

Analysis of Geely's Acquisition of Volvo

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Abstract: Cross-border M&A is one of the ways for enterprises to enhance their international competitiveness as soon as possible. Enterprises may gain technology and other excellent resources through cross-border M&A. In 2008, the financial crisis triggered by the subprime mortgage crisis in the United States caused the consumer market to shrink, and a large number of car companies suffered serious losses and faced a huge risk of bankruptcy, so some well-run companies acquired those companies that were on the verge of bankruptcy. This study examines Geely's acquisition of Volvo during the financial crisis and analyzes the impact of the acquisition. According to the analysis, this acquisition has enabled Geely to obtain many advanced technologies and patents, increase market share, and show a growth trend in revenue. However, the large amount of debt in the acquisition process also makes Geely face huge financial risks in the later stage, as well as problems such as corporate culture integration, and overall, this acquisition provides a good foundation for Geely's subsequent development. These results demonstrate the unique features of Geely's acquisition of Volvo under the financial crisis, summarize the impact of the later period, and make recommendations for Chinese enterprises to carry out cross-border mergers and acquisitions..

Keywords: acquisition, performance, effect

1. Introduction

With the globalization of the economy and trade, many companies are opting for cross-border mergers and acquisitions to enhance the economic benefits of their brands and expand their market share. On 29 March 2010, Geely Holdings Group completed the acquisition of 100% of Volvo for US\$1.8 billion [1]. This is a significant and globally significant cross-border transaction for Chinese automotive companies. According to Geely's 2022 annual results announcement, Geely's revenue for 2022 will be RMB 148 billion, up 45.6% year-on-year, which is significantly related to its cross-border acquisitions more than a decade ago [2]. Geely acquired Volvo's core technology through the acquisition, thereby enhancing its own innovation and research and development capabilities. This has led to a significant improvement in Geely's product quality, expanded international sales channels, increased Geely's market share and facilitated the joint development of both Geely and Volvo brands [3]. As for Ford, under the influence of the sub-prime crisis in the US in August 2007, Ford decided to sell its entire stake in Volvo in order to stop the excessive costs and losses as well as the decline in product sales, this acquisition enabled Ford to improve its financial situation, develop the Ford brand mainly and achieve profitability again, and this acquisition also made Volvo more international [4].

Firstly, due to China's lack of experience in cross-border M&A and its small market share in the past, there have been few successful cross-border M&A cases in China, but this acquisition by Geely made it a classic case of Chinese automobiles going global with a significant increase in technology and revenue over the next decade. Secondly, the financial crisis in 2008 was one of the key points and features of the success of this acquisition. The continued rise in oil prices and the fall in demand made the companies concerned lose money, and it was in this environment that Ford had to sell Volvo Cars to reduce its losses and liabilities and preserve Ford as a whole, which provided an opportunity for Geely's acquisition [4]. Finally, whether the company's performance improves before and after the acquisition is one of the key factors in determining whether the acquisition is successful. This paper examines the relevant accounting indicators to reveal the far-reaching impact of the acquisition on Geely's subsequent development, of which the risks arising after the acquisition are also issues that need to be analyzed and addressed.

In summary, Geely's acquisition of Volvo has not only achieved a leap from the low-end to the mid-to-high-end of its own brand but has also laid the foundation for the success of future cross-border M&A by Chinese automotive companies. This study will analyze the case of Geely Automobile's acquisition of Volvo based on the existing literature review and relevant financial or non-financial indicators, describe the time background, process and funding sources of this cross-border acquisition, determine whether the acquisition was successful, discuss the risks arising from the acquisition and the impact of the acquisition on Geely Automobile's subsequent development, and finally put forward some suggestions to facilitate the cross-border acquisition.

2. Background

Geely's acquisition of Volvo is a classic case of 'snakes swallowing elephants', and it took Geely around eight years to complete the acquisition, which means that it was a landmark purchase. In 2002, Geely's chairman, Li Shufu, was granted a license to manufacture cars, which gave him the idea to buy Volvo Cars. The global financial crisis caused by the spread of the sub-prime mortgage crisis in the US in August 2007 was a decisive factor in Geely's acquisition of Volvo. Ford sold Jaguar and Land Rover, but still lost US\$14.6 billion that year. Geely's net profit was RMB879 million, but Ford's bid of USD6 billion made it difficult for Geely to secure the seller's agreement, despite the fact that Geely had set up a professional acquisition team and raised a large amount of money for the purchase. By the end of 2008, Ford was losing money and decided to sell Volvo in order to avoid the risk of bankruptcy [5, 6]. In March 2009, Ford officially notified Geely to submit a bid, while some domestic and foreign car brands also jumped at the chance to buy the car, but the National Development and Reform Commission issued a letter of exclusivity in support of Geely. On 28 March 2010, Geely successfully acquired 100% of the shares and intellectual property rights of Volvo, as well as the world-renowned brand.

Geely's sources of financing for the acquisition were extensive. Firstly, Geely leveraged government power and received policy support, with Shanghai Jiaerva Investment Co Ltd and Daqing State-owned Assets Management Co Ltd providing Geely with RMB 1 billion and RMB 3 billion in cash respectively in 2010 [4]. Secondly, Li Shufu prepared sufficient financing for subsequent operations, and through mortgage guarantees and other means Geely obtained RMB 4.1 billion for the operational aspects of the business after the acquisition. Thirdly, Ford itself provided \$200 million in financing. Overall, Geely used three main types of financing for its acquisition of Volvo: loans from domestic and foreign banks, equity financing from investors and Ford seller financing [7, 8].

In August 2010, as a result of the financial crisis and the devaluation of the currency, Geely eventually succeeded in acquiring 100% of Volvo and related assets for US\$1.8 billion, which included core advanced technology, a large pool of talent and a significant supplier system and international sales channels. The acquisition was made possible by a key element of the financial

crisis, which not only turned the tide for Geely's subsequent development, but also kept Ford from going bankrupt at the time, as other US car companies had done. Geely's acquisition of Volvo was the largest multinational car merger in China at the time and the first successful acquisition of a famous international car brand by a Chinese car company, rewriting the history of Chinese car companies. They proved to the world, through more than 2.5 million documents and nearly 900 days and nights, the courage and ability of Chinese car companies to go international.

3. Risks of Acquisition

Firstly, the acquisition has increased Geely's debt ratio and increased its financial risk. The gearing ratio reflects the level of debt and measures the long-term solvency of a company. The gearing ratio is equal to the ratio of liabilities to assets, and the lower the gearing ratio, the better the long-term solvency of the company.

According to existing studies, the optimal gearing ratio for the automotive industry is around 50%. Figure 1 shows that Geely's gearing ratio was relatively high for one to two years before and after the acquisition, and in 2011, Geely Group's gearing ratio reached 63.22%, which is too high compared to 50% and indicates that Geely Group will face long-term debt pressure. However, in 2013, the gearing ratio dropped to 51.70%, probably due to its enhanced sales levels, increased profits and a gradual turnaround in long-term debt servicing capacity. 2016-2022, Geely's gearing ratio is in a state of greater volatility. The acquisition makes Geely is operating with debt, and the debt ratio is large. Although the debt ratio can enhance the efficiency of the enterprise's use of funds, it also increases the financial risk, if the enterprise's sales are not satisfactory, it is easy to cause the enterprise's capital chain to break, it will not be able to repay the debt in time, and the enterprise's solvency decreases, so Geely should avoid the financial risk brought by the excessive debt ratio in the late stage of the acquisition [9].

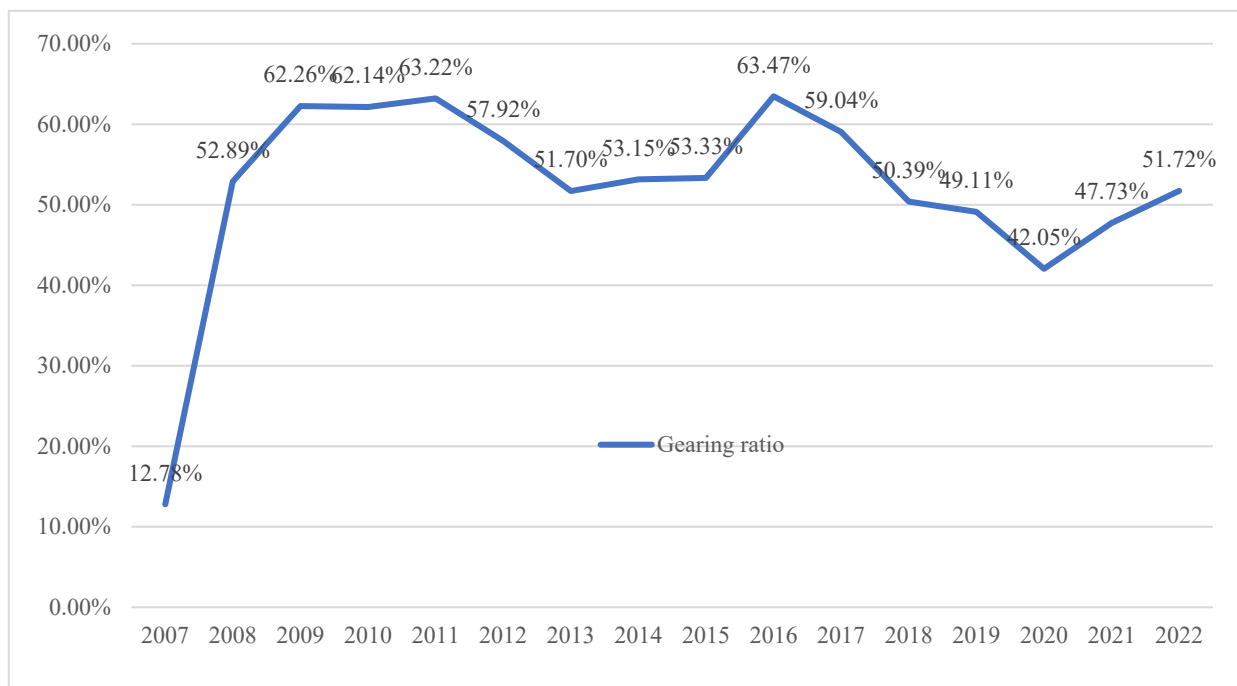


Figure 1: Geely's gearing ratio, 2007-2022.

Secondly, the integration of corporate culture is also one of the challenges that Geely faces after the acquisition of Volvo. Not only should the independent and autonomous operation of the two brands be achieved, but also the corporate culture consensus between the two should be strengthened; better cultural integration will be beneficial to the development of both brands. In the early stages Geely focused on the cost performance and low-cost advantages of its products and was at the low end of the market, while Volvo focused on the safety and environmental protection of its cars and was mainly a high-end brand positioning, and the obvious cultural differences between East and West led to cognitive differences between the two brands in terms of market positioning, design philosophy and national culture after the merger. Only a business model that seeks common ground while preserving differences can preserve the characteristics of both and strengthen the integration of the brands and promote overall development. The only way to achieve this is to seek common ground while preserving differences [10].

4. Pros and Cons of Acquisition

The acquisition has had a huge impact on Geely's development. Geely has gained more than 100,000 patents, two major car factories in Gothenburg, Sweden and Ghent, Belgium, an independent database for vehicle and component development, more than 3,800 research talents, a sales and service network of more than 2,000 outlets and much more. Volvo's safety technology is world-renowned, with its advanced "Fatigue Driving Alert" function, "Automatic Braking" system and Volvo's emphasis on carbon technology, which is now one of the cores of new energy vehicles. This is one of the cores of new energy vehicles, and Geely's access to the relevant technology will enable it to enter the development of new energy vehicles ahead of others. Its access to core technologies has enhanced its ability to innovate and strengthen its competitiveness in the market, and in addition to this, its extensive international sales channels and global reputation have boosted sales and created more profits for Geely [4].

Geely has been in the position of a low-end brand for a long time, which has become one of the obstacles for Geely to go to the international market. Meanwhile, with the upgrading of industrial structure, a large number of automobile brands can be produced at low cost, and the products of these brands are not only cheaper but also of better quality, which makes Geely no longer have the advantage of low cost, and Geely has to quickly get rid of the low-end shackle and enter the middle and high-end market. By acquiring Volvo, Geely was able to diversify its technology, which made up for the lack of international competitiveness. After the acquisition, Volvo became the first brand to sell mid-to-high-end cars from China to other developed regions of the world, which expanded its product sales and improved product quality, allowing Geely to reinvent its corporate image, enter the mid-to-high-end car market and expand its market share. Moreover, this classic "snake swallowing an elephant" acquisition attracted global attention, which indirectly promoted the Geely brand to the general public and increased its visibility and influence, thus attracting more consumers [4].

However, after the acquisition, Geely also faced challenges. On the one hand, the large amount of debt incurred by Geely in the early stages exposed the company to huge financial risks. On the other hand, Geely needed to make the right brand integration plan, the difference between Chinese and Western culture, the overload of low-end to high-end R&D, and the huge operation system all needed to be considered. The most important point is that with the globalization of technology, resources and economy, more and more companies are increasing their value through cross-border mergers and acquisitions. The improvement of independent innovation capabilities and the emergence of automated car concepts may also become factors for Geely to be overtaken by other car companies, so Geely has to use the resources from this acquisition in the most efficient way to maximize and maintain its competitive advantage [3].

5. Judgement of the Acquisition

This acquisition of Volvo by Geely has been more beneficial than detrimental and can therefore be considered a success. In terms of financial performance, Geely's return on total assets improved after the acquisition was completed in 2010, from 9.1% in 2009 to 10.8%, and remained at around 7% from 2011 to 2013[5]. In terms of non-financial performance, Geely's technology has improved and its market share has expanded, setting the stage for future leading growth. For the Volvo brand, in the second year of the acquisition, Volvo Cars turned around, Geely brought in capital and asset financing, and a revival plan for Volvo got it back up and running [9].

6. Impacts on Geely's Subsequent Development

As can be seen from Table 1, from 2017-2021, Geely Automobile Group's operating income still has relatively large fluctuations, from 2018 to 2020, the enterprise's total operating income shows a continuous decline, from 106.595 billion yuan to 92.114 billion yuan. 2018-2019 enterprise revenue decline is mainly due to the company's product life cycle is already in the mature stage, compared to Compared to the new energy vehicle forces in the industry, the enterprise's market competitiveness was diluted to a large extent. 2020 was severely impacted by the epidemic, the automotive consumer market was sluggish and the company's operating revenue declined further. 2021, along with the epidemic normalization policy and other reasons, Geely's operating revenue grew to RMB101.611 billion.

Table 1: Geely automobile operating revenue levels 2017-2022(in billion RMB).

Year	2017	2018	2019	2020	2021	2022
Operating income	927.61	1065.95	974.01	921.14	1016.11	1479.65
Cost of sales	747.79	850.82	804.85	773.77	841.99	1270.69

Table 2: Geely earnings growth analysis 2017-2021.

Profitable growth	2017	2018	2019	2020	2021
Year-on-year growth in operating income %	72.67	14.91	-8.63	-5.43	10.31
Total profit %	105.90	17.11	-35.58	-33.16	-27.57
Net profit %	107.64	18.06	-34.82	-32.52	-21.91

From the perspective of earnings growth, Geely's operating income has seen negative growth in 2019 and 2020, mainly due to the impact of the corporate growth cycle and the New Crown epidemic, etc. Corporate operating income becomes positive in 2021, but the company's profitability is poor, and the net profit growth rate in 2021 is still not back to positive. On balance, Geely's current profitability growth is poor, and the company has not yet fully escaped the impact of the New Crown epidemic, while facing the impact of new technologies in the industry, the company's product mix is relatively traditional, and there is some uncertainty in the future growth expectations of the company.

7. Suggestions

For Geely, it is important to reduce debt and strengthen capital operations and management. Excessive debt can make financial risks high and affect Geely's profitability. Under the condition of ensuring normal operation, Geely should adjust its asset and liability structure to avoid excessive risk. At the same time, Geely should strengthen cash flow management, prepare sufficient funds to meet production turnover and debt repayment, and pay attention to the liquidity of funds to ensure that the

company has stable cash flow in the future. Finally, it should strengthen the integration of technology and intellectual property rights and strengthen its multinational management capabilities. This research shows the pros, cons and implications of Geely's acquisition of Volvo, and provides ideas for subsequent mergers and acquisitions of Chinese enterprises. There are also limitations in this study, when analyzing the subsequent business performance of enterprise acquisitions, some results may not be caused by mergers and acquisitions, and secondly, the data analysis may not be comprehensive enough.

8. Conclusion

Overall, Geely's acquisition of Volvo has not only achieved a brand premium for Geely, enabling it to improve its market share, earnings revenue and overseas sales channels, but also resurrected the Volvo brand and added diversity to its development. However, there are also certain risks in the acquisition process, such as the pressure of debt servicing and the cultural integration problems faced by Geely. The success of the acquisition will depend on whether the company can integrate and utilise resources in the future. These results offer a guideline for cross-border mergers and acquisitions by Chinese enterprises.

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