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Understanding Asia's conglomerates

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Conglomerates are shaping the competitive landscape in Asia. Would-be rivals must understand them to compete with them.

Conglomerates may be out of favor in much of the developed world, but don't tell that to senior executives who contend with fast-growing conglomerates in major Asian markets, where this business model remains a competitive force.

McKinsey research finds that over the past decade, the largest conglomerates in China and India expanded their revenues by more than 20 percent a year, while conglomerates in South Korea exceeded 10 percent annual revenue growth (see sidebar, "About the research"). These companies diversified at a blistering pace, making an average of one new business entry every 18 months (Exhibit 1). The nature of those moves was striking: nearly half of the companies favored businesses that were completely unrelated to the parent companies' operations.

Of course, only time will tell if Asian conglomerates' "step out" approach to diversification will endure as the region's economies mature. Nor is it clear how much shareholder value will be created—and sustained—by these companies' growth. Nonetheless, a closer look at its characteristics and at the aggressive, M&A-fueled strategies that sustain it offers insights for senior executives seeking growth in Asian markets and gives potential entrants a useful glimpse into the evolving nature of competition there.

Big and growing

Over the past decade, conglomerates in South Korea accounted for about 80 percent of the largest 50 companies by revenues. In India, the figure is a whopping 90 percent. Meanwhile, China's conglomerates (excluding state-owned enterprises) represented about 40 percent of its largest 50 companies in 2010, up from less than 20 percent a decade before. All these companies generated strong topline growth: an average of 23 percent a year over the past decade for conglomerates in China and India, and 11 percent for those in South Korea. Such growth is remarkable considering the large size of the companies involved—an average of $3 billion in revenues a decade ago and $12 billion in 2011.

Stepping out

When we looked more closely to determine the sources of this revenue growth, we found a strong connection with new business entry. The average rate of revenue growth for companies that entered at least one new business over the period we studied was 25 percent a year—more than two times higher than the revenue growth of companies that didn't.

Also notable were the strategic motivations behind the new business entries. Fully 49 percent were step-out moves into businesses completely unrelated to the parent companies' existing activities—for example, a South Korean chemical company acquiring a life insurer or a Chinese mining group's

Exhibit 1

The largest conglomerates in China, India, and South Korea are entering new businesses at a startling pace.

Number of new businesses conglomerates entered,[1] 2000–10

[1] For the top 10–15 industrial conglomerates by 2011 revenues in each country (35 conglomerates in total); excludes state-owned enterprises.

Source: Companies' investor-relations materials, annual reports, and Web sites; Kisline; McKinsey analysis

expansion into the media industry. The remaining half were about equally split between two kinds of moves: category expansions into adjacent businesses and value-chain expansions that positioned the parent company up- or downstream from its existing business (Exhibit 2).

Large returns, large risks

Although step-out moves were the most common form of new business entry we observed, they were far from the most successful. Just 22 percent of those we studied had a beneficial impact on revenue growth, profits, and market share relative to those of competitors. In fact, our findings almost certainly *understate* the difficulties involved in diversifying into entirely new businesses, since companies rarely publicize the full financial and organizational implications of unsuccessful moves. Nonetheless, when step-out moves were successful, they delivered strong results—$3.8 billion in additional revenues, on average (Exhibit 3).[1]

Exhibit 2

Nearly half of the business entries made by top Asian conglomerates from 2000 to 2010 were unrelated to the parent companies' existing business.

Share of new businesses by type, for conglomerates[1] in China, India, and South Korea, 2000–10, %

100% = 274 business entries

%	Type
22	**Category expansion into adjacent businesses:** • Hanjin (Korean Air) expands into low-cost-carrier business • Tencent expands instant-message (IM) offering from personal to corporate service
29	**Value-chain expansion:** Downstream or upstream expansion from existing business • Hailiang (copper processing/manufacturing) extends into copper-trading business • Doosan (construction equipment manufacturer) expands into hydraulic equipment manufacturing (a core part of excavators)
49	**Step out:** Totally new business, not linked to existing ones • Hanwha (chemicals and leisure) expands into life-insurance business by acquiring KLI • Fosun (mining and steel) enters media industry

[1]For the top 10–15 industrial conglomerates by 2011 revenues in each country (35 conglomerates in total); excludes state-owned enterprises and financial conglomerates.

Source: Companies' investor-relations materials, annual reports, and Web sites; Kisline; McKinsey analysis

Regardless of how related the new business was to the existing one, the most common paths to success were M&A, joint ventures, and technology partnerships. Together, these accounted for three-quarters of the successful moves we studied.

Outlook and implications

Given the rapidly changing business climate in much of Asia, we believe senior executives in other regions should approach these findings judiciously. Certainly, not all Asian companies will follow the path of the conglomerates we examined. For example, state-owned companies and companies in markets with strong traditions of board governance (such as Malaysia) might find it difficult to convince skeptical boards of the need for bold step-out moves. Furthermore, if governance structures in Asia continue to evolve toward the shareholder-driven models prevalent in Europe and the United States—away from family-ownership or -control models that can introduce major shareholders' personal interests into the equation—the growth patterns will probably change.

Nonetheless, there are equally valid reasons to believe that Asian conglomerates' push for growth through aggressive diversification could continue for some time. For starters, many Asian conglomerates have ready access to capital, as well as aggressive growth ambitions that cause them to view strong local reputations and relationships as platforms for stretching into new areas. They seem to be particularly attracted to nascent industries, such as green energy, where dominant global leaders have yet to emerge. Local market dynamics also play a role.

Exhibit 3

Step-out business entries deliver more revenues on average, but the odds for success are low.

New businesses in China, India, and South Korea

	Average revenues,[1] $ billion	**Probability of success,** %
Step out	3.8	22
Category expansion into adjacent businesses	1.2	38
Value-chain expansion	0.8	21

[1]For successful new entries with publicly available data; excludes unsuccessful cases because of limited financial information.

Source: Companies' investor-relations materials and Web sites; Kisline; Thomson Reuters Datastream; McKinsey analysis

About the research

To learn more about the strategic choices Asian conglomerates are making, and the competitive implications for companies everywhere, we examined some 274 business entries made by the 35 largest conglomerates (by revenues) in China, India, and South Korea between 2000 and 2010. The sample included 231 subsidiaries that together spanned 38 industries. We excluded financial conglomerates and state-owned enterprises from the sample because the former are often prohibited by regulation from diversifying, while the latter often enter business areas for noneconomic reasons, receive strong government support, or both.

Our work drew on all publicly available information associated with the companies and their subsidiaries—for instance, annual reports, investor-relations materials, and analyst reports. We also looked at private databases, such as Bloomberg and Thomson One.

Ambitious conglomerates in smaller Asian economies, for example, may seek growth in new geographies given the relatively limited opportunities at home.

High growth aspirations intersect with a singular feature of emerging Asian economic life: the extraordinary need for infrastructure, since conglomerates are often involved with it. Finally, they can offer up-and-coming managers broader career-development opportunities, boosting their attractiveness to local talent in a region characterized by tight talent markets.[2] Potential competitors will be well served by developing a better understanding of these and other sources of the conglomerates' advantage.[3]

The bottom line: business leaders in Asia are building large, fast-growing companies around the conglomerate business model. Understanding the drivers of that growth may give competitors and emulators alike a firmer footing in a volatile business environment.

[1] With respect to the profitability of the moves, the available data were limited and we therefore cannot draw a definitive conclusion. Nonetheless, among the success cases, for the relatively small sample size of cases where the profit data were publicly available, we observed that 80 percent of them generated profits above the industry average. For cases where profits were below market average, the hefty investment requirement associated with the move appeared to be the main culprit, not the intrinsic health of the business.

[2] For a broader discussion of conglomerates, including those in emerging markets, see Joseph Cyriac, Tim Koller, and Jannick Thomsen, "Testing the limits of diversification," mckinseyquarterly.com, February 2012.

[3] Any discussion of conglomerates and how they seek advantage should be grounded in an understanding of the best-owner principle, which states that no business has an inherent value in and of itself. It has a different value to different owners or potential owners—a value based on how they manage it and what strategy they pursue. For more about this principle, see Richard Dobbs, Bill Huyett, and Tim Koller, "The CEO's guide to corporate finance," mckinseyquarterly.com, November 2010.

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