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Research Report

Why some advanced economy firms prefer to be taken over by Chinese acquirers

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Why some advanced economy firms prefer to be taken over by Chinese acquirers

by

Jan Knoerich *

Bids by Chinese multinational enterprises for leading companies in advanced economies have reached record heights in terms of number and deal size. During the first half of 2016, the investment amount offered for international acquisitions already exceeded Chinese outbound investment for the entire year of 2015. The recent offer of US\$ 43 billion by China National Chemical Corporation for the Swiss pesticide and seed maker Syngenta is a case in point.

Perspectives on such FDI from China are diverse.

Widespread criticisms of Chinese acquisitions focus on the state ownership of many acquiring firms, state backing and resulting unfair competition in global takeovers, the high levels of debt held by Chinese acquiring firms, their inexperience as latecomers in global markets, and their strong interest in acquiring technologies and strategic assets. Moreover, there are several accounts of failed acquisitions.

Yet, despite these concerns, the number and size of Chinese acquisitions in advanced economies have been rising year by year. These deals are regularly approved by the target side, and the owners or managers of many target companies have consciously chosen a Chinese acquirer over a competitor from an advanced economy, despite the many critical observations. Why is that the case?

For many of the target companies, Chinese acquirers are uniquely appealing in several respects. In particular, many target firms have identified a number of complementarities between the motives driving Chinese acquisitions and their own strategic objectives, and expressed their intentions to capitalize on these complementarities.¹

For example, many target firms solicit the assistance of their Chinese acquirers to gain better access to the lucrative Chinese market. In most sectors, a presence in the Chinese

market is nowadays indispensable for success and survival, but managing this market without local support can be difficult. In exchange, target firms offer their own international experience to support the internationalization of their Chinese acquirers' businesses.

Similarly, some target firms solicit the support of their acquirers in cost-reduction efforts, aiming to broaden the market segments in which they are cost competitive. For example, a Chinese firm can help the target firm to establish its own production in China, or can support efforts at reducing costs in procurement and other areas. In turn, target firms are often willing to pass on considered, yet limited, know-how and technology to acquiring firms, and offer to engage with them in joint efforts at research and development. This may be a step toward fulfilling the objective of the Chinese acquiring firms to obtain strategic assets and upgrade their products, allowing them to enter higher-end segments than they have previously occupied in both international and Chinese markets.

In addition, target firms often value the injection of capital by Chinese acquirers, either because they are in dire need of funds to avoid bankruptcy or further to expand their businesses. Chinese companies are attractive bidders because they are often rich in cash—from profits made in the lucrative Chinese market, or as a result of state support.

The attractiveness of these deals to target firms is often further enhanced by the maintenance of a strong separation between them and the acquiring firms, following a “light-touch” post-acquisition integration strategy.² Under this approach, target firms are able to keep their identity and organizational structure and to continue business at their original locations, with most decisions still made by their own management. This strategy helps to mitigate concerns about the potential undesired loss of know-how and reduces other apprehensions about Chinese investors.

Many Chinese companies have pursued this approach to acquisitions in advanced economies in a variety of industries. Although success is not guaranteed, this approach fits with their particular circumstances as latecomers and aims at mitigating the aforementioned concerns regarding Chinese acquisitions.

Governments in advanced economies are challenged by the need to weigh these gains to target firms against potential threats to the national interest. Policy-makers should explore which regulatory and policy tools are at their disposal to minimize any long-term negative effects while harnessing the benefits for firms. For example, they may need to establish more effective methods for screening proposed acquisitions and to regulate the outward transfer of know-how resulting from these deals. They may also encourage target companies to introduce long-term safeguards into their acquisition contracts. Moreover, the Chinese government could do its own part to provide reassurances about the intentions of Chinese acquirers and to reduce the level of state involvement in China's outward FDI. Finally, future Chinese policies should ensure that Beijing offers foreign acquirers the same degree of access to its market as many advanced economies currently offer to Chinese firms.

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¹ Jan Knoerich, "Gaining from the global ambitions of emerging economy enterprises: an analysis of the decision to sell a German firm to a Chinese acquirer," *Journal of International Management*, vol. 16 (2010), pp. 177-91.

² Yipeng Liu and Michael Woywode, "Light-touch integration of Chinese cross-border M&A: the influences of culture and absorptive capacity," *Thunderbird International Business Review*, vol. 55 (2013), pp. 469-483.

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