Path of Chinese Cross Border Merges and Acquisition: Past, Present, and the Future

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Abstract: The cross-borer merges and acquisition came a long way in China and has experienced a significant growth in the past few decades, while at the same time encountering several problems that impede the further success of merges and acquisition with foreign companies, including lack of regulations and transparency, the blurry line between government intervention and company corporate system, and the difficulty of dealing with growing vigilance of foreign companies and countries which are gradually limiting trades with Chinese firms. The cross-borer merges and acquisition system in China is waiting for future reforms. This paper aims to investigate the cross-border merges and acquisition situation in the current Chinese market. Meanwhile, it also manages to provide several suggestions about how to give rebirth to the current cross border merges and acquisition market in China, including reducing the multiple stages required for examination and approval procedures, and adjusting relationship between the government and companies.

Keywords: cross-border merges and acquisition, Reform and Opening-Up policy, national strategy

1. Introduction

The economy in China has developed in a pace faster than expected in the past few decades, carried out by the policy of Reform and Opening-Up under the direction of Deng Xiaoping. Cross border merges and acquisition has introduced active inflow and outflow of finance across the border of China, and therefore played as one of the most important role sin the opening of the markets of China. In the 1990s, when the Chinese market is relatively shallow, the government exchanged the access to China's market for technologies from foreign countries and permitted state-owned enterprises to purchase equity stakes abroad, specialized in energy and production of natural resources. Then as the market grows steadily in the following years, Chinese government enlarged its scope of merges and acquisition the the branch of cross border M&A extended to more powerful countries and industries, including raw materials, energy and power engine. Although the cross-border merges and acquisition in China grew with a surprising speed, there still exist certain problems in the current merges and acquisition system: Chinese companies have difficulty adjusting to the current market of cross border acquisition, and as China faced more restrictions from other countries in different industries, it becomes an important question for China, that how to cope with the demand of growth of the industry while at the same time bypass the dilemma posted by other countries.

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2. Development of Chinese Merges and Acquisition Market

2.1. Under the Reform and Opening-up Policy

The development of Cross border merges and acquisition was not an easy path, and experienced a high and tough growth within decades. Such growth can be categorized into four periods. The very first period extends from 1984-2001, start from the Reform and Opening-up policy, when China began to gradually transform from planned economy to market economy. In this period, the cross border merges and acquisition in China occupies merely 1% of the total value of worldwide merges and acquisition, and did not experience a significant growth over these ten years [1]. In 2001, however, as China joined in the World Trade Organization (WTO), China developed a closer relationship with international markets and accelerated its cross-border acquisition. Many important and significant cross-border acquisition occurred during this period, including the acquisition of IBM by Beijing-based Lenovo Group in a $1.75 bn deal, which eventually pushed Lenovo to the world's third largest PC maker [2]. Although many successful merges and acquisition occurred during this periods and brought development to the Chinese market, many failures occurred at the same time, and the cross border M&A market faced both opportunities and challenges in the beginning of 21 century. For example, in 2003, TCL, the largest maker in color televisions and the second producer in mobile telephones industry n Chinese market, began to expand its international market and started to promote its brand in 2000. In 2004 January, Tcl proposed a $560 million deal to merge with Thomson in France. Holding a 67% equity stake, TCL-Thomson went into operation in that year [3]. However, risks were exposed when TCL refused to hire M&A experts to execute dual diligence, while at the same time Li Dongsheng, the chairperson of TCL, chose to ignore the warnings. The merges did not continue successfully, and TCL suffered a combined loss of 5.07 billion RMB in 2005 and 2006 [3]. By 2007, TCL had to shut down five of the seven European centers and terminated large number of employees. The merges of TCL with France's Thomson was a huge failure and a crash on Chinese M&A market, since it exposes one of the biggest problem of M&A in Chinese market at that time, that Chinese companies fail to evaluate and check the financial performance of their target company carefully before the merge starts, and fail to distinguish that the brand Thomson was actually already old and tired in both European and the US market. This also exposes that the M&A market in China at that time was too eager to connect with international markets and companies, which eventually resulted in greater loss in the market, even though the number of cases of merges and acquisition grew steadily.

2.2. Further Challenges

Then as the financial crisis crushed the global market in 2007, especially the US and the European market, more opportunities were opened to Chinese companies in cross-border acquisition market: international companies were on the verge of bankruptcy and were thus eager to sell themselves, which meets the demands of Chinese companies. As regulations start to be loosened, cross border M&A grew at an astounding speed, reaching 29,825 million RMB in 2011, which almost doubled the number in 2007.

The Merges and Acquisition market continues to grow after 2007 and experienced more advanced development until today. Stricter regulations and laws were introduced by Chinese Central Bank, State-owned Assets Supervision and Administration Commission of the State Council (SASAC) and the Ministry of Commerce in Beijing, introducing further rules on cross-border investment and merges, and more scrutiny was focused on sensitive industries and countries, investment amount over 3 hundred million dollar. Since then, the cross border merges and acquisition system continues to grow, with Ministry of Commerce (MOFCOM) being the main authority responsible for regulation and approving, while the SASAC, The State Administration of Taxation (SAT), the State Administration of industry and Commerce (SAIC), the China Securities Regulatory Commission (CSRC) and the State Administration of Foreign Exchange (SAFE) being collectively responsible authors of M&A rules in China.

The Belt and Road Initiative was established in 2013 to encourage China's economic cooperation with more international markets in Europe, Asia, as well as Africa. The New Maritime Silk Road, one of the two roads in the Belt and Road Initiative, eventually stretches to Europe and East Africa through the South China Sea and the Indian Ocean, and again via the South China Sea it manages to reach South Pacific. The Silk Road Economic Belt, on the other hands, connected China with the Persian Gulf and the Mediterranean Sea by connecting across Central and West Asia [5]. Over 4 billion of people and more than 60 countries were connected by the Belt and Road Initiative and provided a huge opportunity for the cross-border merges and acquisition to boost in Chinese market: one of the most important goals of the Belt and Road Initiative was to importance infra-structure in countries to promote China's outwards foreign direct investment to the nations included in the Belt and Road Initiative. The Belt and Road Plan has brought significant growth in certain industries, with certain improvements in ownership of government [4]. Companies that are intervened by or cooperate with the government has experienced significant growth during this period.

The development of cross border merges and acquisitor in China, in all, was a collectively result of both the efforts of the government and the companies. The government played a vital role by issuing policies promoting cross border acquisitions to attract the inflow of finance, while at the same time fixing existing regulations and laws to ensure that as the market grows, companies will be further regulated and each transactions were closely scrutinized. Such development, on the other hand, was also a result of companies in China, which aimed to take the advantage of policies in order to expand their market and competitiveness. Although they faced large amount of challenges and failures and even the market today is not yet mature, companies still managed to play as one of the major driving forces in the market.

3. Current Cross-border Acquisition System in China

3.1. Increasing Challenges

In 2021, China managed to reach a new peak with 12,790 deals closed, and "up 21 percent from the previous year, though deal prices declined 19 percent to US$637 billion [5]." However, the Chinese market is still experiencing challenges, which on the other hand is also opportunities, which indicates further reforms in the cross border M&A system. China is experiencing post-pandemic effects, which are eventually a jet-lagged effect resulted from the closing during COVID-19 pandemic, and rising geopolitical tensions, including the Russia-Ukrain conflict, and higher interest rate, are also contributing to a slowdown in market transaction.

3.2. Growing Restriction from Foreign Countries

Another problem that the Chinese companies are facing is the growing speculation and restriction imposed by foreign countries. The pandemic has eventually encouraged most of the countries to lighten the Foreign Direct Investment policy, to prevent domestic companies being acquired at low price. As China encourages cross border merges on technology and skills, western countries, especially the US, are becoming more wary about merges and acquisition by Chinese companies on sensitive industries, including Artificial Intelligence, data and semiconductors [6]. The US has shown a special trend of blocking merges and acquisition by state-owned Chinese companies and most of the cases scrutinized by CFIUS are related to China, regardless whether the company itself is based in China or not. The unique relationship between Chinese companies and Chinese government and the unique power owned by the Chinese government in such cross-border transaction are gradually becoming one of the major hinders — foreign companies gain private benefits through merges while China acquires public, or state, benefits through cross-border merges.

Such unique characteristic of Chinese merges and acquisition system can impose significant impact on the choices of the companies. Under the influence and the impacts of Chinese government and party, whether implicitly or explicitly, Chinese private companies would therefore prefer to listen to the message of central government, which will provide a clearer direction about where subsidies, supports and opportunities for profit would flow to. Therefore, the controlling power of the Chinese government, as well as the tendency of following the direction and need of the central government by the companies, would add power to each other and thus turn private benefits to public interests.

Due to such national security concern, there has been legislative proposals to reform the CFIUS, Committee on Foreign Investments in the United States. The proposal focuses primarily on expanding the range of transactions that are covered by the screening mechanism, including joint ventures and other structures in order to eliminate the risk of extracting sensitive data and technology by the acquirer [7]. The current CFIUS regime is government under the Foreign Investment and National Security Act of 2007 (FINSA) and came into effect in 2008. The investigation of CFIUS would usually take three stages: a 30-day nationals security review will determine whether the transaction would impair national security, and if yes the investigation would move to the second stage, a 45 day investigation. If the concerns are still not resolved, a negative proposal would be sent to the president by the CFIUS, and the president is granted with the power to make a final decision within 15 days [7]. Few transactions in history have been blocked under the process, but such screening and blockage of transaction are accelerating nowadays. The acqquisition of Qualcomm by Braodcom, a company based mainly in Singapore, was blocked by the CFIUS and the president in 2018, with the reason of "leave an opening for China to expand its influence on the 5F standard setting process [8]." There have also been similar proposals in EU to strengthen the screening process and control over markets related to national security. Some member states, including Germany, France, Italy and the United Kingdom have already developed their individual stricter screening process. Such increasing regulations on acquisition and merges by foreign countries would necessarily add more impediment to growth of Chinese companies in international market, and the solution awaits.

3.3. Multiple Regulations in Different Places

Another problem that current Chinese cross border merges and acquisitor market have is the multiple regulations of different places that need to compile with. Chinese companies tend to choose Singapore, Hong Kong and the UK as their intermediate holding company since these areas usually has relatively low income tax. However, such advantage may necessarily diminish as international tax regulations are being adjusted, and will continue to adjust in the future: the domestic tex base erosion and profit shifting (BEPS) has been affecting and exploiting the gaps between various tax systems, which resulted in countries 100-240 billion USD lost annually, compelled countries to work together on OECD/G20 Inclusive Framework on BEPS to regulate international tax systems [9]. Such strengthening in regulations, although seems to be a beneficial act for all countries, will impose difficulty for cross border merges and acquisitions, and Chinese companies should pay more attention to the difference in regulations, and make sure that their actions are coherent with local taxation laws.

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4. Suggested Improvements on Chinese Cross-border M&A Market

4.1. Future Improvement Trend

Chinese cross border market, as described, has been not so successful in many cases. It mainly because of its failure in conducting adequate and accurate evaluation about the firms they want to merge with or acquire.

Due to the increasing regulations in the Chinese cross border M&A market, increase cooperation with international countries should be one of the major reforms for both Chinese government and companies. From the recent actions of China, especially the speech of Xi JinPing, the president of China, called for cooperation in the OECD conference. Transparency is the key factor in these calls. According to the terms of its accession to the WTO, China has declared that it will inform all WTO members, all laws and policies and other measures that will affect, or relate to, trade in goods, services, TRIPS or the control of foreign exchange before such measure are implemented and enforced. China also introduced a system of soliciting public comment before finalizing legislation. Although the implementation of such plans remained unclear for now, they do indicate a future path for the Chinese government in the cross-border M&A market, which is to encourage transparency and therefore reduce the complaints and alert of other countries. The increase in transparency can be accompanied with further actions, including reducing the multiple stages required for examination and approval procedures.

4.2. Adjusted Relationship Between the Government and the Companies

Another important factor that Chinese companies, and government, need to pay attention to is the governance of the company in the Cross border merges and acquisition trade. Government intervention, as this passage has discussed about, is fairly common and unique in Chinese market, while at the same time such feature may necessarily lead to a weakening, or a more vague, position for the controller of the company. Corporate governance, although did grow in the past few decades, remained weak. Investors tend to afford less for securities that are issued by companies that have relatively weaker corporate governance system, which can be applied to both creditors and shareholders [10]. The effect of weak corporate governance would necessarily lead to an inaccurate valuation by the foreign investors. Therefore, if the Chinese market is still aiming to arise from current developing state and move to even higher stage, it is necessary to impose more regulations in the company and introduce a better plan about how to increase the transparency of structure of the firms, and therefore increase the efficiency of dealing with different situations.

The role played by the government an the company itself is also an important criteria for China to focus on. Government intervention, as this passage has discussed, is a unique pattern in Chinese market and a special, while at the same time useful, driving force for the Chinese cross-border merged and acquisition. However, it should be admitted that certain problems lie with this feature, as resources and fundings would naturally flow to the side with the government, while private companies that have not been cooperating with government would gain little resources to grow. The strong pro-government and nationalism sense would also compel the companies to follow the policies of the government, which at the same time can distort the market to some extent. Under this environment, companies may irrationally follow the instruction of the government while at the same time ignore, or overlook, the importance of conducting detailed research and investigation, as well as due diligence report.

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5. Conclusion

Since the Reform and Opening Up Policy, China has experienced a significant growth, although sometimes fluctuated, since then and more laws were regulated in many ways to increase the efficiency of dealing with different situations. However, it should be admitted that flaws are still existing in the country cross-border merges and acquisition system and more challenges, both internal and external, are occurring. In order to deal with them, more reforms and scrutinies are necessary in the future China.

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