

An Analysis of the Influence of Chinese Enterprises' Transnational Leveraged Buyouts

Ruijie Song^{1,a,*}

¹*Department of Economics, Shenzhen University, Shenzhen, 518000, China*
a. 2022020358@email.szu.edu.com

**corresponding author*

Abstract: As the epidemic is gradually being brought under control, China's economy is undergoing a rapid recovery. Mergers and acquisitions overseas are a common strategy for many Chinese companies. This article examines overseas M&A cases and provides advice for companies doing M&A. This article looks at the motivation for cross-border M&A, key elements of successful M&A, and how to fund acquisitions to reduce debt pressure. The motivation for M&A can be divided into enterprises' internal needs and external policy guidance. Meanwhile, in the process of M&A, many points need to be focused on, such as financing means. If some key points in the process of M&A are not properly handled, it will increase the burden on the subsequent operation of the enterprise. Enterprises should arrange the integration of two companies after a successful M&A.

Keywords: cross-border mergers and acquisitions, motivation of M&A, key points for successful M&A, leveraged merger and acquisition

1. Introduction

1.1. Background

The IMF expects the global economy to contract by 3% this year amid the huge impact of the coronavirus pandemic. Small and medium-sized enterprises in China are suffering from the drop in demand and production shutdown due to the epidemic. This has caused a severe crisis for numerous businesses. The survival crisis of small and medium-sized enterprises is one of the biggest challenges that China's macro policy must face and try to solve. Overseas M&A provides a reliable means for small and medium-sized enterprises that can acquire new development momentum by acquiring high-quality foreign enterprises to exclude difficulties.

1.2. Related Research

In the process of mergers and acquisitions of Chinese enterprises, there are numerous phenomena of "snake swallowing elephant", small and medium-sized enterprises of China acquire large enterprises of other countries. By using the 'snake swallowing elephant' approach, small and medium-sized enterprises in China can acquire access to the resources of large enterprises for their own development. Ma looked at Grammer's M&A performance from various perspectives. It is concluded that the fund can improve the success rate of overseas M&A, transfer the stage of risk occurrence, and have a

positive impact on enterprises [1]. In the automotive industry, Jifeng has acquired advanced technology and high-quality resources through overseas mergers and acquisitions. In biotechnology, Wantai gained more significant advantages through overseas mergers and acquisitions. Yan examines Wentai Technology and Anshi Group's merger and acquisition. After an in-depth analysis of the merger process and reasons, the author summarizes the four kinds of risks faced by enterprises in merger and acquisition, namely valuation risk, financing risk, payment risk and integration risk, and gives corresponding countermeasures and prevention methods [2]. In small scale and insufficient technology in China's domestic technology enterprises, many companies acquire high-tech enterprises in other countries through the way of "snake swallowing elephant". Lu gave the example of Wentai Technology's acquisition of the Anshi Group. First, he used the case analysis method to analyze the background, motivation, and financing structure of the acquisition. The author analyzes the financing effect and finally summarizes the financing strategy of Wentai Technology, which provides a reference for other companies' M&A [3].

Liu took Shuanghui International's leveraged merger and acquisition of Smithfield as an example to study the financial benefits of corporate mergers and acquisitions and analyzed the financial status, merger process and financing methods of the two companies before the merger and acquisition. Through the benefit analysis and strategy analysis of M&A, the author obtains the problems that Chinese enterprises will face in overseas M&A and puts forward corresponding suggestions for subsequent companies to conduct M&A [4]. With the deepening development of world economic integration, Chinese enterprises have increased their cross-border acquisition activities through leverage financing although they are under financial pressure. Xie used valuation pricing, dynamic risk control and other theories, from the three stages of M&A preparation, acquisitions and integration to analyze the reasons for the increase in debt and risk of Changdian Technology caused by Changdian Technology's merger and acquisition of Xingke Jinpeng. The author generalizes the conclusion obtained from this example and puts forward effective suggestions for other Chinese enterprises through leveraged buyouts [5]. Under the background of high R&D costs and high risks in the medical and health industry, overseas mergers and acquisitions have become the priority for the development of enterprises. Wang took the acquisition of LSG by Tomson Byhealth as the research object and conducted in-depth research. The author focuses on three aspects of M&A motivation, M&A process and M&A characteristic, and uses the financial index method and factor analysis method to analyze the results of M&A. Finally, the author analyzes the acquisition of Byhealth and puts forward some suggestions on transnational merger and integration [6]. Beyond that, Chen takes Geely's acquisition of Volvo as an example for in-depth analysis. The author first analyzes the economic background and discusses the different conditions of the merger and acquisition between the two companies. Then it analyzes several motives for Geely's acquisition: one is to improve market share, and the other is to acquire new technology. Finally, the author analyzes the changes in debt repayment and profit brought about by Geely's acquisition of Volvo, providing useful suggestions for other companies [7].

Choosing the right financing method provides favorable conditions for the success of a leveraged buyout. He first analyzes the reasons for the different financing methods by using the theories related to M&A financing and then specifically analyzes leveraged financing M&A and stock exchange financing M&A based on relevant cases. After analyzing the theory, the author gives examples such as BOE's acquisition of South Korea's TFT-LCD technology and combines them with practice, indicating that the enterprise qualification of both sides should be fully evaluated before the acquisition, and the failure should be avoided from multi-channel financing, and the state should fully develop intermediary agencies [8].

Gu analyzes the debt financing preference of Chinese enterprises in cross-border M&A financing and reveals the underlying reasons for the problem. The financing constraints of Chinese enterprises are one reason for the preference for debt financing. The author also proposes improvement measures

from different aspects and believes that the fundamental way to solve the problem of cross-border M&A financing is to relax the regulation of financing [9]. In the process of merger and acquisition, the company should not only focus on financing restrictions but also focus on the impact of different financing methods on the subsequent management of the enterprise. Cheng studied two typical examples of Haier Group's acquisition of General Appliances and the acquisition of Lexmark International by ApAC to analyze the impact of different financing methods on the performance and risk of enterprises overseas M&A. This article draws three conclusions: First, leveraged financing can obtain high short-term funds to actively promote M&A events; Secondly, the author finds that multiple financing methods are better than debt financing. Thirdly, enterprises can mitigate financial risks by combining various financing methods [10].

1.3. Objective

The objective of this article is to discover the motivation for enterprise mergers and acquisitions and the key points to promote the success of enterprise mergers and acquisitions. The paper also aims to discover how to solve the debt crisis caused by high leverage.

2. Analysis of the Motivations of Cross-Border Leveraged M&A

2.1. Acquire the Resources of the Acquirer to Make up for the Shortcomings of the Enterprise

Resources acquired by enterprises through M&A can be divided into tangible resources and intangible resources. From the perspective of acquiring tangible assets, if the acquirer is interested in the physical resources such as the geographical location and infrastructure of the acquirer, the acquirer will take them as its own in the way of M&A. Under the background of the late start and immature technology of China's home appliance industry, Chinese enterprises need to invest a lot of R&D and experimental expenses to compete with other countries to obtain the international market, which is not beneficial to Chinese enterprises. By acquiring Kuka Group, Midea, on the one hand, obtains Kuka Group's advanced automation technology to save time and cost of its own research and development. On the other hand, Midea has reduced the restriction of imported goods and acquired advanced technology, which has greatly improved the quality of its products. This is the reason that companies acquire intangible assets through acquisitions.

2.2. Enterprise Business Expansion

With the rapid development of the Times, some enterprises engaged in heavy industries such as the chemical industry in the past have become outdated, and it is difficult to obtain profits in the new era. Here, the company may acquire companies in other fields to acquire new development paths. Dupont, which used to make mainly chemical and textile products, transformed its business through the purchase of the plastics group and now produces new energy sources such as renewable wind power. The company's business transformation can also make up for the shortcomings of the enterprise. An enterprise's original field is not comprehensive, which will make it difficult for the company to develop sustainably. Wanda's acquisition of financial institutions made up for its own financial shortcomings, completed the transformation from heavy fixed assets to light virtual assets, and more adapted to the needs of The Times.

2.3. Improve the Market Share

Enterprises can not only eliminate competitors by acquiring them, but also occupy the market and expand their influence. The acquirer learns from others' strengths, absorbs the strengths of the

acquirer, expands the business scope, and increases the diversity of products and services. In addition, M&A provides a new way for enterprises to develop when they are faced with bottlenecks or are hindered by other companies. Expanding market share provides enterprises with more new profit growth points and reduces operational risks. However, after occupying the market, the acquirer should also focus on the product integration of the two companies, so that the products are compatible with the market, otherwise the products will be forced to withdraw from the market because they do not meet the market demand.

2.4. Guidance and Promotion of National Policies

Only internal M&A motivation of enterprises may not make M&A go successfully. M&A also needs the support of external conditions. Relevant preferential policies issued by the government are conducive to the development of M&A. In 2009, in order to promote further development of the automobile industry, the Chinese government promulgated the Automobile Industry Adjustment and Revitalization Plan to encourage mergers and acquisitions in the automobile industry. This favorable policy promotes Geely's overseas M&A, which is an indispensable key factor for Geely's success in acquiring Volvo. In addition, China has begun to implement the M&A review process of filing in advance and submitting for approval afterward, which effectively avoids bad competition within enterprises and reduces the phenomenon that enterprises miss opportunities due to too complicated application processes. Before Geely's acquisition of Volvo, China and Sweden had already performed business cooperation and had a good relationship, which laid a good foundation for Geely's subsequent acquisition of Volvo.

2.4.1. Key Points of Cross-Border M&A

Retain the independence of the acquired company. The acquirer and the acquired are two different companies, so there will be differences in numerous aspects. If the acquirer forcibly changes the internal system of the acquirer to achieve corporate integration and unification, it will make the acquisition impossible to continue or both parties suffer losses after the successful acquisition. Midea was opposed by Germany and the European Union when it tried to acquire Kuka, which has cutting-edge robotics technology and is at the heart of Germany's manufacturing strategy. Rather than take Kuka private through a forced acquisition, Midea wisely preserved Kuka's independence and respected the difference between the two companies. Midea has also developed a special plan for Kuka, so that the two companies can effectively cooperate after the acquisition. Benq Group of China's Taiwan province took over the mobile phone division of Siemens of Germany and declared bankruptcy one year after the acquisition because it did not respect the independence of the acquired company and forced changes in the internal system of Siemens. Benq did not take into account the cultural differences between China and Germany when acquiring Siemens, such as the corporate management system, business philosophy, and laws of each country. For the most typical difference in business philosophy, German enterprises pay attention to quality and operate steadily and carefully, while Chinese enterprises focus on adapting to the market and have fast production speed. That discrepancy led to BenQ's grumbling about "German speed", which caused tension between the two firms. Two different examples prove in different ways that when companies merge, it is important to have some independence between the acquirer and the acquirer.

Expand the company's financing channels. Enterprises' merger and acquisition through the method of "snake swallowing elephant" requires high leverage to achieve, and a single financing channel will produce problems such as insufficient funds or high financing risks. Diversified financing channels can make enterprises sufficient capital sources and provide favorable support for M&A. For example, when an enterprise has only a single capital provider in M&A, if the capital provider suddenly has

financial problems at a critical moment and is difficult to provide the capital needed by the enterprise, the enterprise will not have enough leverage for acquisition, thus the enterprise will miss a good development opportunity. Chinese companies typically raise money by borrowing from banks. The increase of foundations in China has also increased the number of financing channels for enterprises, and many Chinese companies have begun to use "M&A funds" for financing. Meanwhile, the emergence of new financing channels such as borrowing from foreign enterprises has weakened the financial risks faced by enterprises.

Prepare sufficient funds in advance. Chinese enterprises in numerous fields started late and lacked funds, while companies in the same fields in other developed countries had advanced technology and perfect systems. Therefore, when Chinese companies want to achieve cross-border M&A, they adopt the strategy of "swallowing the elephant with the snake" and increase the leverage of M&A through high loans to make up for the shortage of funds. However, this will lay a hidden danger for the development of enterprises after M&A, because if the debt is too high, the enterprise is likely to be difficult to pay off in the subsequent operation, and finally face the possibility of bankruptcy. Although Jifeng successfully acquired Grammer by making up for the lack of funds with various loans, it caused many financial problems. After the merger, the asset-liability ratio of Grammer was much higher than that of Jifang from 2017 to 2018, which led to a great impact on the debt-paying ability of Points after the merger and increased the difficulty of maintaining daily operations. In M&A, enterprises should not try to achieve a leap by acquiring good companies with high leverage through the method of "snake swallowing elephant". Instead, they should focus on their development and prepare sufficient funds before making acquisitions. Moderately high leverage is conducive to the success of M&A, while too high leverage is counterproductive, making it difficult for enterprises to pay off their debts after M&A.

3. Suggestion

3.1. Ways to Avoid High Debt

When enterprises acquire other large enterprises with high leverage, they usually obtain high loan amounts for financing, which lays many hidden dangers for the subsequent operation of enterprises. Therefore, how to avoid high debt has become a hot issue for Chinese enterprises in overseas M&A.

The first method is that the acquirer no longer needs to invest entirely by himself. Instead, they bring in multiple shareholders, such as the government and state-owned capital, to reduce the loan pressure. Enterprises mainly seek loans from local banks to obtain sufficient funds. However, enterprises can describe their future merger and acquisition plans and prospects for the local government before the merger and acquisition. In this way, enterprises could attract the local government to invest and participate in the merger and acquisition. The government agrees to invest in M&A, which can save the acquirer from having to bear high loans and the great pressure of follow-up operations. In addition, the government may also provide corresponding preferential policies to support the development of enterprises and correct guidance to enterprises in the follow-up operation process. This is a win-win situation-enterprises can successfully acquire and meet their own needs without taking on excessive loans, and the government can also hold certain equity to control a relatively large company to develop in a direction that is beneficial to the country.

The second method is to conduct acquisition in stages of the acquirer under appropriate circumstances to stimulate the self-driving force of the acquirer. Step-by-step M&A means that the acquirer first invests to acquire part of the acquirer to stimulate the development potential of the acquirer. After a certain amount of time, the acquirer then acquires the remaining part according to the fair value of the equity on the purchase date. The advantage of step-by-step M&A is that it is more stable, and does not need to carry high debt to operate, just because of this it effectively avoids unknown

risks and can adjust investment returns by using the difference in the valuation of the target company before and after the acquisition. Qingdao Golden King is a classic successful case of using betting provisions for acquisition. First, Qingdao Golden King invested 152 million yuan to acquire 37% of the equity of Hangzhou Youke and valued all the equity of Hangzhou Youke at 410 million yuan. Three years later, Qingdao Golden King bought the 63 percent of Hangzhou Youke that it did not already own for 680 million RMB through a combination of share issuance and cash payments. The total equity valuation of Hangzhou Youke changed from the original 410 million yuan to 1.08 billion yuan, and the 37% equity acquired in the early stage also increased from 152 million yuan to 400 million yuan due to the overall valuation. Step-by-step M&A can not only reduce the debt pressure of the acquirer but also help the acquired obtain new development space and resources because the acquirer has sufficient funds.

3.2. Integration due to Cultural Differences After M&A

In addition to summarizing the above two ways to reduce the debt burden caused by excessive leverage of enterprises. For the integration of enterprises after successful M&A. The two companies in cross-border M&A come from different countries, so conflicts caused by cultural differences are inevitable. The most typical example of failure caused by cultural differences is the merger and acquisition of Siemens by BenQ Group of China's Taiwan Province. After the acquisition of Siemens, BenQ Group imposed Chinese production and management philosophy and working system on Siemens, and Siemens suffered a significant decline in revenue and profit due to its inability to adapt to the Chinese system. Therefore, enterprises should respect the cultural differences between the two in M&A, and the acquirer should maintain the relative independence of the acquired company, and should not forcibly add the national culture to another company. Cultural integration implies risks, so only by establishing values and corporate culture suitable for both sides can new ventures achieve the effect of "1+1>2".

4. Conclusion

This article enumerates many classic cases of Chinese small and medium-sized enterprises' acquisition of large overseas enterprises, it also summarizes the four main motivations for enterprises to perform cross-border leveraged M&A, moreover analyzes the key points of successful cross-border M&A through numerous cases of cross-border M&A. At the end of the article, the author puts forward detailed suggestions for current enterprises' M&A. In the process of M&A, enterprises should maintain the relative independence of the acquirer, expand financing channels to avoid the problem of financing obstruction and prepare sufficient funds before M&A to prevent the problem of excessive debt pressure in the latter stage of operation. In order to prevent the debt crisis caused by excessive leverage, enterprises could not only bring in multiple shareholders like the government but also use the method of betting for acquisition step by step. The post-integration problems caused by cultural differences can be solved by maintaining the relative independence of the acquired party. The success of transnational mergers and acquisitions needs not only the efforts of enterprises themselves but also the support from the outside, for example, the government. After the merger and acquisition, according to the principle of synergistic effect and complementary advantages, it is necessary to maintain the independence of the acquired party while conducting reasonable integration between companies, to achieve the effect of "1+1>2". When preparing for M&A, enterprises should not only consider the problems in the M&A process but also consider whether they can accept the differences brought by the M&A.

References

- [1] Ma Yu. "snake swallow like" type of overseas M&A performance analysis [D]. Yunnan University of Finance and Economics, 2022.
- [2] Yan Ting. "snake swallow like" type enterprise m&a financial risk research [D]. Jiangxi normal university, 2021.
- [3] Lyu H X. Financing analysis of Wentai Technology's "Snake Swallowed Elephant" Merger and Acquisition of Anshi Group [D]. Hebei institute of finance, 2021.
- [4] Liu Jing. Analysis of Financial Effects, Risks and Countermeasures of Overseas M&A -- A Case study of Shuanghui International's M&A of Smithfield Company [J]. Business Economics Research, 2017, No. 726(11): 163-165.
- [5] thank should be ocean. Multinational leveraged mergers and acquisitions of financial risk analysis [D]. Suzhou university, 2019.
- [6] Wang Xi. Tomson times health overseas m&a performance study [D]. Wuhan engineering university, 2022.
- [7] Chen Xuan. Introduction to geely acquisition Volvo cars [J]. China business theory, 2020, No. 800 (01) : 134-135.
- [8] He, L. Southwestern University of Finance and Economics, (2011).
- [9] Gu L F. Debt Financing Preference and Our country Enterprise overseas Merger and Acquisition financing Way Research [D]. Nankai University, (2012). [7] Chen Xuan. Introduction to geely acquisition Volvo cars [J]. China business theory, 2020, No. 800 (01) : 134-135.
- [10] Jin-feng Cheng. The performance management of overseas mergers and acquisitions under different financing analysis [J]. Journal of accounting, 2019, No. 823 (23) : 42 to 45.