity from businesses that excel in areas such as reverse innovation and disruptive technologies. By acquiring these innovative companies in developing countries, mid-market players can potentially reinvigorate themselves in ways that lead to greater growth.

Planning today for tomorrow's growth

As mid-market company leaders consider new cross-border opportunities, they should remember to ask themselves some key questions: What is the overall economic outlook for the new market? How open is the country to foreign direct investment? How will government policies impact the planned transaction? How exactly can a merger or acquisition improve our performance and bottom line? Do we have the resources and capabilities to carry out the plan?

At a time when the world presents significant opportunities for foreign direct investment for mid-market companies, it is up to senior leaders to see that their companies make educated moves. By adapting their strategies to account for the wide range of opportunities and challenges presented by emerging markets today, mid-market companies can lay the foundation for stronger growth tomorrow.

Perspectives

This white paper is just one example of a growing body of Deloitte research on topics of interest to mid-market and privately held companies. Presented by Deloitte Growth Enterprise Services, Perspectives is a multifaceted program that utilizes live events, signature reports, research publications, webcasts, podcasts, and other vehicles to deliver tailored and relevant insights to mid-market and privately held companies.

Please visit our Perspectives library on the Deloitte Growth Enterprise Services website http://www.deloitte.com/us/perspectives/dges to view additional material on issues facing mid-market and privately held companies.

Additional resources

Mid-market Perspectives: America's Economic Engine – Competing in Uncertain Times
Mid-market Perspectives: 2011 Report on America's Economic Engine

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