



THE INTEGRATION CHALLENGE BEHIND CHINA'S GROWING OVERSEAS M&A ACTIVITY

Domestic success stories and overseas challenges

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Amid the most severe economic downturn in decades, almost all of the big names in the international M&A arena are tightening their purse strings. China, however, continues its global spending spree. The huge wave of investment by Chinese enterprises in foreign-based firms reached US\$20.5 billion in 2008, representing a hundred-fold jump over 2002 (US\$200 million),¹ and there is no end in sight.

While the deal making, such as Sinopec's acquisition of Addax Petroleum for \$7 billion, grabs the headlines, the post-deal integration is rarely covered. What typically happens after the deal is made? How successful is the post-deal integration? As the Chinese take their first steps toward creating global enterprises, it is worth looking at some of the lessons we can learn from their forays into both the domestic and overseas M&A arena.

1.1 Plenty of domestic success stories

The impetus behind Chinese domestic M&As is, of course, product and market expansion and the greater economies of scale that can be gained. TCL, China's first television and mobile phone manufacturer, produced its first color TV in 1992; by 2003, it was recognized as the fourth largest electronics producer in China. During this 11-year span, it made a number of notable acquisitions such as Henan Meile Electronic Group in 1997, Inner Mongolia Rainbow TV Company in 1999 and Wuxi Hongmei TV factory in 2000. Most of the acquired companies were on the brink of bankruptcy, and TCL managed to turn them around. Its success rested on the ability to take its cost cutting expertise and integrate it into the operations of the acquired companies.

Another example, China International Marine Container (CIMC), a small producer of containers, was competing with more than 20 other container producers across China in 1990. They embarked on an aggressive expansion plan in 1991. Then, with the proceeds from its IPO in 1993, it bought and merged more than 10 container producers along China's coast. These acquisitions enabled CIMC to expand its operations to five massive plants, and by 1996, it was the number one container producer in China. CIMC was successful at gaining maximum economies of scale.

Success stories such as these are common when it comes to domestic M&As. However, as many Chinese companies have discovered, overseas M&As have proven to be more challenging.

¹ China's Ministry of Commerce

1.2 Overseas M&As are more challenging

After the deal is announced, we see very little about how the post-acquisition integration was carried out and what the results were. When we do learn something, it is usually about a failed attempt. Our observations below are largely based on extensive case studies of high-profile M&As (e.g. TCL acquiring Thomson's TV business and Lenovo acquiring IBM's PC division) as well as our conversations with industry insiders.

While no solid statistics are available, it is probably safe to say that most overseas M&A efforts by Chinese companies have not turned out as expected. While there have been some successes in natural resource-based acquisitions, examples of success for non-resource-based acquisitions overseas are rare. During our interviews with Chinese oil and gas executives, they told us that their short history of overseas M&A activities has really been a painful learning process – they have paid their dues. While they learned some valuable lessons from their successes, they also learned more from their failures. Some of their recent successes could be attributed to a number of factors, including the strategic importance placed on resources by the Chinese government, sufficient capital, technology and know-how, and the experience they have accumulated from previous failures and successes. And, this type of M&A also has one clear goal (to access resources). Once the resources are extracted, the job is done.

In contrast, when Chinese firms acquire non-resource-based overseas firms for their brand, distribution channels, technology or market access, the success of the acquisition depends on the acquiring company having a host of post-acquisition integration capabilities – financing, technology know-how, the number of managers with international experience, ability to manage brand and distribution channels on foreign soils. They must also have the cooperation of the target company and its employees. So often Chinese companies want everything (brand, technology and market access), only to lose sight of their priority and become unclear about their strategic direction after the acquisition. They have neither the capabilities nor the resources to launch a multi-pronged assault.

In one example of a Chinese acquisition, only one executive was sent overseas to manage the foreign operation. Even though he was on-site, he hardly spoke the local language and lacked international experience, so he didn't fully understand what was going on behind the scenes. In contrast, companies that have successfully managed post-deal integration invest far more resources in the process. For example, during the HP-Compaq deal in 2002, the companies launched a massive integration planning effort long before the actual integration could officially start. Within weeks of the merger's announcement, the integration team grew from 30 people to 500 and eventually grew to 2,500 full-time dedicated members who were not distracted by the day-to-day concerns of running a business. For deals of such scale and complexity, any Chinese firm would be hard pressed to locate 20 internal people with the experience to carry out overseas M&As.

While Chinese companies have great potential to expand beyond their home market, they must build the necessary skills to carry out the post-deal integration that is so important for lasting success in international markets. In the meantime, they might be better off to think along the lines of technology licensing or brand licensing rather than large scale M&As that require integration to realize their value. Alternatively, they could follow the example set by Lenovo's acquisition of IBM's PC division for \$1.75 billion in 2004. From the start, Lenovo recognized that cultural and organizational integration would be key success factors and spent more than a year planning for the acquisition before the deal was done. Once completed, the CEO, Yang Yuanqing, assumed the chairmanship of Lenovo and appointed the former head of IBM's PC business – Stephen Ward – to serve as the CEO and focus on customer retention and organizational integration. Ward retired a year later, with William Amelio, a former Dell executive with experience in emerging market, replacing him. Both Ward and Amelio laid the foundation for a smooth transition and integration.

As more Chinese companies succeed internationally, others will follow. But first, they must develop the integration capability to fully realize the value.

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