

# Analysis of Risks and Countermeasures in Cross border Mergers and Acquisitions of Chinese Enterprises

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## ABSTRACT

With the process of economic globalization and world integration, cross-border mergers and acquisitions have become a major strategy for the rapid development of enterprises. Analyze the uneven distribution of cross-border M&A countries, lack of M&A experience, and unreasonable industrial structure of Chinese enterprises in cross-border M&A. Based on the successful case of Geely's acquisition of Volvo, propose reference suggestions such as establishing information dissemination channels, expanding financing channels, selecting different M&A locations based on different motives, and strengthening integration to achieve complementary advantages between both parties in M&A, To help governments and businesses make better decisions on cross-border mergers and acquisitions.

## KEYWORDS

Cross border mergers and acquisitions; Merger and acquisition risks; keep away.

## 1. INTRODUCTION

China's economy is rapidly developing, and the development of the world economy is also deepening the internationalization requirements for enterprises. In the context of increasingly fierce market competition, enterprises need not only mature internal systems and effective management models, but also appropriate and successful mergers and acquisitions to achieve stable operation and successful expansion. Overseas mergers and acquisitions are one of the direct and effective ways. From the perspective of the supply chain, cooperation between upstream and downstream can enhance the efficiency of the supply chain, and the extreme form of cooperation is strategic integration, including vertical integration of forward and backward integration, as well as diversified horizontal integration.

After entering the 21st century, under the guidance of policies and the rapid development of the national economy, more and more enterprises are participating in cross-border mergers and acquisitions, which has led to a rapid increase in the volume of cross-border M&A transactions for Chinese enterprises. Cross border mergers and acquisitions are also an important way for enterprises to respond to national policy calls and promote national economic development. With the continuous construction of the theoretical system of cross-border mergers and acquisitions, it has played a theoretical support role in the cross-border M&A activities of Chinese enterprises, helping to facilitate the successful progress of cross-border M&A.

## **2. DEFINITION AND CURRENT SITUATION OF CROSS BORDER MERGERS AND ACQUISITIONS BY CHINESE ENTERPRISES**

### **2.1. Definition of Cross border Mergers and Acquisitions by Chinese Enterprises**

Cross border mergers and acquisitions (M&A) by Chinese companies refer to the acquisition of all assets of one or more foreign companies (target companies) by Chinese companies (acquiring companies) through investment or other means in order to achieve their business and development goals. Thereby implementing control over the operation and management of the target enterprise, and obtaining the operational and control rights of the target enterprise after a successful merger and acquisition. This is also a way for enterprises to expand and manage capital. Chinese companies generally have the goal of entering the international market when conducting cross-border mergers and acquisitions. Cross border mergers and acquisitions involve capital flows across countries, as the cultural differences, policy and regulatory differences, and business philosophies between the acquiring and target companies make M&A activities more complex and risky than typical domestic M&A.

### **2.2. Current situation and characteristics of cross-border mergers and acquisitions by Chinese enterprises**

According to the "Overview of China's Overseas Investment in the First Half of 2023" released by Ernst & Young Greater China on August 14, 2023, China's industry wide outward direct investment in the first half of 2023 was 75.36 billion US dollars, an increase of 9.6% compared to the same period last year; Among them, non-financial outward direct investment reached 62.29 billion US dollars, a year-on-year increase of 14.8%. Non financial direct investment in countries along the "the Belt and Road" reached US \$11.57 billion, up 15.4% year on year, accounting for 18.6% of the total amount in the same period. It mainly invested in ASEAN, the United Arab Emirates, Kazakhstan, Russia and other countries and regions. For the overseas mergers and acquisitions of Chinese enterprises in the first half of 2023, according to the report, if calculated by the amount of mergers and acquisitions, the top three popular industries are electricity and public utilities, financial services, and advanced manufacturing and transportation, accounting for a total of 54% of the total transaction volume. Among them, electricity and public utilities saw a significant increase of 438%, while the financial services industry, real estate, hotels, and construction also achieved certain growth rates. In the second quarter of this year, the announcement of large-scale transactions included the acquisition of two distribution and energy service companies based in Peru by a Chinese company (totaling approximately 2.9 billion US dollars). This investment will help the Chinese company expand and consolidate the Latin American market; Chinese companies have also acquired a real estate investment trust fund in the UK (approximately \$1.03 billion). If measured by transaction volume, the popular industries are TMT (technology, media and entertainment, and communication), advanced manufacturing and transportation, and financial services. TMT continues to become the most popular industry, announcing 69 transactions, accounting for over 30% of the total transaction volume, far exceeding other industries. It is worth noting that in the first half of 2023, Chinese companies announced a merger and acquisition amount of 3.2 billion US dollars in Latin America, a year-on-year increase of 1737%, ranking first for the first time in nearly a decade. According to the analysis of the report, in the first half of this year, the visit of the President of Brazil to China, the establishment of diplomatic relations between Honduras and China, the first visit of its President to China, and the signing of the cooperation plan of jointly building the "the Belt and Road" between China and Argentina all reflect the continuous expansion of China's "circle of friends" in Latin America, which promotes the continuous advancement of China Latin America economic and trade relations. North America, as the only continent with an increase in transaction volume in this period, although the year-on-year merger and acquisition amount has decreased, the level of transaction activity has not decreased. Among them, the TMT industry's transaction volume has increased

significantly by 150%, mainly investing in software development and electronic components. Chinese companies account for 75% of their total mergers and acquisitions in the healthcare, life sciences, and TMT industries in North America. For Europe, over 40% of the mergers and acquisitions by Chinese companies are invested in the financial services industry, while other popular industries include mining and metals, real estate, hotels, and construction; The main destinations are the UK and Germany, with M&A amounts rising by 117% and 91% against the trend, respectively. The total M&A amounts of the two countries account for 86% of the total M&A amounts announced by Chinese companies in Europe.

The top three merger and acquisition destinations in Asia are Vietnam, Singapore, and Japan, accounting for a total of 64% of the total merger and acquisition amount. Among them, investment in Vietnam has risen against the trend, with both investment amount and quantity increasing by over 200%. Overall, the activity of Chinese enterprises in mergers and acquisitions in ASEAN has increased, with a year-on-year increase of 35% in the number of mergers and acquisitions. The main industries for Chinese companies to acquire in Asia are real estate, hotels and construction, financial services, and advanced manufacturing and transportation. In Oceania, Chinese companies announced a merger and acquisition amount of \$1.39 billion, a year-on-year increase of 225%, mainly investing in Australia's mining and metal industries, real estate, hotels and construction, and consumer goods industries; In Africa, Chinese companies announced a merger and acquisition amount of 610 million US dollars, a decrease of 24% year-on-year, mainly targeting advanced manufacturing and transportation industries in South Africa and Egypt. The main transaction in the second quarter was the acquisition of a cement producer in South Africa by Chinese companies, which is another key measure for the company to actively promote its overseas development strategy and expand into emerging markets.

Based on data from the first half of 2023, Chinese companies have shown the following characteristics in overseas mergers and acquisitions:

- (1) The scale of overseas mergers and acquisitions is constantly expanding. From 2012 to 2016, Chinese companies mainly concentrated their overseas mergers and acquisitions in North America and Europe, both of which accounted for over 75% of the total M&A transactions. In 2016, the amount of mergers and acquisitions by Chinese companies in the United States reached 23.579 billion US dollars.
- (2) The destination of overseas mergers and acquisitions is more inclined towards developed countries and regions. At present, about 70% of the total scale of overseas mergers and acquisitions by Chinese enterprises is in developed countries and regions, among which regions with good economic development prospects such as North America, Asia, and Latin America are expanding in scale. In addition, according to data, in China's outward foreign direct investment regions, developed economies have surpassed developing and transitional economies, becoming the choice of most Chinese enterprises.
- (3) Overseas mergers and acquisitions tend to be diversified. One of the characteristics of Chinese enterprises conducting overseas mergers and acquisitions is their diversification and high-end development. In recent years, manufacturing and information technology services have accounted for a significant proportion of China's overseas mergers and acquisitions. We can also see that for energy industries such as health and social work, electricity, heating, and residential services, although the proportion is small, it also reflects that China's overseas M&A industries have more diverse and high-end choices.

### **3. PROBLEMS IN CROSS BORDER MERGERS AND ACQUISITIONS OF CHINESE ENTERPRISES**

#### **3.1. Uneven distribution of cross-border M&A countries**

Cross border mergers and acquisitions by enterprises are concentrated in developed countries and regions such as the United States, Germany, and Australia, accounting for over 95% of the screening sample. It cannot be denied that enterprises in developed countries have higher technological levels, political and economic stability, and sound legal systems, which are the main objects for Chinese enterprises to learn advanced technology and management experience. However, enterprises cannot blindly choose similar markets that have been acquired in the past based on investment experience, and still need to consider timeliness risks such as policy changes and industry changes. Although investing in developed countries that have cooperated with them can reduce the cost and risk of entering the market, enterprises have heterogeneity. Chinese enterprises need to choose the most appropriate market based on their own corporate attributes and weaknesses, the characteristics of the acquiring country's market, and strategic development direction.

#### **3.2. Lack of experience in cross-border mergers and acquisitions**

The enhancement of corporate competitive advantage through cross-border mergers and acquisitions requires integration and resource restructuring after the merger, which requires companies to have rich international experience to cope with the integration challenges they face after the merger. Before the booming development of cross-border M&A business in China, European and American countries had already experienced five large-scale M&A waves, and China had always played a bystander role, so the experience of Chinese enterprises in cross-border M&A was slightly insufficient. The goal of mergers and acquisitions was originally to acquire the brand, technology, or simply to enter the market, but the ultimate success depends on whether the acquiring company has sufficient integration capabilities. For example, Sano Group's acquisition of Bayer Group resulted in the failure of the merger due to insufficient experience and integration ability, which led to the mismatch between the company's development and expected goals. Because overseas mergers and acquisitions are a complex system process with high costs and risks, decision-makers need to conduct in-depth investigations and make cautious judgments about the merger and acquisition decisions themselves. Once the merger and acquisition fails, it can cause investment losses, hinder the speed of enterprise development, and increase financial burden on the enterprise, resulting in significant economic losses.

#### **3.3. Unreasonable industrial structure**

According to KPMG statistics, in 1995, Chinese companies only covered four industries including energy through overseas mergers and acquisitions. However, in recent years, the pattern of overseas mergers and acquisitions by Chinese companies has undergone significant changes, with Chinese companies focusing on high-end manufacturing, the internet, and other fields. However, over 70% of M&A cases occur in the manufacturing industry, which hinders the diversified development of Chinese enterprises.

### **4. RISK ANALYSIS OF CROSS-BORDER MERGERS AND ACQUISITIONS BY CHINESE ENTERPRISES**

#### **4.1. Decision risks before the implementation of corporate mergers and acquisitions**

When Chinese companies engage in cross-border mergers and acquisitions, some companies overlook the risks of M&A decisions, which brings difficulties to their development. When acquiring,

enterprises do not start from the overall development goals of the enterprise itself, nor do they consider the advantages and disadvantages of the enterprise, as well as the internal and external environment. Instead, they are influenced by public opinion and only consider the benefits brought by the merger and blindly carry out the merger and acquisition; Some companies, seeing the disadvantaged position of disadvantaged enterprises, have the motivation to consider buying assets at a low price to achieve their own interests, but have not taken into account their own shortcomings in terms of funds, technology, management, etc., and have made wrong mergers and acquisitions, falling into the trap of low-cost expansion.

#### **4.2. Operational risks during the implementation of corporate mergers and acquisitions**

There are risks of information asymmetry and financial risks in the implementation of overseas mergers and acquisitions by Chinese enterprises. The risk of information asymmetry refers to the situation where, in the process of overseas mergers and acquisitions, a company falls into a trap due to a lack of detailed and in-depth understanding of the asset status, profitability, and specific business of the acquired enterprise, and the failure to discover previously concealed debt disputes, litigation disputes, and other issues. At the same time, enterprises need a large amount of financial support to complete overseas mergers and acquisitions, and most Chinese companies find it difficult to rely on their own strength to complete cross-border mergers and acquisitions. Enterprises need a large amount of funding to complete mergers and acquisitions and a series of integration work afterwards. To be precise, enterprises will face risks such as uncertainty in fundraising methods, variability in exchange rates, and high growth in fundraising costs during the fundraising process.

#### **4.3. The risk of "non synergy" in the integration process after enterprise mergers and acquisitions**

After overseas mergers and acquisitions, Chinese enterprises need to integrate resources to maximize the benefits of mergers and acquisitions. In the integration process, there are mainly the following risks: first, management risks. After the merger and acquisition, whether the enterprise can coordinate the relationships between management personnel, whether the level of management can be improved, and whether the methods and means of management are coordinated will all bring management risks to the enterprise; Secondly, cultural risk. Cross border mergers and acquisitions are carried out between two or even multiple countries. Due to cultural differences, companies cannot achieve a common business philosophy, resulting in inefficient work efficiency and posing significant risks to cross-border mergers and acquisitions.

### **5. COUNTERMEASURES TO PREVENT RISKS IN OVERSEAS MERGERS AND ACQUISITIONS OF ENTERPRISES**

#### **5.1. Reasonable use of financial instruments to avoid exchange rate risks**

In the preparation stage of mergers and acquisitions, the acquiring party needs to fully understand the policies and financial markets of the host country, and respond promptly to the financial risks they will face. The acquiring party can reduce the foreign exchange risk of the enterprise through options contracts, futures contracts, forward contracts, etc., and can also purchase corresponding insurance to reduce foreign exchange risk. Once corresponding insurance losses occur, the insurance company will provide corresponding compensation to reduce the losses.

## 5.2. Improve information asymmetry and control evaluation risks

Merger and acquisition companies need to collect as much information as possible, review and evaluate the collected information, and fully utilize the information disclosed in financial reports. In the process of information collection, the more sufficient the information, the lower the risk of information asymmetry, greatly increasing the probability of successful mergers and acquisitions. That is, enterprises hire authoritative and professional evaluation agencies to collect, review, and evaluate information, and make a reasonable judgment on the true value of the enterprise. At the same time, it is also necessary to hire professional intermediaries to have accounting firms review and verify the authenticity of the information collected. Compensation agreements can also be used to determine the responsibilities of both parties and reduce losses.

## 5.3. Develop a strategic integration plan to reduce integration risks

Chinese companies need to fully consider the domestic and international environment they face when conducting overseas M&A strategic plans, so as to align it with their own long-term strategic goals for development; Fully understand the foreign political, economic, legal, cultural and other environments, hire third-party authoritative institutions to conduct comprehensive evaluations of the target company, and reduce the risk of overseas mergers and acquisitions.

In the integration process of cross-border mergers and acquisitions, Chinese enterprises can adopt risk control or risk conversion to reduce risks, reduce financial integration risks through risk hedging, adjust human resources through risk supplementation, reduce operational risks through risk avoidance, and manage integration risks through risk control.

## 6. CONCLUSION

The overseas mergers and acquisitions of Chinese enterprises are showing a growing trend, which is of great significance to the development of the Chinese economy. However, cross-border mergers and acquisitions often take place between two or more countries, and there are political, economic, legal, cultural, and other risks involved in mergers and acquisitions. Therefore, it is extremely important to prevent the risks of overseas mergers and acquisitions.

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