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The Role of Government in Cross-border Acquisition

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Abstract: So far, cross-border mergers and acquisitions is still working as one of the key motivates of globalization whether the economy is booming or not. As the economy connection among countries becomes stronger, governments tend to strengthen their control of international cooperation, which lead to the intervention actives. The article mainly talks about the role of government plays in cross-border mergers and acquisitions. Case study is used to help the illustration. It first introduces the global environment and background of cross-border M&A. After that, it analyses around the systems and regulations of China, and then use the failed case of Chinalco as an example to do the further analysis. At last, political bias is found to be the key influencing the degree of government intervention. To face with the problems, some solutions are discussed, such as emphasising market attributes instead of state-owned attributes, improving relevant systems, as well as doing a more perfect preparation.

Keywords: government intervention, politics bias, mergers and acquisitions

1. Introduction

Through the research on the development process of the market economy in developed countries, it is proved that the transnational merger and acquisition cannot be separated from the intervention of the government and the support of relevant national policies. In fact, since the financial crisis, countries around the world have begun to tighten regulation while continuing to liberalize. By mastering the degree of policy tightness, the government regulates the scale of M&A activities, and with the help of specific policy, the actions of government affect the capital flow of cross-border acquisitions and how much the banks and other financial institutions support [1]. Back to 2021, AstraZeneca, the British pharmaceutical giant, announced an agreement to buy Alexion Pharmaceuticals of the United States for a total consideration of $39 billion. The shareholders of Alexion will own about 15 percent of the combined company. As the UK has relatively complete regulations on cross-border mergers and acquisitions, and any merger connected with British companies must be reported to the British government for security review in advance and the UK regulates cross-border mergers through The Office of Fair Trading, the Competition Commission and relevant industry bodies, therefore, although the boards of directors of both companies have approved the transaction, for the legitimacy of the acquisition process, the acquisition will officially start only after the regulatory approvals, which shows that the government plays a certain role in the acquisition process.

2. Current Regulations in China

2.1. The Background of China's Enactment of Relevant Legislation

Different from developed Western countries, China’s contemporary economic and policy environment highlights that political factors importantly implicate the character of the cross-border acquisition activities of Chinese acquirers [2]. So far, China's national political power structure is based on the "6+1+2" system with the Central Committee of the Communist Party of China as the core, the power is relatively centralized, government intervention in the economy has been written into the law since 1980s and 1990s. As a result, cases of government intervention in cross-border acquisition are common.

The basic financial regulatory system in China is now called "One line, three meetings" regulatory system. It is generally consisted by four parts, which are the People's Bank of China; the China Banking Regulatory Commission; the China Securities Regulatory Commission and the China Insurance Regulatory Commission, embodying the strict separation of supervision mode. Among them, the PBC occupies the core position and is the highest competent authority of the financial industry in the country, which performs some state functions, while the other three supervise banking, securities and insurance institutions and the market respectively.

2.2. Sorting of Current Legislative Documents

Since 1980s, China has gained large amount of capital inflows from foreign direct investment and the trend remains until now [3]. Peng pointed out that national regulations of China have given more freedom to cross-border Mergers and Acquisitions, which is also a kind of encouragement to it [4]. For instance, in 2021, the transaction activity in the M&A market of Chinese enterprises increased, and the transaction size increased slightly. In 2021, there were 7,493 M&A transactions disclosed, up 12.36% year-on-year; There were 5,545 deals with a total value of $415.323 billion, up 1.19% from a year earlier. Nowadays, the upsurge of transnational merger and acquisition will be more and more intense in the global economic integration. Meanwhile, a series of anti-monopoly problems caused by the cross-border behaviour will be more. It surely can bring advanced technology, management experience, capital, and so on, which can promote the development of Chinese market economy. However, this may also damage the order of Chinese market competition. To fix this, Anti-monopoly Law of the People's Republic of China was set up in 2007. The State Council establish an anti-monopoly Commission as well to do organizing and coordinating work. In 2009, Provisions on the acquisition of domestic enterprises by foreign investors was carried out, clarifying that foreign investors shall abide by Chinese laws, administrative regulations and rules when they acquire Chinese enterprises. Besides, all parties involved in the cross-border merger and acquisition shall pay taxes according to the provisions of the Chinese tax law and accept the supervision of the tax authorities.

3. Practical Problems: Based on the Case Analysis

Using Chinalco, who got involved in the merger of the two companies, resulting in a loss of $8 billion, as a negative example. On 1 February, 2008, Chinalco suddenly intervened in the merger between BHP Billiton and Rio Tinto, announcing that it had acquired 12% of the existing shares of Rio Tinto's UK-listed company through a new wholly-owned subsidiary and Alcoa. The purchase price is about 60 pounds per share, with a total consideration of $14.05 billion, making it the largest overseas investment by a Chinese company in history. As a result, Chinalco became Rio's largest single shareholder. At that price, BHP would have had to raise its offer price to at least one for every four shares to match Chinalco's offer. In the months that followed, market conditions deteriorated and the financial risks and cost burden were so serious that BHP Billiton announced it was abandoning its bid for

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Rio Tinto. On news of the merger's failure, Rio's share price fell to as low as 15 pounds per share. That is a drop of 75%, from Chinalco's purchase price of 60 pounds per share, leaving the company with a loss of more than $8 billion.

The whole process of Chinalco's merger and acquisition of Rio Tinto has so far gone through three stages: initial capital injection, re-acquisition and participation in rights issue.

3.1. Three Stages of the Process

The first stage is from February 2008 to February 2009, Chinalco and Alcoa paid $14bn for 12% of UK-listed ordinary shares. Chinalco's stake in Rio is about 9% of Rio's total.

Then in February 2008, at the peak of the market, Chinalco and Alcoa paid 14.05 billion dollars to acquire 12% of the ordinary shares of Rio Tinto UK at a price of 59 British pounds per share, and held 9.3% of Rio Tinto Group to become its single largest shareholder. Alcoa contributed $1.2 billion of that in the form of bonds from Chinalco's Singapore company, while Chinalco contributed the remaining $12.85 billion. After the global financial crisis, Chinalco had lost more than 70% of its initial investment by February 2009. At the same time, Chinalco began its second stage of capital injection. On 12th February, 2009, Chinalco and Rio Tinto Group reached an agreement on a strategic cooperation, and Chinalco initiatively invested 19.5 billion US dollars to make its shareholding in Rio Tinto Group more, from the current 9.3% to about 18%, approximately doubled. What would have been China's largest overseas investment deal to date collapsed on June 5, 2009, when Rio unilaterally withdrew its agreement to inject a second capital from Chinalco. Following the terms of the agreement, Rio would only have to pay Chinalco a $195 million break fee.

After Chinalco's second failed capital injection, the whole deal was not over. The third stage involved Chinalco's participation in Rio's $15.2bn rights issue. On a rough estimate, Chinalco had invested nearly $1.5 billion by July 1, 2009, in full exercise of its rights to buy new shares in Rio Tinto to maintain its existing stake and reduce the cost of its previous hefty investment. Based on Rio's UK closing price of 21.7 per share, Chinalco still had a loss of nearly $9 billion.

3.2. The Problems

From the failure of Chinalco, it can be seen that due to the different political systems between China and the West, unavoidable political factors became blocks. The lack of political considerations, Chinalco bought the company so directly that they forget the Australian public, who worried about Chinese control of Australian mining. Cross-border mergers and acquisitions involving state-owned enterprises are subject to interference from government agencies in Australia, which will not approve the acquisition on the excuse of national security concerns. In this case, Australia's Investment Review Board extended its review period by 90 days, allowing Rio to wait until metals markets recovered and then shareholders rejected the takeover.

Through large amount of specific research and analysis, Rowoldt and Starke [5] clarified that government opposition was the clear determinant of the tender's failure. In addition, they found that the size of the deal have positive impact on active government intervention. By analyzing the case, it can be found that the essential of government intervention is economic nationalism, which refers to an inevitable result of the political independence when a country is in the development stage. It is “a set of policies that emphasize domestic economic activity and the unity of national interests” [6], as the result of globalization, similar to mercantilism, in the form of government policies to erect trade barriers against imports and impose various protectionist policies to protect its domestic industries. There are several ways to implement economic nationalism in M&A actives [7]. The Government may intervene using the measure of delaying the time with the excuse of non-compliance with certain formalities or administrative requirements instead of releasing claims directly, just like what Australia had done in the case. Above support the opinion that government involvement follows nationalism motives to adjust their behaviour [5].

4. Suggestions for Institutional Development

Government intervention has a positive impact on SOEs' CBM &A. However, if government involves too much, the beneficial effects will be weaken, and even get an opposite outcome [8]. The failure of Chinalco's takeover of Rio Tinto is a painful lesson for Chinalco. Once the merger is successfully implemented, it would have extremely important strategic significance for the internationalization and diversification of Chinalco, and become a big step of turning into a world brand. As a result, summing up experience and lessons will not only have positive meaning for the possible M&A of Chinalco in the future development, but also become important reference for the success of other Chinese enterprises in cross-border M&A in the future.

4.1. Dilute State-owned Attributes and Highlight Market Attributes

First of all, dilute state-owned attributes and highlight market attributes is necessarily. Although the reform and opening-up policy has been conducted for over 40 years, the economic system of our country is still at the stage of transformation from planned economy to market economy, in comparison to those developed countries, China's economic has strong dependence on policies, and majority of large enterprises in China are state-owned property, basically it for the European and American countries take the market as the guide, government's over- intervention can easily lead to bias, which is not conducive to cross-border mergers and acquisitions. In comparison, Europe has caught up with the trends as well. The ownership structure of continental European companies have the feature of a high degree of concentration and a predominance of cross-holdings. Thus, the European market for corporate control has a low level of activity and is lack of hostile takeovers [9].

Therefore, as a Chinese state-owned enterprise which tend to be internationalization, in the process of acquisition, the micro market status of enterprises should be highlighted, and the profit as the purpose, the maximization of shareholders' interests as the foothold, and the market attributes of enterprises should be displayed. Considering other factors of government involvement, the decentralization at central and local levels in China and that between state-owned and local governments and SOEs attached to them, has changed the way of interaction and communication between the two sides. "Depoliticization" and "deadministration" will truly eliminate the ultimate control of the government over enterprises. The theory of ultimate control rights suggests that at the appropriate time of political reform, the ultimate control rights of the government over enterprises should be transferred by means of privatization, and the political control of the government over enterprises should be reduced and finally eliminated by means of depoliticization and deregulation. From the theory of ultimate control rights to promote the transformation of government functions. Future research needs to deeply explore the mechanism, path and transmission mechanism of the influence of the shareholding structure of government holding on enterprise mergers and acquisitions, break the limitation of government intervention in enterprise mergers and acquisitions, and propose effective solutions to reduce the ultimate control of the government over enterprises.

4.2. Adjust and Establish Appropriate Related Systems

It is known that the government usually intervenes the final decision of enterprises to adjust to various social, political, and environmental agendas. The Chinese government's policies and regulations on foreign investments are included with no doubt, which greatly impact the cross-border M&A activities in China [10]. Since the overseas investment of state-owned enterprises is difficult to avoid political risks, freeing up the administrative approval of domestic mergers and acquisitions and allowing

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dynamic market enterprises to carry out mergers and acquisitions overseas is a feasible choice to avoid the rock of politics. For example, the government should encourage private enterprises and small and medium-sized enterprises to invest abroad.

Establish an economic regulation system suitable for enterprises. Drawing lessons from the new trend of regulation in western countries, while loosing the traditional administrative regulation, the introduction of economic regulation adapted to the requirements of the market economy of our country, let the government and the market in their respective positions and their respective roles.

In the meantime, efforts should be made to create an external environment conducive to Chinese enterprises' cross-border mergers and acquisitions. First of all, accelerate the step of promoting policies and service systems for outbound investment, and establish related financial and information service platforms. Secondly, accelerate the legislative work on transnational merger and acquisition, formulate and perfect the laws on it as soon as possible, formulate the applicable operation methods and procedures as well. Thirdly, market intermediaries such as investment banks, accounting firms and law firms related to cross-border mergers and acquisitions should be vigorously developed, and a comprehensive one-stop service platform should be established to provide overseas investment services covering the whole process at home and abroad.

4.3. Make Sufficient Comprehensive Preparation Before Cooperation

Rio Tinto has the opportunity to default, an important reason is the Australian government review period extended. To prevent similar situation, more accurate assessment to the political risks of investing in Western countries is indispensable. Second, it is still necessary to implement countercyclical strategies, because the host government and the private sector are less resistant during the downturn.

Apart of that, the low liquidated damages agreement gave Rio the chance to default, and it was ill-prepared for Chinalco to follow its rival BHP Billiton, which cost Chinalco an opportunity to go abroad. Transnational acquisition can be said to be an extremely complex system engineering, the acquisition company needs to make a comprehensive estimate of the target company, competitors, changes in the economic environment and other aspects, so as to determine the most favorable conditions for enterprise acquisition.

5. Conclusion

This article mainly introduced the role of the government in the cross-border M&A. With the background of globalization and the prospective of market economy, cooperation of companies among countries become a trend. Meanwhile, to protect local enterprises and country safety, government intervene and conduct series regulations.

In the third part, through the case of Chinalco acquisition, first the whole process of the case is introduced from the hopeful beginning to the failure. Then the article analyzes the specific problems which lead to the outcome. The main problem is the over intervene based on the political bias.

Several suggestions are given in the last part, which are: dilute state-owned attributes and highlight market attributes, adjust and establish appropriate related systems and make sufficient comprehensive preparation before cooperation.

Based on the analysis, more complete regulations can be put into effect, and better M&A measures can be conducted even in different economy and politics environment. Overseas key industries and high-quality enterprises will not allow other countries to get involved easily, to face it, Chinese enterprises should be cautious in overseas mergers and acquisitions and capital injections.

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