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Points to Remember in Outbound M&A Deals by Chinese Companies

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Chinese companies have been vigorously advancing overseas. Especially, mergers and acquisitions (M&A) by Chinese companies have been involving even major overseas companies in recent years, while we now have more opportunities to hear news about high-value M&A cases. Following the slowdown of economic growth, Chinese companies that have targeted domestic markets so far are now seeking opportunities in overseas markets. In addition, encouraged by China's "One Belt, One Road" initiative, referred to as the "modern Silk Road," Chinese outbound investment targeting resource / infrastructure - related businesses is expected to further increase in the future.

Accelerating outbound M&A deals by Chinese companies

The start of China's so-called "Going Out" or "Going Global" policy dates back to 2001. Since then, outbound investment by Chinese companies has been gradually gaining momentum, backed by the steady growth of the Chinese economy and by support from Chinese authorities that hope to promote the sophistication of domestic industries through the introduction of overseas technologies. Especially, outbound M&A deals by Chinese companies, mainly private companies, became active in 2015, with the number of M&A deals having reached a record high of 382, a 40% year-on-year increase, with the value of M&A deals reportedly having increased by 21% year-on-year[1].

The trend of outbound M&A deals by Chinese companies is a move to aim to acquire the main players in the target markets. This suggests that Chinese companies are trying to buy time and know-how so as to advertise brands from scratch and diligently launch new products into markets, while developing technologies and human resources.

Among past M&A cases by Chinese companies involving Japanese companies, Chinese major photovoltaic battery manufacturer, Suntech

[1] PwC China, "M&A 2015 review and 2016 outlook"

Power, bought MSK, a solar battery module manufacturer, in 2006, and Suning Commerce Group (former Suning Appliance) bought Laox, an electronics retailer, in 2009. Shandong Ruyi Group acquired Renown, an apparel manufacturer, in 2010, while Haier bought SANYO Electric's white goods business in 2011. In this way, there are many cases in which Chinese companies buy companies with advanced technology or a high profile (see Fig. 1). For European and U.S. companies, the acquisition of IBM's business unit in 2004 and the acquisition of Volvo in 2010 made headlines, while this year as well, China National Chemical Corporation bought Pirelli PECI.MI., the major Italian tire manufacturer, giving the impression that outbound M&A deals by Chinese companies are going into full swing.

Fig. 1: Major M&A cases by Chinese companies

Year	Buyer	Selling side	Country of origin
2009	Suning Appliance	Laox	Japan
2010	Shandong Ruyi Group	Renown	Japan
2010	Zhejiang Geely Holding Group	Volvo	Sweden
2011	Haier	SANYO Electric	Japan
2014	China Huaxin Post & Telecommunication Economy Development Center	Alcatel-Lucent Enterprise	France
2015	China National Chemical Corporation	Pirelli PECI.MI.	Italy

Source: Based on media reports, etc.

Boosted by deregulations in China

Outbound M&A deals became familiar to Chinese companies also because of domestic deregulation. If Chinese companies want to make investment or establish a company in foreign countries, they must obtain approval from the commercial department and/or the State Administration of Foreign Exchange, etc., in China, while it was quite rare that approvals are given to applicant companies in the past. However, since the "Going Out/Going Global" policy was advocated, there has been progress in deregulation in China. As a result, the number of rejected cases drastically decreased. In addition, application procedures were streamlined, and the time required was drastically reduced to approximately one or two months. However, the fact remains that Chinese companies are not allowed to make outbound investment without obtaining approval from relevant authorities, and this fact should be kept in mind in M&A deal negotiations with Chinese companies.

Points to remember in M&A deal negotiations with Chinese companies

On the selling side, there are some other points to remember when conducting M&A deal negotiations with Chinese companies.

First, there is a large difference in the sense of time between Chinese companies and non-Chinese companies. For example, when Japanese

companies try to buy a non-Japanese company, many of them conclude a non-disclosure agreement (NDA) first and repeatedly hold talks with the selling side. They then move to the next step only after confirming that all those concerned have come to a common understanding and recognition. In addition, many Japanese companies exhibit a cautious attitude that they want to confirm not only the information of Chinese companies on the buying side such as credibility, but also various aspects such as the president's character. Meanwhile, at Chinese companies, the president or some top management officials have decision-making authority, in general, and thus most Chinese companies negotiate in a speedy and straightforward way in which they will not hold a second negotiation meeting if the selling side fails to present a sales price or acceptable investment ratio during the first meeting. In a first meeting for an M&A deal, the first words that the president of a Chinese company on the buying side gave to an official of the company on the selling side were: "Do you have the authority to make a decision?" This is not a joke at all. While many Japanese companies first start a joint business and then consider a share transfer if business goes well, they need to realize that it is impossible to apply such a process to M&A deals with Chinese companies. It is necessary to keep in mind that such way do not work well in M&A deals with Chinese companies as starting a joint business first and then considering a share transfer if business goes well.

Second, as previously mentioned, Chinese companies have a strong tendency to opt for relatively large-scale M&A deals. In cases in which non-Chinese companies buy Chinese companies, it is not uncommon that non-Chinese companies buy small companies and then nurture employees by passing on know-how, while expanding the company size by investing their own skills, experience, and brand strength into the company in question. However, especially as a recent tendency, many Chinese companies do not have a long-term business plan but put emphasis on gaining profits in a short amount of time, and thus they have no intention to invest time and cost. Therefore, in many cases, Chinese companies do not show any interest from the beginning if candidate companies for the selling side are small or have a weak presence in relevant markets. Obviously, negotiation techniques based on common sense in foreign countries cannot be applied to Chinese companies with such an attitude. In the worst case, non-Chinese companies could put themselves in a disadvantageous position against Chinese companies that hope to immediately absorb know-how and skills from non-Chinese companies.

By swiftly buying main players in their target markets under the initiative of top management officials, Chinese companies primarily aim to dominate a large part of the market at once and gain profit. With that in mind, non-Chinese companies must not forget that they should sufficiently understand that they need to reinforce the appeal of their strengths, such as technologies, know-how regarding development/design, and brand strength, as one of the keys to advantageous negotiations, and then do business with Chinese companies (see Fig. 2).

Fig. 2: General characteristics in M&A deal negotiations

	Chinese companies	Non-Chinese companies
Decision -maker	President or several key persons in many cases	Calling for involving many officials and holding many meetings
Requested information	Detailed information, such as investment amounts and methods of alliance, requested from the first meeting	Confirming each other's intentions at first; investment amounts, etc., presented in the end
Methods of alliance	Obtaining a majority share, fastest entry into the market	Possible to make the scale larger little-by-little; also taking into consideration employee training, etc.

Meanwhile, some non-Chinese companies on the selling side investigate the basic information of Chinese companies on the buying side with an aim to protect their own brands and maintain their business policies. In such investigations, if the buying side is a Chinese company, it is relatively easy to obtain data, such as their capital stock, scope of business, shareholders, address, and name of representative, as publicly available information, because Chinese companies must register such basic information at local offices of the State Administration for Industry and Commerce. Meanwhile, if the buying side is a Chinese-affiliated Hong Kong company, non-Chinese companies need to buy registration-related documents from the Companies Registry to obtain basic information of the company. However, unlisted companies are not obliged to disclose detailed company information due to the protection of privacy, and thus it is necessary to conduct credit investigations to obtain detailed information. Even though the buying side is a Chinese company, non-Chinese companies on the selling side may hope to obtain more information than simply registered information. In addition, it is highly likely that data on a company's website is old or not reliable. Therefore, it will be safer for non-Chinese companies to conduct credit investigations or interviews with company officials and to conclude NDAs to obtain information directly from a Chinese company on the buying side.

Conclusion

The days where the acquisition of Chinese companies by European, American, and Japanese companies was the mainstream ended long ago, and we have entered an era in which famous brands and big-name companies are owned by Chinese companies if we notice. Outbound M&A deals by Chinese companies are expected to further increase in the future, as they aim to make up for the disadvantage of being less developed in key fields of growth such as in research & development, compared to companies in developed countries such as Europe, the U.S., and Japan, and as they aim to swiftly advance into solid markets. Even though the pace of economic growth is slowing, China has an enormous amount of accumulated assets. Given the Chinese government's current policy direction and Chinese companies' willingness to make investment, the trend of using abundant

funds for outbound investment will not change for the time being. The businesses and industries possibly targeted by Chinese companies range from food, seasonings, and beverages to industries related to elderly people. Excellent non-Chinese companies having technologies, development capability, and brands are one of the likely targets of Chinese companies. I would like to recommend that non-Chinese companies always keep these facts in mind and pay attention to the fact that Chinese companies have a common sense that is different when compared to non-Chinese companies. Non-Chinese companies should hold negotiations with Chinese companies while maintaining such an understanding.