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Research on the Prevention of External Risks in Overseas Mergers and Acquisitions of the Mainland Chinese Enterprises

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Abstract

Thanks to the expansion of economic globalization and the unceasing progress of science and technology, overseas Mergers and Acquisitions (M&A) have developed into a current trend. On the one hand, globalization has offered opportunities and possibilities to the global economy while, on the other hand, it has also posed more risks and challenges simultaneously. Fueled by the strong momentum of globalization, economic integration, national strategy and foreign investment policy, Chinese enterprises have undergone a swift growth and then continued to decline in respect of the scale of cross-border M&A. Chinese enterprises are confronted with enormous external risks throughout overseas M&A, and the number of cases influencing the process of overseas M&A of Chinese enterprises keeps on the rise every year on account of political, legal and cultural risk factors. The success rate of M&A can be increased to a certain degree by choosing reasonable financing channels, hiring a specialized M&A team and comprehending cultural differences, thereby boosting the development of corporate M&A.

Keywords: China, Overseas Mergers and Acquisitions, Status Quo, Risk Prevention

Introduction

Thanks to the expansion of economic globalization and the unceasing progress of science and technology, overseas Mergers and Acquisitions (M&A) have turned into a way for corporate development. On the one hand, globalization has offered opportunities and possibilities to the global economy while, on the other hand, it has also posed more risks and challenges simultaneously. Overseas M&A enable enterprises to bring into full play the world's production resources, increase the market share and competitive edge of M&A enterprises, and tremendously cut down their transaction costs.

In 2020, the Chinese government made it clear that "we will expedite the formation of a new pattern of development in which China's domestic cycle is the mainstay and both domestic and international cycles reinforce each other." Currently, China's epidemic situation has been under effective control, and its GDP increased by 2.3% in 2020. It is the only major economy in the world that has grown against the trend, with investment and consumption gradually

returning to the pre-epidemic level, exports turning from negative to positive, and the domestic economy developing continuously in a big cycle. China's domestic cycle is the mainstay of the dual-cycle strategy, while the international external cycle will offer countermeasures and support for it. As a significant means of the international external cycle, overseas M&A can furnish extension guarantee, experience supplement, market spillover and strategic security for the economic internal cycle (Gao & Wang, 2008).

With a view to upgrading the overseas market, introducing international advanced technology or management mode, and acquiring the resources needed by enterprises, enterprises will take into account overseas M&A. Overseas political situation, cultural environment, destination of country's economic structure, social development status, economic policy, industrial structure and social service level are all objective factors that influence enterprises' overseas M&A (Li, et al., 2020). Li Yanni (2016) holds the idea that internationalization is an inevitable trend for Chinese enterprises. Overseas mergers and acquisitions can enhance the internal governance and upgrade the external adaptability of enterprises. Jiang Qiankun and Xu Rui (2021) consider that if enterprises fail to know enough about the risks they may encounter in the course of overseas M&A, or if they deal with the risks improperly, they will probably confront the failure of mergers and acquisitions. Apart from the common risks of mergers and acquisitions, enterprises will also suffer from some special external risks (Zhou Xunshi, 2017). Along with the development of overseas M&A of Chinese enterprises, it is worth studying how to prevent external risks.

Status Quo of Overseas M&A of Chinese Enterprises

Overall Situation of Overseas M&A of Chinese Enterprises

Over these years, Chinese enterprises have undergone a swift growth and then continued to decline in respect of the overall scale of cross-border mergers and acquisitions. From 2012 to 2016, the overseas M&A of Chinese mainland enterprises grew in a vigorous manner. In 2016, there were as many as 920 overseas M&A projects of Chinese mainland enterprises in existence, with a transaction value of up to US\$ 204.5 billion. Influenced by numerous factors, in 2017, the overseas M&A of Chinese mainland enterprises continued to decline. In 2020, affected by the COVID-19 epidemic and the international political situation, overseas M&A activities of the Chinese mainland enterprises were badly hit, and engaging in overseas M&A was extremely difficult, especially in developed markets such as those of the United States and Europe; the amount of overseas M&A transactions dropped to the lowest value since 2010. Statistically, in 2020, there were only 403 overseas M&A transactions of the Chinese mainland enterprises, and the transaction amount was merely 42 billion US dollars. With regard to quantity, there were 253 transactions for private enterprises in mainland China and 123 transactions for state-owned enterprises in the mainland China, and private enterprises in the mainland China were more active by contrast.

Table 1: Number and Amount of Overseas M&A Transactions of Mainland Chinese Enterprises

Year	2016	2017	2018	2019	2020
Number of transactions	920	806	627	667	403
Transaction amount (\$1 billion)	204.5	119	91.4	58	42

Source: Review and Prospect of Chinese M&A Market in 2020 issued by PricewaterhouseCoopers

In 2020, the total overseas M&A transactions of Chinese enterprises totaled more than CNY 155.3 billion, down 35.69% year-on-year. Therein, there were only five large-amount M&A transactions worth \$10 billion in 2020, compared with nine in 2019.

Table 2: Top Ten Overseas M&A Cases of Chinese Enterprises in 2020

M&A case	Acquisition target	Target country	Transaction amount
CR Capital MGMT and KKR acquired Viridor in the UK	100% equity of Viridor	Britain	4.2 billion pounds
GlobalWafers acquired Siltronic	All outstanding shares of Siltronic	Germany	3.75 billion euros
Tencent Holdings led the consortium to invest in Universal Music	10% equity of Universal Music	United States	3 billion euros
State Grid acquired CGE	96.04% equity of CGE	Chile	2.57 billion euros
Savills acquired Pinehill	Total equity of Pinehill Group	Indonesia	2.998 billion US dollars
Alibaba acquired AXA Insurance Building	50% equity of AXA Insurance Building	Singapore	1.68 billion Singapore dollars
Zijin Mining acquired Mainland Gold	100% equity of Mainland Gold	Canada	1.33 billion Canadian dollars
Shanshan Shares acquired LG chemical polarizer business	70% equity of LG Chemical LCD Company	South Korea	770 million US dollars
Maple Leaf Education acquired Singapore International School	All shares of Star Readers Pte. Ltd.	Singapore	680 million Singapore dollars
Ping An invested in Shionogi Seiyaku	2% equity of Shionogi Seiyaku	Japan	33.53 billion yen

Source: Morning Whistle Group

Selection of Overseas M&A Industries of Chinese Enterprises

In 2020, overseas M&A of Chinese enterprises experienced a downturn trend and, to some extent, almost all industries were influenced by this. With regard to transaction amount, the top three industries were respectively TMT, consumer goods and advanced manufacturing and transportation, among which TMT made up 36%, leading the other industries by a large margin. TMT industry chiefly relates to low-sensitivity hardware manufacturing, software development and IT services and other areas. Among all industries, the industries of medicine and life sciences became the only ones showing positive growth, with the amount of mergers and acquisitions being up to US\$ 2.27 billion, up 7.2% year-on-year. The industries of medicine and life sciences emphatically invested in biotechnology, drug research and development and medical devices. As far as the transaction volume is concerned, the top three industries were respectively TMT, financial services and advanced manufacturing and transportation, making up 52.1% of the total; among the rest, only the financial services industry (up 12.7%) and TMT (up 0.7%) that recorded an increase in the number of mergers and acquisitions, while the number of mergers and acquisitions in other industries was decreased to some degree.

2.3 Selection of Overseas M&A Regions of Chinese Enterprises

In 2020, the overseas M&A amount of Chinese enterprises in North America was US\$ 13.89 billion, with a year-on-year decrease of 38%, and investments were chiefly made in TMT, consumer goods and financial services. Overseas mergers and acquisitions of Chinese enterprises in Asia amounted to US\$ 13.7 billion, down 44.1% year-on-year, and investments were chiefly made in consumer goods, financial services and TMT. Saudi Arabia, South Korea and Singapore were the top three recipient countries in Asia in respect of overseas M&A of Chinese enterprises. Numerically, the overseas M&A of Chinese enterprises in Asia took up 40% of the total, up 4.3% year-on-year, making it the only continent to gain growth. The overseas M&A of Chinese enterprises in Europe amounted to US\$ 12.5 billion, down 48.6% year-on-year, and investment were chiefly made in TMT, real estate, hotel and construction, as well as advanced manufacturing and transportation, among which the investment in Germany and Italy increased to a substantial degree. Over the years, investments of the Chinese enterprises in Europe have shrunk dramatically. In view of the signing of the RCEP and the scheduled completion of the negotiations for the China-EU Comprehensive Agreement on Investment at the end of 2020, it is predicted that the investment of Chinese enterprises in Asia and Europe will be on the rise in 2021.

Table 3: Transaction Amount of Top Ten Destinations of Chinese Enterprises' Overseas Mergers and Acquisitions in 2020 (\$100 Million)

Destination	2020	2019	Year-on-year growth
United States	131.3	156.4	-16.0%
Germany	51.5	18.1	184.0%
Chile	30.3	46.2	-34.3%
Saudi Arabia	30.0	-	-
South Korea	27.9	19.7	41.7%
Singapore	27.8	74.1	-62.5%
Australia	22.3	41.5	-46.2%
Britain	20.9	102.2	-79.6%
India	16.3	38.7	-57.9%
Italy	14.4	5.3	173.2%

Source: Overview of China's Overseas Investment in 2020 issued by Ernst & Young

Analysis on the External Risks Facing Chinese Enterprises in Overseas Mergers and Acquisitions

Legal Risks

In the course of overseas M&A, enterprises will chiefly suffer from the following legal risks: security review risk, anti-monopoly legal risk, labor protection risk, intellectual property risk and environmental protection legal risk, etc. In terms of the risk of security review, throughout the overseas M&A, enterprises will be under all sorts of pressures from the host government. For the sake of national security, the host government will launch an extremely strict examination of the acquirer's enterprises. Since the factors considered by the host government are uncertain, it is not easy for the acquirer to find the right direction when guarding against the risk of security review. It is also a common practice in some host countries to intervene in mergers and acquisitions using anti-monopoly law. Anti-monopoly investigation can be classified into pre-declaration investigation and post-declaration investigation, which will pose different risks to overseas M&A. Before mergers and acquisitions, due diligence should be launched to fully learn about the ways and means of anti-monopoly investigation in the host country. In the course of mergers and acquisitions, the legal risks in labor protection cannot be ignored. If ignored, it may cause labor opposition and even fierce resistance, and the integration before and after the M&A will exert an enormous impact on the M&A. The legal risks in intellectual property rights chiefly come from the low awareness of intellectual property rights of Chinese enterprises, and it is easy to ignore the issues concerning the protection of intellectual property rights in the course of M&A, which may incur high costs to enterprises, such as high litigation fees of intellectual property rights. Issues on environmental protection laws are easy to surface when merging resource enterprises in developed countries. The standard for environmental legislation in developed countries is comparatively high, and environmental protection laws are strictly enforced. Without a good knowledge of environmental protection laws of the host country, it is easy to violate the relevant laws of the host country and cause economic losses to the M&A enterprises.

Political Risks

Enterprises will suffer from political risks in the course of overseas M&A. The political environment of the host country will impose an impact on overseas M&A. If the host country is politically stable, enterprises will only face common management risks upon the completion of overseas M&A. In the event that the political situation in the host country is unstable, the risk of personal security and property loss arising from political changes will be increased. The attitude of the host country's governing authorities towards foreign investment also needs attention. In the case of the fact that the host country's ruling authorities hold a skeptical or even negative attitude towards overseas investment, enterprises will be subjected to severe scrutiny and multiple protection measures of the host country in the course of negotiation and implementation of M&A, which will tremendously increase the possibility of failure in M&A. The attitude of the host people towards China and Chinese enterprises' investment should also be taken into account. Where an M&A violates the local religion or ethnic customs, it will be resisted by the local people, which will cause enormous risks to the M&A.

Cultural Risks

Cultural risks chiefly relate to the internal corporate culture of the target company and the cultural differences after the M&A, where there exists a strong conflict between the

corporate culture of the target enterprise and the M&A enterprise. Even if some M&A conditions are superior to others, it is also difficult to facilitate the success of the final M&A. The risks arising from cultural differences after M&A are chiefly embodied in corporate integration, including employment, operation and management, intellectual property rights, performance evaluation, salary distribution, reward mechanism, communication methods, intellectual property rights and the like. These aspects are overlooked from time to time, which result in risks such as employment, operation and management, and labor salary, and ultimately influences the business performance after M&A.

Precautionary Measures for Overseas M&A Risks of Chinese Enterprises

Measures for Prevention against Legal Risks

At the national level, it is essential to reinforce the legislative construction, revise and perfect the relevant laws and regulations of overseas M&A, and offer legal support for Chinese enterprises' overseas M&A. Besides, the database of overseas M&A cases should be encouraged to enhance Chinese enterprises' identification capability of legal risks in overseas M&A through data analysis. At the enterprise level, attention should be paid to the legal issues in the course of overseas M&A. It is advisable to hire a specialized legal team or set up a legal talent team in order to deeply learn about the relevant laws and judicial investigation procedures of the host country, and effectively cope with the legal risks involved.

Measures for Prevention against Political Risks

The Chinese government should come up with major policy orientations and guidelines; enter into investment protection agreements with many countries and regions; push the analysis of national security situations to enterprises on a regular basis; build and perfect risk prevention systems; register relevant information of large-scale overseas personnel; set up relevant record databases for overseas personnel of foreign-funded cooperation; monitor and publish overseas social situations, natural disasters, changes in economic situation, public health and so on in real time; emphatically pay attention to security situations in hot spots and issue early warnings to remind enterprises and personnel concerned to evacuate in a prompt manner. Moreover, it is required to supervise overseas enterprises to set up their own overseas security management and control system strictly in line with regulations, and carry out patrol inspections on an irregular basis to help Chinese enterprises enhance their emergency response capability to deal with emergencies. In the early stage of foreign investment activities, enterprises should make full preparations by checking the latest foreign investment news on the relevant websites of the state in a prompt manner, getting a clear understanding of the social situation of the country where the target enterprises are situated, the local government's investment attitude towards foreign capital is to be fully understood, and the country's major policies and guidelines are easy to follow. Only after completing that preliminary stage can enterprises be able to choose suitable M&A projects, grasp the opportunities, and acquire a business organization in a prompt manner, in a bid to minimize political risks.

Measures for Prevention against Cultural Risks

After successful M&A, enterprises will be surely faced with cultural influences. In this regard, enterprises should probe into the changes of internal and external environment and work out different cultural strategies by classification. Post-M&A integration should lay emphasis on intellectual property rights and human resources. With regard to human resources, it is

necessary to become aware of the differences in human resources between the two companies, promote communication with employees, know their wishes, and furnish employees with promotion channels suitable for their development; it is also essential to conduct training in culture, launch get-together activities on an irregular basis, enhance mutual understanding, build trust, properly deal with conflicts, and mobilize employees' work enthusiasm in a short period of time; in addition, it is crucial to work out a reasonable operating system, boost the operating efficiency of the company, and shape a new culture of the enterprise; equally important, as far as intellectual property rights are concerned, the Chinese government should build and perfect the evaluation system of intellectual property rights, vigorously train high-quality evaluation talents, perfect evaluation indicators, and offer reasonable evaluation prices to Chinese enterprises in order to prevent evaluation loopholes and cut down the risks of M&A transactions. Apart from that the recommendations given above, specialized teams should be hired: a specialized investigation team can finish the investigation of employees' wishes in enterprises with low cost and high efficiency, a specialized public relations team, for example, can guide the trend of public opinion to build a good image for enterprises and popularize their new culture; a specialized management team can help enterprises complete effective integration with the least delay possible. Teams can cooperate with each other to lower their cultural risks.

Conclusion

The Chinese government has come up with the international and domestic dual-cycle development strategy and, as an effective approach of international external cycle development, overseas M&A will offer powerful support for China's dual-cycle development strategy. Over these years, Chinese enterprises have undergone a swift growth and then faced constant decline in respect of the overall scale of cross-border mergers and acquisitions. In 2020, affected by the COVID-19 epidemic and the international political situation, overseas M&A activities of the Chinese mainland enterprises were badly hit. In spite of this, China is one of the active economies in existence throughout the world, and Chinese enterprises call for international development. As there exist differences in social economy and politics, Chinese enterprises often suffer external risks in legal, political and cultural aspects in the course of overseas M&A. If Chinese enterprises do not have good awareness of the external risks that may arise in the course of overseas M&A, or is not able to deal with the risks in a proper way, it is extremely likely that M&A will fail. To this end, the Chinese government and Chinese enterprises should attach high importance to the external risks of overseas M&A, and take all sorts of measures to respond to the external risks arising from overseas M&A.

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