The Light Touch

By Janine Coughlin

"As Chinese companies spend billions on deals abroad, their unique management style gets a warm welcome."

In just the first five weeks of this year, Chinese companies spent around US$68 billion on outbound M&A deals, according to figures compiled by Dealogic. ChemChina grabbed headlines with the largest-ever Chinese acquisition of a foreign company, making a US$43 billion all-cash bid for Swiss pesticide and seed maker Sygenta. This came just two weeks after the state-owned chemical company offered US$1 billion for German machine tool builder KraussMaffei. That was then the largest Chinese acquisition to date in Germany; but not for long. In early February Beijing Enterprises offered US$1.4 billion for EEW, a recycling and energy company. It was also about the same time that Haier snapped up General Electric's appliance division for US$5.4 billion, while Dalian Wanda Group bought US film studio Legendary Entertainment for US$3.5 billion. Smaller deals during this period included Pearl River Piano acquiring Germany's largest piano maker Schimmel, and China Visual Group buying stock photo company Corbis Entertainment from Bill Gates. These deals follow last year's US$112 billion foreign shopping spree by Chinese companies.

Does this wave of acquisitions abroad by Chinese companies mean that workers in the US and Europe will have to start learning Chinese? That's not likely, according to Co-Director of the CEIBS Centre for Globalisation of Chinese Companies (CGCC) Klaus E Meyer who is also Professor of Strategy and International Business. He says Chinese companies tend to have a more long-term view towards foreign acquisitions and, therefore unlike private equity acquirers or western multinationals, tend to take a more "light touch" approach when integrating them with their domestic business.

"Private equity is looking over managers' shoulders all the time. They want to get the performance numbers up and then sell," Prof Meyer explains. "With Chinese investors who have a light touch approach, they are typically in a loosely related industry and they want to learn something about the industry; but they don't have a plan to directly intervene." He expects that's the approach ChemChina is going to take with its recent acquisitions because they have few competencies that overlap with Sygenta or KraussMaffei. The major change, he says, will probably be to the companies' balance sheets. "They will likely get a bit more financial resources to invest so they can build the market in China, and also maybe they can convince their new bosses in China to take on other investment projects so they can grow the business," says Prof Meyer.

For many employees, there is a great deal of uncertainty when their company is gobbled up by another. According to Prof Meyer, the light touch approach used by the Chinese usually means employees of the firm being acquired have less to worry about.

"For the management team, especially middle management, it's often less stressful to have Chinese owners than having the private equity," he says. That's because the very essence of the light touch approach is a more hands off management style. There is also less uncertainty with a Chinese owner than with a private equity firm that may eventually auction off the company. "The likely bidder is another PE company who is going to squeeze even more money out of it and sell it again. Or they could be bought by a competitor or someone in a closely related industry. In those two cases, if they take over the company, the first thing they want to do is to realise synergies to create value. For middle management that means someone is going to lose his job. So for all those

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reasons, the Chinese investor who has a light touch is quite an attractive proposition," says Prof Meyer.

Last spring during a London forum on globalisation of Chinese companies, CEIBS faculty with the CGCC explained that Chinese companies usually look abroad for deals in order to gain a competitive advantage in their home market. Since they are looking to acquire intangibles they lack, such as management expertise, brand value, and technology, the "heavy hand" approach often employed by western multinationals does not work for them. When they acquire or enter into a joint venture agreement with a foreign company, the Chinese tend to leave the existing management structure in place, and provide investment that creates jobs and increases production capacity in their host country. Their ultimate goal is to increase their capacity and competitive edge in the Chinese market. Western multinationals, on the other hand, tend to go abroad in order to expand their market share beyond their home turf. Therefore, like PE acquirers, they tend to take a heavy hand in managing their foreign acquisitions.

During the forum, Associate Professor of Strategy Chen Weiru gave the example of AVIC's acquisition of US engine manufacturer Continental Motors. He explained that AVIC promised no layoffs and no factory shutdown and only sent one Chinese executive to Continental's US headquarters. That employee's task was to focus on coordination and building mutual trust.

However, it will not always be smooth sailing for Chinese investors. Prof Meyer stresses that the key issue in making any acquisition work is strategy implementation. "To realise synergies, to actually get involved in a company overseas, you have to have people who understand the industry in that country. At this time in China there is still a shortage of such people," he says, explaining another reason for the light touch, long-term approach that Chinese companies have regarding these acquisitions. "Ten years down the line, when the next generation grows into leadership roles, it's likely to be different." Today's Chinese companies, he adds, have strong financial resources but weak human resources when it comes to international experience and confidence in speaking English – skills that are essential if you want to lead people overseas. "When the next generation, the people who are now under 40, are in leadership roles, this gap will close," says Prof Meyer. "And their approach is likely to be very different from what we are observing today, the light touch. That's because by then they will have built the organisational capacity to actually run a global company."

But has the light touch approach being used today paid off for the Chinese in their acquisitions abroad? Has it actually helped them create more value with their foreign acquisitions than their western counterparts? Prof Meyer says the jury is still out on that point. "To evaluate this empirical puzzle, one has to take into consideration that Chinese companies are at a different stage of development, and we have very imperfect markets," he says. "If a Chinese company that is previously relatively unknown makes an acquisition overseas it sends a very strong signal to the market. It says, 'we have very good resources, both financial and government ties and we are able to do this'. It sends a signal about the strength of the company but it is not necessarily reflective of the merits of the deal itself. That's why the stock market reaction [to Chinese foreign acquisitions] tends to be positive, or at least more positive than comparable studies show for such acquisitions by western companies."

He also makes the point that the light touch approach is less suitable for companies who are serial acquirers. That's because once a company takes over several firms in the same industry, the logical move is to get as much synergy as possible from these acquisitions. "Once we talk about companies as serial investors, then the question of how they realise synergies between their different foreign operations becomes more complicated, and at that stage they need managers with relevant experience. The light touch may become less suitable," he explains.

The knowledge transfer that Chinese companies seek abroad may also be challenging to bring about when employing the light touch integration approach. "You need to have lateral collaboration, which is always difficult in any organisation," says Prof Meyer. He explains that it requires middle managers on both sides – knowledge owner and knowledge recipient – to have good cross-cultural competencies and a good understanding of both organisations; not to mention fluency in a common language. Thus, it is a long-term process.

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As this trend of Chinese investment abroad gathers steam, in which sectors can we expect to see more Chinese outbound M&A? Prof Meyer advises looking at the Chinese government's most recent five year plan for clues. "The five year plan gives a pretty clear, detailed explanation of the industries that China wants to develop, and in certain industries that requires acquiring companies overseas to help fill in competencies," he says. "My reading is that there is a priority on anything that has to do with digital economy, including industry 4.0. There will be a focus on anything that is somewhat high tech, including for example the machine tool industry, but also technologies that help China with its vast environmental pollution challenges. China wants to build competencies in these areas and to get to the technological forefront worldwide."

He adds, "At this time, most Chinese investments appear to pursue long-term objectives. If you are short-term oriented, I don't think you would take these sorts of big risks."