Why Chinese Firms’ Cross-Border Deals Fall Apart

By Laurence Capron , INSEAD

By Laurence Capron & Will Mitchell
During the past decade, Chinese firms have become aggressive cross-border acquirers. Unfortunately they have been struggling to actually close their deals.
Some deals have failed because of national security concerns in the U.S., including CNOOC’s attempt to purchase Unocal in 2005 and Huawei’s attempt to buy 3Leaf Systems in 2011.

More often, though, Chinese firms have announced deals and are then unable to follow through. For instance, **Bright Food was near closing on a deal to purchase GNC for between $2.5 billion and $3.0 billion in 2011**, but then had to retract because the companies could not agree on terms and struggled to get Chinese regulatory approval.

These examples are rather more typical than they should be. According to a study (forthcoming) by**Olga Hawn of Duke University**, cross border deals involving Chinese companies are almost twice as likely to break down (15% of the time) as deals involving companies from other BRICS countries (8%)

and three times as likely as those involving Western multinationals (5%).

There are many explanations for this. Chinese companies are relatively new to the M&A game, governments in many target markets are quick to detect a political agenda, Chinese companies sometimes struggle to obtain financing or face unexpected political opposition at home, and many acquiring Chinese firms operate in particularly dynamic — and volatile — global markets.

These are all perfectly good reasons. And walking away from bad deal is a good thing. That’s precisely why seasoned acquirers like Cisco, GE, Siemens, and Johnson & Johnson have strong processes to enforce discipline throughout their acquisition process and can kill as many potential deals as they make.

But as these companies also know walking a way from a deal is best done before the deal is announced. Cancelling an announced deal causes substantial losses not only for the acquirer but for the target as well. Failed deals impose significant out-of-pocket costs (financial advisory fees and due diligence expenses) and take up a lot of management time and energy, distracting many senior managers from important line responsibilities. If companies are incurring these costs unnecessarily they are destroying value.

More importantly, though, the difficulty Chinese firms seem to have in completing deals will over time damage their ability to expand and adapt. Companies will become even more wary of their Chinese suitors than they already are if they have to worry about being left at the altar and this may foreclose many opportunities for Chinese companies.

So **although many Chinese acquirers are becoming more adventurous in their deal-making deals, they need to reduce the cancellation rate of their announced acquisitions**. To do so, they must:

1. **Make sure that acquisitions are aligned with strategy.** Companies jump to an acquisition out of fear of missing an expansion opportunity. This is a recipe for failure and acquirers need to make sure that their M&A strategy is aligned with a well thought-through broader strategic plan. Obviously, this requires that you have a robust strategic planning process to begin with, which is not always the case in China.
2. **Assess the political attitude in the target country.** Governments in most countries will review major foreign investments. As noted,

several high profile deals involving Chinese firms, such as CNOOC's 2005 attempt to purchase Unocal in the U.S., have been blocked, either formally or by delaying the negotiations to the point that the buyers withdraw. Before going too far with your acquisition process, Chinese acquirers need to assess how the target's local government is likely to react.

3. **Make sure there is no opposition at home.** Although some deals may be blocked in the target countries, others fail because of opposition at home. Tengzhong's 2010 attempt to buy Hummer from General Motors, for instance, fell apart because of opposition from the Ministry of Commerce in China. Before embarking on deals that are likely to be controversial inside China, Chinese acquirers should first make sure there is a clear path for approval.
4. **Consider sequential engagement.** When there is high uncertainty about the value of the combination or how you will be able to work with your foreign target, you may want to start out with a more focused partnership. You can start with a specialized alliance or undertake an initial equity stake and gradually deepen your relationship.

Bottom line, we suspect that too many Chinese companies are opportunistic dealmakers. They need become more sophisticated in their M&A processes and should explore more carefully less headline-grabbing ways of acquiring new resources and capabilities, along the lines we set out in our book, **Build, Borrow, or Buy**. If they do so, their cancellation rates will fall and they will be seen as more reliable M&A counterparties, which will open up more opportunities for them.

>> This post originally appeared on **HBR**

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