

Risk Identification and Prevention of Cross-Industry M & A: A Case Study of Midea's Acquisition of Kolu Electronics

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ABSTRACT

With the rapid development of our country's economy, the replacement of major industries speed up. In order to seek better development, cross-industry M & A has become an important means to rapidly enter new industries and expand strategic blueprint. Through the case analysis of Midea Group's acquisition of Kolu Electronics, the paper takes pre-acquisition and post-acquisition as the discussion node, and identifies the risks faced by Midea Group as the M & a party, this paper analyzes the industry choice risk, enterprise choice risk, management integration risk and financial integration risk in the early stage of M & A, and puts forward some corresponding risk prevention measures, that is to strengthen the pre-merger investigation, stabilize the core talent to reduce the risk of management integration, seek common ground while reserving differences to reduce the risk of financial integration, for the future cross-industry M & a process of emerging industries risk identification and prevention provides some reference.

KEYWORDS

Cross-industry M & A; M & a risk; Risk prevention

1. CASE BACKGROUND

1.1. Midea Group

Since its inception in 1968, Midea Group has undergone decades of development, and has grown into a leading enterprise in China's home appliance industry, and has set foot in logistics and other fields, forming a large comprehensive modern enterprise group pattern. Its home appliance business started in 1980, and began to use Midea's brand in 1981. This decision has laid a solid foundation for Midea's future brand building and market expansion. At present, Midea Group has a huge staff team and rich brand resources, covering many well-known brands such as Midea, Cygnet, Weling, Hualing, and these brands have a wide range of market influence and competitiveness in different fields.

1.2. Kolu Electronics

Shenzhen Kolu Electronics Technology Co., Ltd. was established in Shenzhen in 1996. It is a listed enterprise on the main board, a national high-tech enterprise, a nationally recognized enterprise technology center and a number of national and provincial technology centers and laboratories. The company's main business focuses on smart grid and new electrochemical energy storage, and its strategic vision is to become a first-class energy service provider in China and even in the world. In the field of energy storage, the company is one of the earliest enterprises to layout energy storage, is a leading enterprise in the energy storage industry, and is also one of the few domestic energy storage system integrators to enter Europe and the United States. In the field of smart grid, the company has

been the core supplier of China and South Grid for many years, and the overseas business of smart grid covers many regions of "Belt and Road".

1.3. Industry Analysis

In recent years, the white goods market tends to be saturated, Midea, Gree and other manufacturers are seeking change, aiming at the track is new energy. Midea Group focuses on the development of four core ToB businesses, including robot and automation, building technology, energy management and intelligent travel. As one of the earliest enterprises involved in the field of energy storage system integration, Kelu Electronics has huge development potential and competitive advantage in the industry. The main purpose of the acquisition of Kelu Electronics is to take it as the main platform for developing energy management business. Through this extended expansion, it will help Midea Group to open up a situation in the new energy industry chain.

2. CASE RISK ANALYSIS

2.1. Pre-merger Risk

2.1.1. Industry choice risk

Industry policy risk —— government policy support decline risk. The policy support of the government can promote the vigorous development of new energy storage industry. In 2023, the Development and Reform Commission, the Energy Bureau and other departments will release many relevant policies on the power market mechanism, which is conducive to the spot market of energy storage power and auxiliary service market, and promotes the diversified and industrialized development of new energy storage. According to the White Paper on the Development of China's New Energy Storage Industry in 2024, China has frequently issued supporting policies from top-level design, scientific and technological research and development, industrial management, talent training and other aspects, and a new energy storage policy system has been basically formed. At the end of 2017, since the first guidance on the energy storage industry jointly issued by the five ministries and commissions, the energy storage heat has been rising continuously. Good market expectations introduced a batch of "gold miners". In the small-scale industry with only the output value of billions, a large number of enterprises were attracted to join in a short time. In the case of limited downstream application space, the energy storage track is more and more crowded. This also means that China's energy storage industry is entering the stage of integration and elimination. In the future, only products with core technologies, technological innovation and cost reduction and efficiency under the premise of ensuring safety can have living space. Therefore, in terms of new energy storage policies, the technical level of domestic standard standards will be improved in the future, and the products will lead technological progress through standards, and the corresponding domestic subsidy threshold will be gradually increased. At that time, it is uncertain whether the new energy storage enterprises can maintain sustained profits after the government policy support declines or after the policy support standards are improved.

Industry economic risk. With the proposal of the "double-carbon" target and the support of relevant national policies, the rapid growth of energy storage systems in China has attracted a large number of manufacturers into the energy storage system industry, leading to a significant increase in the price of upstream raw materials. The rise of raw material price will lead to further pressure on the cost of downstream energy storage industry, making it difficult for related enterprises to invest more technology research and development funds. The low scale makes it difficult for enterprises to achieve economies of scale effect of processing technology to reduce the cost, so as to realize the improvement of profitability. Raw material prices rising in 2022, even in 2023, but due to the existence of production cycle, the price of raw materials downward need some time to conduction to the cost of sales, at the same time due to 2022 raw material prices caused by the economic risk

continues, the future volatility of raw materials to the profitability of manufacturers will still cause greater influence.

2.1.2. Companies choose risks

Profitability is in doubt at risk. Kelu electronics company has been repeatedly exposed to losses, profitability is in doubt. As a company with the energy development, distribution, use and storage products as the core, Kelu Electronics shows its profound strength and extensive layout in the energy field. The company not only integrates independent research and development, production, sales and service, but also becomes a leading comprehensive service provider in the field of energy with its innovation ability and market insight. In terms of the current environment, the business environment involved in Kelu Electronics is highly prosperous, but the performance of Kelu Electronics is far from ideal. After combing the financial results of Kelu Electronics in recent years, it is found that the company made a loss of 1.22 billion yuan in 2018 and continued to lose 2.376 billion yuan in 2019. Due to two consecutive years of losses, the company was ST in April 2020. In 2020, Kelu Electronics turned a profit through selling assets and other means, and the net profit reached 185 million yuan, a year-on-year increase of 107.80%, to successfully protect the shell. However, in 2021, Kelu Electronics fell into a loss dilemma again, and the net profit loss of the parent reached 665 million yuan. In 2022, the net profit loss attributable to the mother narrowed to 101 million yuan. There is a certain risk in acquiring a company that loses money for consecutive years. It can be seen from the above data that Kelu Electronics has been losing money for many years. Although there is a narrowing trend, there is great uncertainty whether it can turn a loss into a profit in the future.

Weak liquidity. In the early process of blind expansion of Kelu Electronics, it has indeed failed in the photovoltaic business and new energy vehicle business, which has caused a considerable impact on its financial position and sustainable operation ability. In order to ease the financing squeeze and replenish liquidity to support its core business, the company had to sell assets and equity, even using the funds originally used to raise projects. This situation shows that the capital liquidity situation of Kelu Electronics has been quite severe. In addition, the share repurchase plan issued by the company in 2018 was not purchased at the expiration of the repurchase period on the grounds of tight liquidity shortage. It can be seen that the capital liquidity of Kelu Electronics is worrying. In recent years, the current ratio has fallen sharply since mid-2017 to 0.58 in 2022; the quick ratio has been below 1 since 2017, and 0.42 in 2022. The continuous decline of the current ratio and quick ratio means that the company's short-term solvency is constantly weakening, which is a dangerous signal for any enterprise. Especially when its cash on hand can only cover about 20% of the current liabilities, it also shows the difficulties of Kelu Electronics in the capital liquidity.

2.2. Post-merger Risk

2.2.1. Management and integration risks

On the whole, Midea and Kelu Electronics, which respectively belong to the home appliance industry and the comprehensive energy industry, have significant differences in industry characteristics, technology core, operation and management mode and other aspects. Such a difference between industries will undoubtedly increase the difficulty of management integration and increase the risk of integration failure after the merger. If the measures taken should not be taken, or the effect is not good, it will not only affect the synergistic effect of the listed company and the target enterprise, but also adversely affect the normal operation of the Group itself. From the technical level, there is also a risk of inefficiency of technology integration. As a leader in the home appliance industry, Midea's core technology fields are mainly in air conditioning and refrigeration, and new electrochemical energy storage. The differences between these two technologies cause significant differences in R & D direction, resource investment and R & D process. How to effectively integrate the technical resources of both parties and realize technology complementarity and synergistic effect is the key to technology integration after the merger. If there is no breakthrough technology improvement in a

short time, the diversified development strategy of the merger party may be difficult to achieve on schedule. From the perspective of human resources, cross-industry mergers and acquisitions may also bring the risk of core personnel loss. Due to the differences in the corporate culture, business model and internal control system of the two parties, the core personnel may become uncomfortable or dissatisfied after the merger, and then choose to leave.

2.2.2. Financial integration risk

The complexity of cross-industry M & A is mainly reflected in financial management. Due to the significant differences in operating characteristics, profit models, solvency and operating capacity of different industries, the difficulty of financial integration of both parties will increase accordingly. The difference is particularly clear in the merger case between Midea and Kelu Electronics.

From the point of asset structure and monetary funds, lu electronics as a comprehensive energy enterprise, for example, in its smart grid project, the customer's payment is usually "181" or "361", which makes the enterprise must first large sums of money in advance, and accounts receivable recovery cycle is very long, resulting in the company's monetary ratio in the total assets. As the leader of the home appliance industry, Midea has a relatively high proportion of monetary capital, reflecting its steady financial management strategy. Therefore, in the process of merger and acquisition integration, the difference of this asset structure needs to be effectively integrated after the merger and acquisition to ensure the efficiency and benefit of the use of funds. In addition, in terms of enterprise scale, mergers and acquisitions of the enterprise scale difference also brought great problems to company financial integration, such as in 2022, midea company total assets reached 422.6 billion yuan, close to the lu electronic more than 50 times, that is to say, the two companies in the volume of financial activities and the complexity of accounting treatment there are obvious differences. After the merger, how to unify the financial system, coordinate financial activities, and ensure the accuracy and timeliness of financial information are all the issues that the merger party needs to pay close attention to. From the perspective of accounting information quality, due to the different purposes and priorities of the two companies in financial management, the accounting information system and financial system adopted by the two companies will also be different. In this way, it will cause accounting information inconsistency and communication barriers, which will affect the effective transmission of accounting information within the company, and then affect the efficiency of the company's financial management work. In the process of integration, if enough attention is not paid to the importance of financial integration, the company's financial management will be confused and the responsibility is unclear, which will have a negative impact on the company's financial work efficiency and the quality of accounting information. This will not only affect the efficiency of capital use and operating performance of the acquired party, but also may have a negative impact on the financial situation of the whole group.

3. RISK PREVENTION ADVICE

3.1. Strengthen The Investigation Work Before Mergers And Acquisitions

Compared with inter-industry mergers and acquisitions, cross-industry mergers and acquisitions do have greater information asymmetry. Because the acquisition party does not have a very thorough knowledge of other industries, so there will be a greater risk to make the wrong strategic decisions. In cross-bank merger and acquisition, special attention should be paid to the negative impact of information asymmetry in the process of merger and acquisition on enterprise value, industry selection and enterprise selection. first, Before M & A, the acquirer should master the market situation, competition situation, technology development trend and other key information of the industry of the acquired, In order to avoid the large deviation of the value evaluation of the target enterprise in the merger and acquisition; next, When choosing the target industry for a cross-industry acquisition, The ers need to fully understand the policy environment, market prospects and technology development

trends of the industry, Especially for those involved in emerging industries, Especially those emerging industries that have been heavily influenced by national policies, After the data were collected from the survey, To combine your company's strategic development needs to match the industry, Then you can determine if you want to enter the field. In addition, in the process of selected acquisition object, also should pay attention to the target company's financial situation, management ability, management level, etc., and the acquirer should also hire professional evaluation company, to ensure the quality of the company's accounting data, and its continued profitability and the quality of accounting information, as much as possible to avoid after the financial burden, business integration difficult problems.

3.2. Stabilize The Core Talents And Reduce The Risk Of Management And Integration

First of all, the merger party can reduce the risk of management integration more effectively through the two-way allocation method and talent stability measures. Two-way deployment means that the personnel between the acquirer and the acquired party can flow to each other, which can not only promote the understanding and communication between the two parties, but also bring the management experience and advantages of the acquirer to the acquired party, and learn the professional knowledge and skills of the acquired party in the industry. Talent stabilization measures include providing competitive salary and benefits, clear career development path and good working environment, so as to retain the core talents of acquired parties and avoid the risk of brain drain; secondly, open communication channels to strengthen communication with core personnel is also an important means to reduce the risk of management integration. The acquirer needs to keep close contact with the core personnel of the acquirer, understand their thoughts and concerns, and answer their questions and puzzles in a timely manner. By establishing a good communication mechanism, it can enhance their trust and understanding, reduce misunderstanding and conflicts, and thus facilitate the smooth integration process; finally, the buyer can take some specific measures to further reduce the integration risk. For example, to restrain the behavior of the two parties, ensure that the integration after the merger can be conducted according to the established plan; stabilize the original management and technical team through employee stock ownership incentives, enhance their sense of belonging and loyalty; introduce the core members with the new industry background into the board to increase the effectiveness of the supervision and control of the acquired parties, and ensure the effective implementation of the work in the integration process.

3.3. Seek Common Ground While Reserving Differences To Reduce The Risk Of Financial Integration

Cross-industry mergers and acquisitions are indeed a complex and carefully considered task, especially when it comes to financial consolidation. There is a large gap in the operating characteristics, financial management objectives and priorities of different industries, which requires the acquirer to fully consider the characteristics of the industry of the acquirer in the cross-industry merger and acquisition activities, so as to realize the efficient and reasonable financial integration. In the process of financial integration, the acquirer should make use of its own resources to improve the efficiency of capital use and the quality of accounting information of the acquirer, including optimizing capital allocation, ensuring the effective investment of funds in key business areas, and strengthening the accuracy and transparency of accounting information, so as to provide strong support for decision-making. In addition, improving the comparability of financial indicators is also an important part of financial integration. Through the formulation of unified financial system and standards, the financial data of both parties can be compared and analyzed, which is able to help to find potential risks and opportunities and provide a basis for financial decisions. In the process of integration, the acquirer should avoid ignoring the actual operating characteristics of the acquired bidder in order to pursue the "unification" in the financial statements. Each industry has its own

unique business model and financial needs, so the financial integration activities should be closely combined with the characteristics of the industry of the acquired party, to ensure that the integrated financial system can not only meet the overall strategic needs of the acquirer, but also adapt to the actual business needs of the acquired party. In addition, the acquisition party should establish a capital early warning system, through setting reasonable capital indicators and monitoring mechanism, timely find and respond to the problems in the capital flow, to ensure the safety and stability of enterprise funds.

4. SUMMARY

Through the case analysis of Midea Group's acquisition of Kelu Electronics, we can clearly see the complexity and risk of cross-industry mergers and acquisitions. Although cross-industry M&A provides enterprises with the opportunity to enter new areas and expand their strategic blueprint, it also comes with multiple challenges such as industry selection risk, enterprise selection risk, management integration risk and financial integration risk. In order to effectively deal with these risks, enterprises must conduct adequate due diligence before M&A, understand the real operating conditions and potential risks of the target enterprises, and evaluate the difficulty of management integration and financial integration after M&A.

In the process of M&A, it is important to stabilize core talents and maintain the continuity and consistency of corporate culture to reduce the risk of management integration. In addition, by seeking common ground while reserving differences and flexibly adjusting financial strategies, the risks of financial integration can be effectively reduced and the steady development of enterprises after M&A can be ensured.

The case of Midea Group's acquisition of Kelu Electronics provides us with valuable enlightenment: in cross-industry mergers and acquisitions, enterprises must establish risk awareness, strengthen risk prevention measures, and achieve win-win or even multi-win mergers and acquisitions through scientific decision-making and effective execution. In the future, with the intensification of market competition and the continuous adjustment of enterprise strategies, cross-industry mergers and acquisitions will continue to become an important means of enterprise development, and risk identification and prevention will also become the key factors for the success of enterprise mergers and acquisitions.

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