South China Morning Post

What it takes for firms to expand global reach

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708 words
8 September 2008

After decades of being pursued by multinational companies, mainland firms are turning the tables and doing the pursuing. Flush with funds and encouraged by relaxed government regulations, Chinese businesses are ratcheting up the pace of foreign acquisitions.

In the first quarter of this year, the value of businesses making investments abroad surged more than 1,200 per cent to US$21.1 billion, from US$1.6 billion a year earlier. Mainland companies are using cross-border mergers and acquisitions to accelerate their entry into the global marketplace.

In the best of conditions, mergers and acquisitions are a high-risk growth strategy. Nearly all studies have shown that only three in 10 large deals create meaningful value for shareholders. Slightly more than 50 per cent actually destroy value. When the acquisition is in a foreign culture, the risk escalates because of the added hurdles and unknowns. And mainland firms have an additional risk factor - their lack of global mergers and acquisitions experience as well as managers with international experience.

While it is too early to say if recent mainland acquisitions will deliver on their promises, we can look at winning dealmakers to see what they do differently. Our research and work with clients show that they follow a clear roadmap with four major steps.

Have a clear strategy. Understand how an acquisition fits into a global expansion plan. Successful dealmakers start by asking a fundamental question - do we really need to go overseas? In other words, has the company maximised its core market at home?

Computer maker Lenovo did not venture into the global marketplace until it had built critical mass in its core domestic market. Only then did it have the management breath and operational skills to expand globally. Industrial and Commercial Bank of China views foreign acquisitions as a way to hedge the risks of cyclical economic downturns.

Winners write out a clear deal thesis explaining why and how an acquisition will boost the business. They also target deals that enhance their core strengths. We have found that deals that grow a company's scale - adding similar products or customers - outperform deals that expand a company's scope by moving into distantly related businesses.

Gain experience with smaller deals before attempting mega mergers. To avoid costly rookie mistakes, top dealmakers sharpen their skills by acquiring and integrating companies in smaller, lower-risk deals. They gradually move up to larger acquisitions.

China International Marine Containers eased into cross-border dealmaking with a German joint venture in 1995. Having learned what works and what does not, the company now deftly uses acquisitions to stay ahead of marketplace trends.

Determine what you don't know - and be aware of cultural differences in business practices.

Winning mainland firms conduct a two-part due diligence process - business and cultural - helping them zero in on the big questions. Once answered, these questions will demonstrate whether the deal's investment thesis will pan out.

Rigorous due diligence on the culture of the target company helps head off problems before a purchase is completed. What's critical in due diligence: determining what you don't know and should know, and then nailing that information down.

For example, since China's unions are relatively weak, Chinese firms may not think of asking if workers are subject to a labour contract. Top dealmakers look into any existing union contracts and examine terms that may impact the deal's premise.

Identify regulatory or national security issues that might be roadblocks.

To get an inside point of view, companies should tap into their existing networks, send in an advance team or perhaps dispatch their lawyers.

Huawei Technologies learned the lay of the land in Sweden by establishing a research and development unit there before entering into a joint venture with network service supplier Banverket Telenät. Huawei has used this approach of carefully learning a market before putting a stake in the ground as part of its global expansion strategy.

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