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New drivers and challenges in a multi-polar world

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Abstract

Purpose – The purpose of this paper is to explore current trends in multi-polar world with the aim of assessing new drivers and challenges in cross-border M&A.

Design/methodology/approach – A case study analysis of cross-border M&A is described and discussed.

Findings – The paper indicates strategic motivations and implementation challenges of cross-border M&A under current pressures of a world characterized by multiple centers of economic power.

Originality/value – This paper evidence new direction in cross-border M&A research for reinterpreting existing paradigms and developing new ones.

Keywords Strategy, Multipolar world

Paper type Research paper

Introduction

Much of the volume of research on M&A has investigated the potential sources of value creation and destruction in a world mainly dominated by the economic power of USA, Europe, and Japan (Caiazza and Volpe, 2015b). However, the emergence of a multi-polar world is changing the global context for cross-border M&A, demanding a reconsideration of the prevailing theoretical constructs (Caiazza *et al.*, 2013; Caiazza, 2011). Unfortunately, very little empirical work has centered on the drivers and factors leading to successful M&A under the current pressures of a world characterized by multiple centers of economic power (Caiazza and Ferrara, 2016; Caiazza and Volpe, 2015a). At the aim to fill this gap we decided to present a case study in automotive industry because it is a sector that shifted from a dominance of developed to developing economies. In 2015 most of the world's vehicles were produced in emerging economies and many companies of these economies see M&A as a key component in transforming themselves into global organizations (Euler Hermes Automotive Report, 2015). Most of these deals were realized in Asia. Thus, based on in-depth interviews with a sample of advisors, our research investigates new drivers and process challenges faced by acquirers from emerging economies when acquiring abroad, as happened in Chinese carmaker Geely's acquisition of Sweden's Volvo from Ford. Finally, we discuss how the results help to improve our understanding of current cross-border M&A success.

Global trends

The world is moving from an era of geographically-concentrated economic power to another characterized by multiple centers of economic and business activity. The economic dominance of the triad economies – the USA, Europe, and Japan – is giving way to more widely dispersed global economic power as emerging economies contribute an ever-increasing share of the world's output, trade and investment (Caiazza and Ferrara, 2016). The emergence of Asian, South American, and East European countries with billions of new workers and consumers are radically reshaping the economic geography in which all businesses must operate. The diffusion

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of global economic power across diverse and multiplying regions and countries are creating new opportunities and risks that firms cannot ignore (Caiazza and Volpe, 2015b). In such a multi-polar world, firms from both developed and emerging economies must define multi-polar strategies to compete everywhere with everyone for everything. Consequently, while in the past, only companies in developed economies pursued outward investment, today these flows are becoming larger, more numerous and multi-directional (Carbonara and Caiazza, 2010). In particular, flows between emerging economies are growing more rapidly than those between developed economies, and a number of innovative and dynamic emerging-market firms are on the path to globally dominating their industrial sectors (Caiazza, 2012, 2013). A notable development has been also the gradual emergence of cross-border M&A as the dominant vehicle for outward investment in preference over joint ventures and overseas subsidiaries (Useem, 2006; Hitt, 2000; Hitt *et al.*, 1998a, b). The World Bank has estimated that between 1997 and 2003 companies based in emerging economies engaged in outbound cross-border M&A deals valued at $189 billion, while from 2004 to 2010, that amount had increased to $1.1 trillion (Dailami *et al.*, 2012).

New trends in the competitive environment and firms' strategic behavior challenge researchers to rethink factors affecting cross-border M&A success in each phase of its implementation process (Barkema and Vermeulen, 1998; Brouthers and Brouthers, 2000). With this aim, in the next section of this paper, we first offer a general framework for analyzing factors affecting the principal phases of cross-border M&A. Then, considering that China is the single largest emerging market source country for M&A deals – which from 1997 to 2015 accounted for 30 percent of the total billion invested in emerging economies – we focus our analysis on the case study of Geely-Volvo (Bcg, 2015; Caiazza and Nueno, 2014).

Theoretical background

Pressures of current multi-polar world and new flows in cross-border M&A force researchers and managers to reconsider the challenges to successful deal execution that acquirers now face. The acquisition process involves numerous activities and demands that decision-makers answer some questions (Carbonara and Caiazza, 2008a, b, c, 2009a, b, c, d). These include defining an acquisition strategy (Why buy?); defining targets of interest for the acquisition (What buy?); identifying, selecting, and analyzing acquisition candidates (Who buy?); and integrating acquisitions (How combine?) (Caiazza and Ferrara 2016; Caiazza *et al.*, 2016; Very and Schweiger, 2001).

Why buy?

It is the nature of buyers and their strategic priorities that leads them to acquire other firms. Unlike financial buyers who decide to buy a firm just as an investment without participating in management, corporate buyers follow their own strategic intents, predicated on an imperative to reinforce their basis of competition. Under current pressures, corporate buyers sense the need to strengthen their basis of competition by reinforcing their cost position, brand strength, customer loyalty, and ownership of a distinctive set of assets and capabilities. Thus, their decisions to access foreign markets can depend on the relative market size, the ability to exploit factor price differentials between the two production locations, and the desire to take advantage of differential access to finance or of differences in the speed of diffusion of technological advances (Brainard, 1997; Helpman *et al.*, 2004; Horstmann and Markusen, 1992). One of the main reasons motivating emerging market firms to acquire firms in advanced economies is the interest in technological and knowledge transfer (Caiazza, 2015, 2016; Audretsch and Caiazza, 2016, Ethier, 1986; Fosfuri *et al.*, 2001).

What buy?

Another important aspect to clarify from the beginning of the process is what the buyer really wants to acquire. Of this aim, it is possible to distinguish among acquisitions of knowledge, customers, and structures. Acquisition of biotechnological firms abroad by pharmaceutical multinationals is an example of knowledge-oriented M&A. In this case, the buyer is mainly interested in target-specific knowledge, and not in customers or structures. Pharmaceutical firms can pursue M&A to acquire a high-value drugs' producer, reducing the inefficiency of duplicated research activities, and more rapidly achieving critical mass or a greater marketing presence in some developed market. Faced with gaps or a general weakness in its product pipeline, M&A can enable a company to quickly restore balance or build capacity. Moreover, pharmaceutical companies are also interested in acquiring small biotechnology companies to capture and exploit disruptive knowledge, technologies, and products that they do not have the ability or inclination to develop in-house (Helpman and Krugman, 1985; Markusen, 2002; Markusen and Venables, 1998).

Horizontal acquisition in the banking industry is an example of customer-oriented M&A. With globalization, the survival and success of many financial service firms lies in understanding and meeting the needs, desires, and expectations of their customers. Financial firms that do not realize the significance of being customer oriented are wasting their resources and eventually will perish. Businesses that fail to recognize the impact of these consumer-driven transformations will struggle to survive in a global market. Thus banks are interested in acquiring other banks to extend their presence on the market and reinforce their relationships with customers.

Acquisition in mature industries, such as the automotive industry, is an example of structure-oriented M&A. The global automotive industry, increasingly characterized by global mergers and relocation of production centers to emerging economies, is in the grips of a global price-war. The rising competition and increasing global trade have forced many firms to acquire their competitors to achieve dimensions that allow them to compete in a global market.

Who buy?

To create sustainable value through M&A, buyers must choose a target that supports their overall strategy, presents synergies, and offers exploitable skills and capabilities. Under current pressure, target selection benefits from due diligence, which is a critical step in quantifying the strategic value of a potential transaction, considering its effects on customers, suppliers, competitors, industry, and firm's profit. This will likely be the first inside view of a target company, shining a light on where synergies might exist and where they are likely absent. Among various critical factors affecting a transaction, one is the impact of human resources issues. Human resources due diligence is an important step ahead of a transaction – one that helps acquirers to avoid delay of important decisions that will impact people, instead allowing them to be made at the time the deal is announced or shortly thereafter (Schweiger and Goulet, 2000). Under current pressures, the due diligence advisor's role in cross-border M&A has become fundamental to identifying a target's stand-alone price, future synergies, and walk-away price. This knowledge can inform the prospective acquirer's decision on whether to pursue a deal, and strengthen their negotiations should they decide to follow through.

How combine?

The ability to successfully combine companies from different countries is generally ranked as the most important factor influencing M&A success. Integration is a complex activity that involves structure, process, and people. Integration of structures is probably the easiest part, and bears on the rest of the integration. To avoid redundancy, most overlapping structures need to be integrated. If done well, this is one area that could lead to synergies, and even not-so-obvious cost benefits. Process integration enables different ways of sharing and combining resources, and may even give birth to new competencies and distinctive capabilities. It requires managing the assimilation of multiple cultures, innovating, building new teams and, in general, managing a complex change process. However, under current pressures, integration of people is the most sensitive area, comprising rationalization of compensation; creation and deployment of a communication plan; and devising new employee retention mechanisms as well as employee feedback processes.

Integration challenges due to organizational and national differences between the firms involved are high-risk issues for companies in emerging economies that aim to operate in Western regions. In these transactions, in fact, high cultural distance is a source of risk (David and Singh, 1994) and a potential obstacle to realizing integration benefits (Aguilera and Dencker, 2004). It can affect realization of synergies and shareholder value; and raises the likelihood of incompatible management styles leading to acculturative stress, implementation problems, (Vermeulen and Barkema, 2001), and lower performance (Datta and Puia, 1995). The embeddedness of firms undergoing acquisitions in highly different national contexts has increased the relevance for cross-border M&A success of cultural fit (Weber *et al.*, 1996), cultural change (Kavanagh and Ashkanasy, 2004) and cultural convergence (Birkinshaw *et al.*, 2000), acculturation (Larsson and Lubatkin, 2001; Nahavandi and Malekzadeh, 1988), double-layered acculturation process (Barkema *et al.*, 1996) and acculturative stress (Very *et al.*, 1996, 1997).

Methodology

Based on the literature presented above, the objectives of our research were to identify challenges faced by acquirers from emerging economies abroad.

Considering the exploratory nature of our research objectives, we present a case study for evidencing main challenges in cross-border M&A. To gain an initial understanding of the case, we first conducted Web-based database research (Google Scholar, ProQuest, Wiso-net, etc.). Then we used official data from Geely annual reports and verified our findings with several external consultants and scholars to refine our discussion.

Results

Geely Holding Group Company Limited (Geely) is a Chinese auto manufacturer. Geely started its auto manufacturing business in 1997, targeting low-end customers. It was listed on the Hong Kong Stock Exchange in 2005 and shifted its strategy in 2007 to become a global manufacturer of safe, energy-saving, green automobiles (Caiazza *et al.*, 2016).

(Who buy?) The Volvo Car Corporation ("Volvo") is one of the car industry's premium brands. Volvo was founded in Sweden and produced its first car in 1927. It has operations in multiple locations across more than ten countries (Volvo Report, 2015). It sold about 334,000 cars globally in 2009, down from a record 460,000 in 1997, and was operating at a loss. In the end of 2008, Ford confirmed that it planned to dispose of its 100 percent equity interest in Volvo (Fetscherin, 2011).

(Why buy?) In January 2009, Geely received the formal bidding invitation from Ford. In February 2009, the Volvo team met with Geely's management team in China and provided some relevant materials on the proposed transaction (Alon *et al.*, 2011). In March 2009, Geely submitted their first-round bidding letter to Ford. In April 2009, the dataroom with over 6,000 documents was open to Geely and its team of professional advisors, and a comprehensive due diligence process began. On July 30, 2009, Geely submitted the legally-binding, second-round bidding letter to Ford (Caiazza *et al.*, 2016). On October 28, 2009, Ford announced Geely to be the preferred buyer of Volvo. On March 28, 2010, Geely signed a definitive agreement with Ford to purchase Volvo and its related assets. The purchase price for Volvo and related assets, mostly intellectual property, was US$1.8 billion, to be paid with a note for US$200 million, and the balance in cash. The cash portion of the purchase price was adjusted at the closing with modifications for pension deficits, debt, cash and working capital. In early August 2010, Geely completed their purchase of Volvo for US$1.5 billion (Geely Report, 2010).

(What buy?) As with other Chinese homegrown auto manufacturers, proprietary technology, and brand is the bottleneck of Geely's growth strategy. Merger and acquisitions of overseas automotive companies will allow Geely easy access to the target company's intellectual property, its well-known and respected brand name, as well as an established market position and distribution channels. In addition, Geely can also leverage its low-cost structure in China and thus add value to the acquired company.

Before the acquisition of Volvo, Geely had already completed another two outbound investments to pursue its growth strategy. In 2006, Geely had acquired a 23.2 percent equity stake in Manganese Bronze Holdings ("MBH") and became the company's largest shareholder. MBH manufactures the renowned London black taxis and provides high quality support, repairs, and serving for taxis (Caiazza and Dauber, 2015). Geely had also signed a joint venture agreement with MBH to manufacture taxis in China. Geely thereby accumulated experience in operating and managing overseas companies, and also leveraged the low-cost advantage in China. Geely announced recently that its equity interest in MBH had risen to 51 percent, and that an R&D center and a plant to manufacture sample car will be built in Britain (Kasperk *et al.*, 2012).

Next, in 2009, Geely had acquired Drivetrain Systems International ("DSI"). DSI is one of the two largest independent automotive transmission manufacturers in the world. It is a major supplier to Ford, GM, and Ssangyong, and has an annual capacity of 180,000 gearbox units. Going forward, Geely expected to be able to take advantage of DSI's expertise in gearboxes to improve its own gearbox development abilities Caiazza *et al.* (2016).

Despite Geely's prior outbound acquisitions of MBH and DSI, a deal on the scale of the Volvo transaction was something of a first for Geely. In any case, the operations of a large auto manufacturer are very complex; Volvo has operations at multiple locations in more than ten countries; Volvo had shared resources with Ford, such as raw materials and parts procurement, manufacturing platforms, R&D, and fleet distribution agreements. Geely previously had limited experience and sophistication in such a complicated cross-border transaction (Caiazza *et al.*, 2016). However, Geely worked with a strong professional advisory team to assist in the Volvo transaction. Rothschild acted as buy-side financial advisor to coordinate the proposed transaction and provide valuation services (Pieterse, 2011). Deloitte & Touche provided financial due diligence analysis on the quality of earnings, quality of assets, cost reduction plans, carve-out analysis, and treasury, as well as tax due diligence on tax exposures, pension due diligence on pension exposures, tax structuring advisory services on the proposed deal structure from a tax perspective; operations/separation and IT due diligence on the existing shared resources with Ford, and a "first 100 days" blueprint in relation to post-merger integration advisory services (Deloitte Report, 2010). Freshfields was legal advisor on legal affairs, including intellectual property, commercial agreements, litigation, employment, real estate, dealerships and franchising, imports, customs and customs duty, and competition. Brunswick acted as public relations advisor. The professional advisory team not only assisted Geely in the transaction execution process, but also provided recommendations on the post-transaction issues (Accenture Report, 2010).

(How combine?) One challenge is to transform Volvo into a money maker. After four straight years of annual losses, it was a challenge for Volvo to make a successful turnaround without losing its reputation for building safe and sturdy cars (Caiazza *et al.*, 2016). It was also a challenge for Geely to cut costs enough without breaking their promise to keep most production in Sweden, rather than in lower-cost China. However the biggest challenge that Geely has to face in the next future concerns the correct integration of structures, processes, and people.

Conclusions and discussion

The diffusion of economic power across a widening range of regions and the rise of emerging-markets firms on the global scenario has changed nature and direction of international flows of investment.

This study provides a systematic investigation of cross-border M&A under current pressures of multi-polar world. It contributes to previous research in two ways. On one side, it identifies new drivers of cross-border M&A. On the other, it sets forth the main challenges in each phase of the M&A process. Specifically, challenges in pre-closing phase are summarized in the ability of the buyer to identify who, why, and what to acquire, while challenges in post-closing phase are summarized in firms' ability to define how to combine structures, people, and processes.

The paper shows the purpose of investment flows from emerging to developed countries as intended to strengthen corporate buyers' basis of competition abroad. Unlike Western companies that use cross-border M&A to reinforce their structure and promote efficiency or growth, emerging giants acquire companies to gain knowledge and with the intent to obtain technologies and competencies. These multinationals tend to avoid overturning acquired firms' management structures or people and processes, ensuring smoother integration.

These findings have important implication for future research on cross-border M&A. They demonstrate that existing theories based on developed economy firms do not completely explain cross-border M&A under pressures prevailing in a multi-polar world, prompting scholars to undertake future studies in this direction.

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