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A Study of the Determinants of the Successful Mergers and Acquisitions

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Abstract: As studies in recent Merger and acquisition (M&A) research, single determinant is preferred to be analyzed, while this report tend to divide factors into 4 determinants towards successful M&A. This report will analyze the determinants of synergy, valuation, cultural difference and policy with several actual cases to support the objectivity of the analysis. Initially, the effect of "1+1>2" is called synergy which can be split into operating synergy, management synergy and financial synergy that will enhance the coordination internally and attain extra market segments externally. Secondly, as the asymmetry of information, overestimates of valuation may generate unsuccessful M&A, for the goodwill is intangible and easy to be overvalued. Thirdly, the cultural difference in region, belief and corporate experience will impact on the M&A positively or negatively, for the uncertainty of cultural differences will increase the difficulty but also the opportunity in M&A. Lastly, different target company in different regions with different strategies might cause different results. In fact, the 4 determinants have internal relation. The enterprises used to prefer to expand the market or the scale in the industry by vertical M&A and horizonal M&A, but nowadays they tend to make a technical acquisition.

Keywords: Mergers and Acquisitions, Synergy, Valuation, Cultural Difference

1. Introduction

As a universally acknowledged method to expand the comprehensive strength of an enterprise, Merger and acquisition (M&A) are powerful patterns to achieve this target in capital market. Based on enterprises' different operating demand, M&A help the enterprise with different roles to achieve its development goals. To a great extent, the M&A is beneficial to achievement of market value management performance, and it also demonstrates the unique influence on driving the capital convergence, optimizing allocation of resources and achieving the goal of export-oriented growth. M&A has already been a common means in the business world, but how can it be more effective and successful remains to be explore.

The research of determinants of the successful M&A has been studied for a long time, but much of them tend to major in one determinant and carefully analyze the cause and effect, so it is proper to integrate the determinants in one essay. The following text content will be divided into 4 major determinants. Initially, for the determinant of synergy, vertical M&A like Suning.com Co., ltd. merged TianTian Express emphasize on the synergic effect in the view of value chain [1]. Horizonal M&A like S.F. Express merged Kerry Logistics analyze the drivers of the M&A and the result of

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synergic effect [2]. Cross-border M&A like Geely Automobile merged Volvo in the field of long-term synergic effect [3]. Furthermore, the research of the valuation occupies a large proportion. As the value of the target enterprise is easily to be overestimated due to the asymmetry of information, the overestimation led to the failure of the M&A, such as BYHEALTH merged LSG at the beginning of 2018 [4]. China Literature Limited Merged New Classics Media at the end of 2018 [5]. OIMEC merged Beijing Wanlihong Technology Co. Ltd. in 2021, so the financial risks and control deficiencies matter [6, 7]. On top of that, cultural difference will be a crucial determinant in M&A, for it can affect the results both positively and negatively according to the methods [8]. If improper method imply the M&A would be suffering like the case that Midea Group merged Wuxi Little Swan Company [9]. By contrast, in proper methods after the lesson of failure, Midea Group also merged KUKA successfully after considering the cultural differences [10]. Geely successfully merged Volvo in the aspect of corporate culture integration [11]. Additionally, distinct policies used in M&A have brought about different outcomes like CITIC securities intended to merge GF securities and GZ securities respectively which generated different consequences [12].

2. Synergy

The effect of synergy is the most important determinants among all factors contributing to the successful M&A, which will have an effect of “1+1>2”, leading to more competitive operating and financial capacities.

Synergy can be divided into 3 categories – operating synergy, management synergy and financial synergy. Operating synergy means the optimize integration of the company’s internal resources, improving the efficiency of productivity, thus occupying the brand advantage and enlarging the market share. Management synergy stands for optimizing the configuration and regroup those resources, by improving the operating ability and reducing expenses to reach the noticeable promotion of the management efficiency. Financial synergy represents affectively reallocate the financial resources, including complement internal financial capital, acquire funding advantages and enhance the ability to raise funds, to construct a better circulation of funds, lower the cost of capital and financial risks.

Among one supply chain, M&A would be happened not only acquisition of competitive industry or substitutes, but also their suppliers and customers, according to this M&A can be sorted into vertical M&A and horizonal M&A. According to the research of Lin Han, a classical vertical case of vertical M&A is TianTian Express was merged by Suning.com Co., ltd., while the former is in the downstream express industry and the latter is an excellent comprehensive sellers in China. Firstly, the operating synergy effects in this M&A exists, as the internet economy prevails, it is not a good choice for company to only sell products in retails, the new retail sector performance continues to decline, Suning.com Co., ltd. stepped off a cross-border merger to form downstream integration. During 2013-2016, TianTian Express took a seat among the excellent private express industry except for the five biggest delivery companies in China, and it is equipped with enormous scale, if being merged, Suning.com Co., ltd. will expand the business to the whole society, reaching noticeable improvement of delivery capacity. After the M&A, the Suning.com Co., ltd. realized the combination of online and offline, protecting the profit from fewer shocks of the internet economy trend. Secondly, as various indicators generally climbed up between 2016 and 2018, the debt was stably operated, this can be supposed by quick ratio increased from 0.77 to 1.17, for its satisfactory asset liquidity and the stable long term solvency capacity. The operating capacity and development capacity both shoot up for the inventory turnover, trade receivable turnover, total asset turnover, operating income growth rate, net profit growth rate and total asset growth rate all ascended noticeably. Last but not the least, the M&A is not simply aggregate the resources together, but the deep integration of business and

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management. The offline enterprises acquire the logistics enterprises built the all-platform development, laying a solid foundation in the industry [1].

As for the M&A can happen in the same industry, Kerry Logistics Network Limited was acquired by the S.F. Express Company in 2021, while the former has Asia's strongest network of international third-party logistics services providers and the latter is the domestic leading express logistics integrated service providers. As the government think highly of the development of cross-border logistics by emphasizing on the construction of international and domestic logistics channel, and Kerry Logistics being a competitive international logistics service provider, S.F. Express will direct access to the international market, seizing market share. Based on the research of Yiyun Zhang and Yang Wang in 2023, the customer basis of Kerry Logistics mainly specialized in high-end brands, it matches the target customers that S.F. Express wants to have, further enhancing the ability of integrated logistics solutions and improving the strategic layout of freight forwarding and international business. After the M&A, the operating cash flow per share drastically increased, from 0.67 in 2021 to 1.68 at the end of 2022, much higher than the YuanTong Express of 2.15 during the same period. This financial synergy may attribute to making better use of idle funds for research and development and investment. Nevertheless, as the revenue, net profit, net cash flow from operating activities and gross profit increased 29%, 45%,113% and 30.35% respectively, resulting better profitability and operating synergy after the M&A. The acquisition opened up the Southeast Asian market and international business, simultaneously supply chain business revenue growth has been significant, exerting brilliant synergetic effect [2].

When it comes to long-term synergetic effect in horizonal M&A, Geely Automobile Holdings merging Volvo Car AB will be an excellent example, it is a case of a snake swallowing an elephant, the huge gap in brand position between the two led many to underestimate the merger, but it actually has a clear upward trend in sales in 13 years. Geely Auto, as one of the fastest growing enterprises in China for 50 years, gained market share swiftly at a low price at first, while Volvo Car, being honored as the safest car in the world, is in the first echelon in both brand value and technical content. On the basis of the research of Baixiang Wang, the core purpose of the M&A is acquiring the technical resources of Volvo Car and improving the enterprise's technical capacity and innovation capacity. Although the problem of slow product switching, the strategic transition hitting a snag and exports suffered, the capacity of profitability and development still has a bright future. Additionally, by managing, coordinating and controlling the resources, the operating capacity rising markedly and the growth rate of cost-expense level was much lower than that of the net profit's which means the operating efficiency and management efficiency had both improved. On top of that, the improvement of financing capability, the enhancement of financing channels and sufficient cashflow supporting the financing synergy of the enterprise [3].

To sum up, the effect of synergy plays an important role in M&A, for one thing, for the vertical M&A not only can it reduce the transition of products to save cost, but also enhance the coordination during production and reducing the marketing expenses. For another thing, for the horizonal M&A, it can tap a new market as well as attain economy of scale.

3. Valuation

Valuation is an essential determinant in M&A, but as the asymmetry of information, the parties to a merger and acquisition are likely to value the same asset very differently, the acquiring companies worry about buying too high, while target companies worry about selling too low, generating contradictions. If overpaying during M&A, the financial risk of the enterprise will be dramatically increased [7].

Under normal circumstances, the acquiree's valuation is usually high in the merger. In line with Jinyi Zhu's research, it is astonishing when Life-Space Group Pty Ltd. (LSG) was merged by

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Australia By Saint Pty Ltd, a subsidiary of BYHEALTH, on January 31th, 2018, the consideration was nearly 3.4 billion yuan, this figure far exceeds the company's equity premium of nearly 33 times (101.5 million yuan), forming part of the premium recognized 2.165 billion yuan of goodwill and 1.379 billion yuan of intangible assets. Unfortunately, in subsequent years, the impairment of goodwill and intangible asset drastically cut half down. Although the revenue of the parent company is increasing 20.94%, the huge deduction in goodwill and intangible asset made the total net profit below 0, which is a financial catastrophe. The improper selection of valuation methods (based on income method and market method) leads to the unsatisfactory control effect of valuation risk and the lack of control effect of exchange rate risk, resulting in the goodwill impairment, which indicating that goodwill is overrated in overseas M&A, for if the future performance do not hit the target, the goodwill will be impaired, impacting the profitability as a whole [4].

On October 31th, 2018, China Literature Limited acquire New Classics Media for 15.5 billion according to the study of Ye [5]. Faced with such huge merger premium, two parties chose to form a wager agreement to restrict the minimum level of net profit of acquiree. If not meet, the compensation will be interfered. Unfortunately, for the subsequent 2 years, there is an 176 million and 151 million gap respectively between expected and actual net profit, triggering the wager agreement. Firstly, for the impact of gambling on performance path, the valuation of New Classics Media calculated by China Literature Limited was inappropriate, the indicators in the agreement are deficient in flexibility, thus the synergetic effect and the incentive effect are not generated. In addition, the wager agreement lacks preventing the risk of impairment of goodwill, while during the period there was a huge goodwill write-off. On top of that, the declaration of the wager agreement, profit warning of New Classics Media and the modification of the agreement all presented negative market reaction. Furthermore, the financial indicators after M&A all showed negative reaction [5].

On February 24th, 2021, Beijing Oriental Jicheng Co., Ltd.(OIMEC) merger Beijing Wanlihong Technology Co. , Ltd. for 3.8 billion yuan, 153.64% of its net asset value in accord with Jia's study in 2023 [6]. As the acquiree possesses a good brand reputation and stable customer base, the valuation used income method and the market method for comparative evaluation, in terms of assuming the high-tech enterprise still enjoying preferential policies and information security market will gradually exaggerate. In order to protect the interests of the acquirer, the two parties entered into a performance commitment to restrict the minimum threshold of net profit, but the commitment was stimulated though, the valuation was overestimated [6].

To sum up, the asymmetry of information and the impropriate evaluation method will cause the deviation between the real figure and the valuation results. Usually, the expected value will surpass the actual one, for the goodwill is intangible and difficult to estimate. Thus, ridiculous wrong valuation will lead to the high risk of the enterprises, valuation is also a significant determinant of M&A.

4. Cultural Difference

There is no denying that cultural difference has an essential effect of M&A, both positively and negatively. For one thing, as the difference in distance, belief and experience contributes to enhance the opportunity of mutual learning, improving the performance. If the complement in each other's advantages is realized, the diversity and the heterogeneity will benefit the companies, fortifying the effect of synergy. For another thing, the cultural distance may negatively hinder the understanding of core competitiveness, slowing the adaptation to the environment, which will reduce the efficiency of M&A parties to reach an agreement [8].

In 2019, Wuxi Little Swan Company Limited was officially merged by Midea Group Co., Ltd., during a long period of M&A. According to the research in 2018 of Siyuan Wang, before it was acquired, the challenge of integrate the culture between the two arouse attention. As Midea developed

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in the early market in Guangdong region, employee efficiency and contribution are attached great importance to its value. The emphasis on competition stimulated the sense of urgency and the feeling of pressure. However, Wuxi Little Swan located in the southern area of Jiangsu has a strong background and philosophy of state-owned enterprises, paying more attention to employees' sense of belongings. Moreover, the adjustment on institutional framework, leading personnel as well as rules and regulations made the acquiree company think the acquiring company is cleaning up his enemies, thus resulting the high quit rate. On top of that, for Wuxi Little Swan used to be state-owned, staff are used to a relatively fixed pattern, which increased the difficulty of change management. Although the synergetic effect was attained consequently, the process was incontrovertible suffering [9].

At the end of 2016, Midea Group Co., Ltd. also completed the M&A of KUKA. Based on Yaxing Cai's literature in 2023, as a cross-border M&A, the culture difference in China and Germany cause difficulty in transaction. Furthermore, Midea is a typical home appliance manufacturing enterprise whose products has low technical content and weak self-innovation, while as a company with high technology, KUKA has a complete product production chain and advanced industrial production automation technology. Yet, the M&A is conducive to the improvement of technological innovation ability on the whole. Typically, KUKA think highly of the intellectual property awareness and the uniqueness of brand position while Media not. When facing this huge difference between them, Media chose to maintain the independent brand status and signed the quarantine protocol, separating the information collection section. In addition, Media also respects KUKA's own administrative decisions and R&D input activities [10].

When it comes to the enterprises in the same industry but in different markets, according to the literature of Chao Liu et al., Geely Automobile Holdings merging Volvo Car AB will also arouse attention. Geely, as an old Chinese private automobile enterprise, initially implemented a low-price strategy to occupy the low-end market, lasting a profound impression in people. Whereas, Volvo is a luxury car brand in Sweden at opposite pole. Situated in different national cultural environments, the power distance, collectivism/individualism, uncertainty avoidance, short-term/long-term orientation and masculinity/femininity are quite different. And the enterprise culture in history development, market positioning and product orientation have discrepancy. According to related research if management grid theory, under the orientalism Geely emphasizes on contribution and exact demands, while Volvo used to be operated under Ford, deeply influenced by Western culture. There is a clear boundary between staff's work and lives and keep a watchful eye on the quality of life, pursuing personal value. Fortunately, Geely's management of Volvo is not a dingle control and repression, but retain autonomy in handling internal affairs. Additionally, not only they established a cooperative committee to communicate and share resources, but also hire a professional cultural integration team to train staff. The M&A make Gelly got rid of low-end image quickly and broke through key technical limitations, expanding domestic market share. On top of that, Volvo successfully achieved brand premium and laid a solid foundation of introducing Geely cars to international market [11].

To sum up, the cultural difference is vital in M&A, the acquisition in different regions as well as the differences in their own corporate culture increase the difficulty but also the opportunity in M&A.

5. Policy

The policy and attitude of the acquiring enterprise is also a crucial factor. For different target company in different regions with different strategies, the results may be different. In light of the literature of Song Gao in 2022, CITIC securities, as the largest enterprise in the securities industry, is seeking for mergers to fortify its leading status. Nearly 20 years ago, CITIC securities intended to merge GF securities mightily, but as the scale of GF was resemble to that of CITIC at that time and the consideration did not satisfy them, the internal staff including the management were unwilling to accept the occupational risks of integration, they unite the existing major shareholders to execute an

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anti-takeover strategy, result in the failure of the merger. However, after more than a decade, CITIC chose to merge an enterprise whose scale was much smaller called GZ securities, and the aim of this time is more concentrated and definitely, with a commitment to absorb all employees, CITIC merged GZ successfully [12]. For a competitor of comparable size, the mighty policy might stimulate the dissatisfaction of the target company. By contrast, to merge a smaller enterprise with mild method is easier to succeed.

6. Conclusion

In conclusion, the four determinants including synergy, valuation, cultural difference and policy contribute to the most effective factors for a successful M&A. The determinants meaning that the deviation in the condition during the M&A, the ultimate consequence will be different though. Initially, the successful M&A rely on the accuracy of the valuation, for the overestimates of acquiree's authentic value may result in high risks for the both. Subsequently in the acquisition process, whether the synergic effect would be realized plays a vital role in M&A, and this will also be a significant motive to the M&A. Additionally, to integrate resources in different culture can be challenging and different policies to acquire will cause different outcomes. Those four factors above lay the solid foundation to a successful M&A. There are still some other determinants that will influence the outcomes like preferential legal policies, stakeholders' comments, cashflow and so on.

In fact, M&A has been an extremely important means of enterprise expansion, and this method is an essential decision-making fashion for the preceding determinants and for other elements. The enterprises used to prefer to expand the market or the scale in the industry by vertical M&A and horizonal M&A, but nowadays they tend to make a technical acquisition. After absorbing and transforming them into internal skills, the efficiency of work might be doubled. No matter what kind of acquisition, various determinants push the enterprises considering their own positions with manifold factors to achieve the desired effect of M&A, the technical acquisition will be a trend.

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