

How Chinese Companies May Succeed in Overseas M&A Transactions

- Interview of the US M&A Specialist Mr. Andrew Ross

Recently, as the pace of “going global” speeds up, a large amount of Chinese companies have participated in M&A, control investments and substantial minority investments in businesses and properties located outside of China. Moreover, the development of China’s economy will make China a major source of foreign direct investment. However, how could Chinese companies accomplish an overseas M&A transaction as it may differ entirely from its counterpart in China? How to locate the most valuable business partner as soon as possible in the ever-changing international market? These questions have become important topics for Chinese companies. Journalist Mr. Kai Guo recently interviewed US M&A specialist Mr. Andrew Ross, esq. Mr. Ross used the activities of the Chinese companies in his area of specialty as examples and interpreted the keys to a successful overseas M&A transaction.

Question: What are the major reasons for the Chinese companies to engage in “going global?”

Mr. Ross: There are many reasons that Chinese companies are doing business in foreign countries, especially in the United States. From a macro perspective, the Chinese government provides large amounts of policy support in favor of going global. From the perspective of various companies, they may have multiple goals in mind when doing an overseas M&A. In general, Chinese companies have three important reasons to go global. The first reason for a transaction can be to obtain goods and services not otherwise available to them. Examples can include talent generally, including intellectual property and research and development capabilities and facilities, such as Alibaba’s U.S. acquisition and the acquisition of Compete Genomics, a U.S. DNA mapping company. The second reason for a transaction can be to acquire a company, such as a seller of valued international or U.S. brands, and in addition to continuing to sell their goods outside China, also sell them in China. In this way, Chinese companies may utilize the existing marketing and sales channels of the target companies and accomplish the win-win solution in both national and international markets. The third reason for a transaction can be to acquire products that flesh out a product line or improve a competitive market position. Going global can also increase market share and increase brand recognition.

A significant motivating factor is also the opportunity to expand into new markets. In some cases though, Chinese buyers are less concerned with these strategic points and instead focus on their potential return on investment or geographic diversification of capital.

Question: Based on your knowledge, what are the common challenges to Chinese companies’ overseas M&A projects?

Mr. Ross: Chinese companies usually encounter the following two challenges:
One key challenge is that, as in dealing with businesses in any foreign country, Chinese buyers must accept that there are cultural differences and look to adapt to foreign cultural practices or bridge these differences, rather than expecting U.S. parties to adopt Chinese culture as to deals in the U.S.

A second key challenge for Chinese companies is to observe accepted norms in the U.S., including that any deal in the United States will be done in accordance with U.S. business practices, so called “U.S. deal style.” For most Chinese companies the two preceding points likely means changing their approach from how they do deals domestically. Examples of different practices include the very significant role played in the U.S. by outside advisors such as lawyers and investment bankers, the need to retain them early in the deal process and that, in the large majority of deals, investment bankers and consultants (in either case, “financial advisers”) representing a buyer receive a retainer, which is usually applied against the success fee if the deal closes. Not making these adjustments or failing to follow these practices can result in several adverse effects on a prospective buyer, both in terms of its knowledge-base, or more likely lack thereof, in U.S. deal practices, and appearance as to both its commitment and its professionalism.

Question: what are the main methods of doing overseas M&A deals? Which of these methods work(s) better for Chinese companies?

Mr. Ross: Taking the US market as an example, there are five different means by which Chinese companies can seek to establish an M&A transaction.

The first approach to be discussed, and the one Chinese businesses appear to most often adopt, is a completely reactive approach – waiting for foreign deal opportunities to be presented to them instead of actively seeking for the opportunities. We may call it a “wait and see” approach. Sometimes, the foreign entities or specialists may inform their contacts in China of a potential investing opportunity. However this approach should not become a common practice because any result largely depend on fortuitous factors.

A second approach employed by some Chinese companies, is to seek targets through informal networks of “friends,” that is, informal social contacts. This approach is predicated on the “friend” happening to know of a deal on the market at that particular time, which means not only being familiar with the specific field, but also knowing one or more companies which are for sale at that time. This knowledge is not easy to come by as a rule other than from financial advisers who devote substantial efforts to this. However, this approach generally excludes a referral to a financial adviser as Chinese companies making such requests are generally looking to avoid the cost of retaining a financial adviser.

The third approach used by a few Chinese companies is in each case for it to make known to appropriate U.S. financial advisers its interest in making acquisitions and for it to evidence its capability to carry them out. This approach is based on the reasonable position that if the Chinese company makes clear to financial advisers that it is interested and is a capable potential buyer, then when the financial adviser is retained by a potentially appropriate U.S. company to handle that company’s sale (i.e. a “sell-side” engagement), the financial adviser will include the Chinese buyer among the parties which receive initial target company information. One short-coming of this approach though is that, even if successful, it only provides a Chinese company with information about a target at the same time as other prospective buyers receive this information. This will likely cause competition in the process.

A fourth approach, which is quite proactive and is one that the author of this article recommends in

many cases, is for the prospective Chinese buyer to use its own staff to in effect do their own investment banking work, including researching the market and prospective targets. This is the approach taken by some of the most sophisticated Chinese buyers and can be very successful, especially if the Chinese company has substantial insight into the market and the various other companies in it, which can result from the Chinese company's own commercial and marketing activities. Nevertheless, in general, a Chinese buyer should not take the process too far even under this process without involving its US lawyer and perhaps a financial adviser as the lawyer is necessary to address at a minimum the legal issues and the financial adviser can add value even if they are not the ones who find the target.

A fifth approach, which is also proactive, is for the Chinese company to retain a U.S. financial adviser to analyze the applicable market and find suitable acquisition opportunities. This is the most effective approach in general, especially for any company that does not have the expertise to successfully carry out the fourth approach. This is generally perceived to be the basis for many completed China to U.S. deals. The foregoing is the case even though in most such instances the Chinese company likely pays a retainer to the financial adviser. Generally retaining a U.S. financial adviser expert in the particular field is the best way to become knowledgeable regarding a particular segment of the U.S. market, the various companies in it and an analysis of them, which are available for sale or may be willing to consider a sale if approached, and valuation metrics in that industry. In many if not the majority of cases this need not involve retaining the largest financial adviser or even a large firm. Rather the key is often specialization and the relevant knowledge base. It is also important to note that for several reasons this approach is likely to enhance the credibility of a Chinese company in dealing with U.S. targets and their advisers as well as enhance the willingness of a U.S. company to engage in negotiations. Moreover, the Chinese buyer's U.S. advisors will be seen as a potential bridge between the cultural and business differences between the two principals.

In my opinion, the fourth approach is suitable to be used by large Chinese companies with strong marketing skills. The process of an M&A transaction will tremendously improve the company's overall capacities. For mid and small sized firms, the fifth approach is more feasible. It may enable closing in the shortest possible time and increase the professional image of the company in the international realm. Please feel free to contact us for further request.