



# **Cross-Border M&A Process in China**

## **Pre Engagement Planning and Considerations**

*Discussion Document*

*February 2015*



**CDI GLOBAL**

***CDI Global China – Wilton Partners***

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# Wilton Partners

Overview	Services
<ul style="list-style-type: none"><li>▪ Focus on Greater China</li><li>▪ 20 Years of Experience in China</li><li>▪ Shanghai Based Company</li></ul>	<ul style="list-style-type: none"><li>▪ Opportunity Assessment</li><li>▪ Business Development</li><li>▪ Transaction/Execution</li><li>▪ Executive Search</li><li>▪ Market Expansion</li><li>▪ Post Implementation</li></ul>



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# Introduction to Wilton Partners

*Wilton Partners is a merger and acquisitions, pre-listing, business development and strategy consulting firm, focusing on value-added service sectors related to Greater China. Our services lifecycle also includes market assessment, market entry, market expansion, talent sourcing and other customized services that are prerequisites for successful execution in China.*

- Wilton Partners offers a combination of highly experienced cross-border banking, wealth management, legal and corporate governance professionals. Furthermore, we leverage our global networks, working as a cohesive team, to dramatically improve our clients rate of success.
- We are not the typical Western style investment bank that all too often fails in China by relying on theoretical analysis, short-term thinking and lacking local operational expertise. We are not typical consultants that depend too much on “vanity metrics” that are not executable. We focus on both macro and micro issues where seemingly insignificant details can cause unnecessary complexity and execution risks that can be mitigated.
- Wilton Partners develops commercial and ethical “guanxi” – navigating China’s distinct political, social and economic climate. Fusing experienced “China Hands” with global capital markets knowledge is what it takes to greatly improve success in such a dynamic environment.
- China will soon be the largest economy in the world. At the same time China is still in its developing phase and needs to source value-add corporates and institutions from abroad. For this reason our international – China nexus is well suited for the next phase of growth by adding world leading global expertise and know-how, and applying these skills to the largest growth market.

# Why Consider CDI Global?

*Combination of highly experienced cross-border banking, wealth management, legal, talent and subject matter experts – leverage global networks, working as a cohesive team, to dramatically improve the rate of success*

## Global Investment Banks

- Insufficient “on the ground” experience in China.
- Limited interest in developing long-term business relationships (i.e. overly transaction focused).
- Model driven and theoretical decision-making processes.
- Limited senior management attention paid towards onshore aspects of China transactions.
- International experience and supporting skills in Mainland China is extremely limited.
- Overly reliant on Western legal and accounting conventions.
- Set engagements.

## CDI GLOBAL Wilton Partners

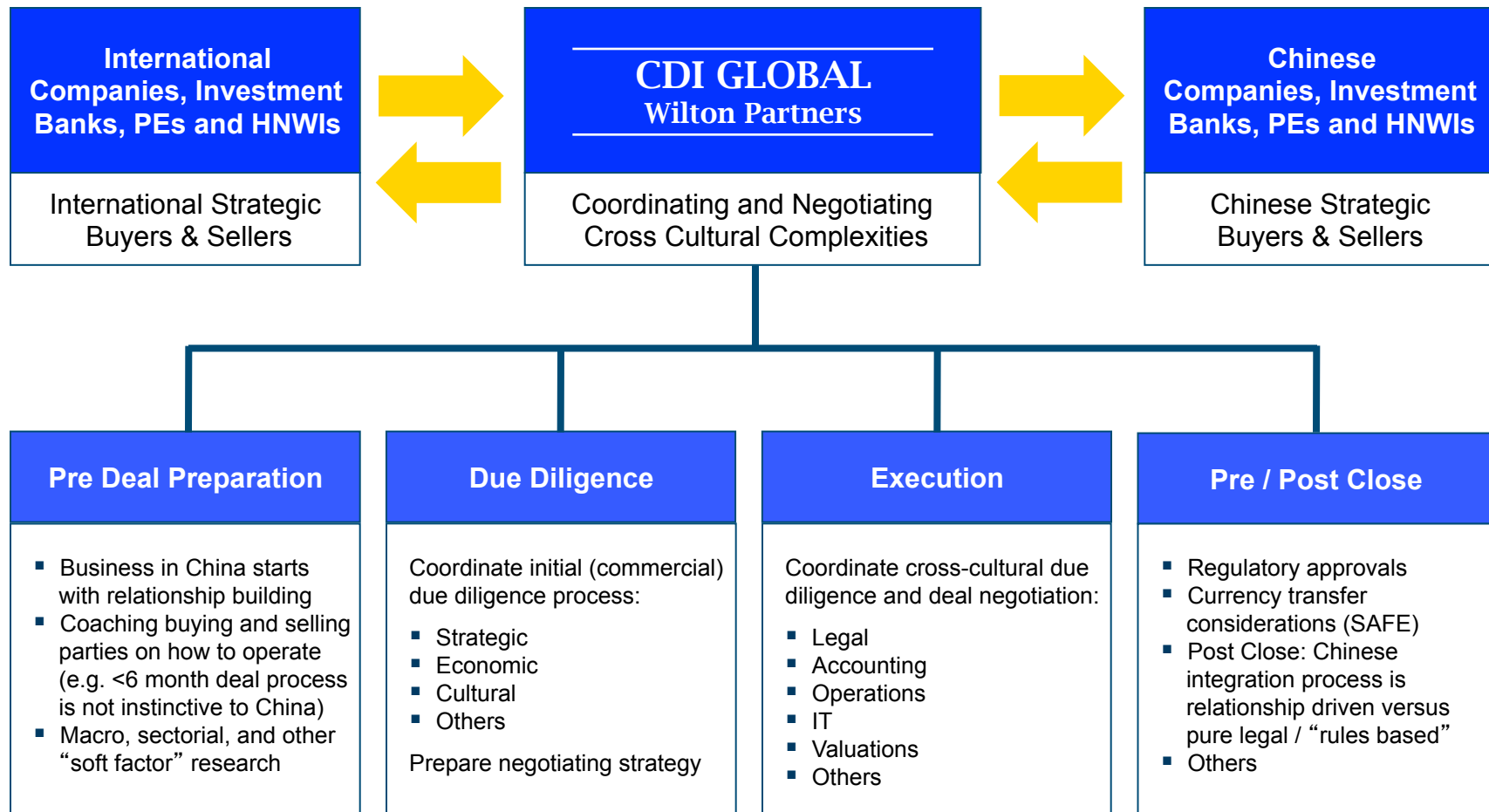
- On-the-ground cross border (global) M&A experience.
- Subject matter experts with planning, acquisition, integration and project management skills.
- Experienced in taking projects from business plans to actual execution of transactions.
- Mature team with international and China experience.
- Understanding of the Chinese decision making process.
- Ability to synthesize information and to determine issues/risks, other complex implications.
- Flexible, adaptive engagements.

## Consulting Firms and “Specialists”

- Limited experience in transactions, related financial, legal and operational due diligence.
- Spends too much time learning about clients business than providing value-added services.
- Focusing on non-core issues that hinder the ultimate success of a transaction.
- Top-down “30,000 foot view” with limited understanding of the bottom-up complexity.
- Managed by junior associates with limited review by senior partners with China knowledge.
- Set engagements.

# Sino-Foreign M&A Facilitation

*M&A facilitation is a major competitive advantage of Wilton Partners by working with our banking relationships and the ability to support the pre-deal, deal, and post-deal processes – managing related issues and risks.*



# Negotiating Your Strategy: Mind-the-Gap

*Successful combinations of investment banking and “China hand” experience is rare as some firms try to hire “connections”, learn banking skills on trial-and-error, or recruit teams of fresh bankers – all with their own risks.*

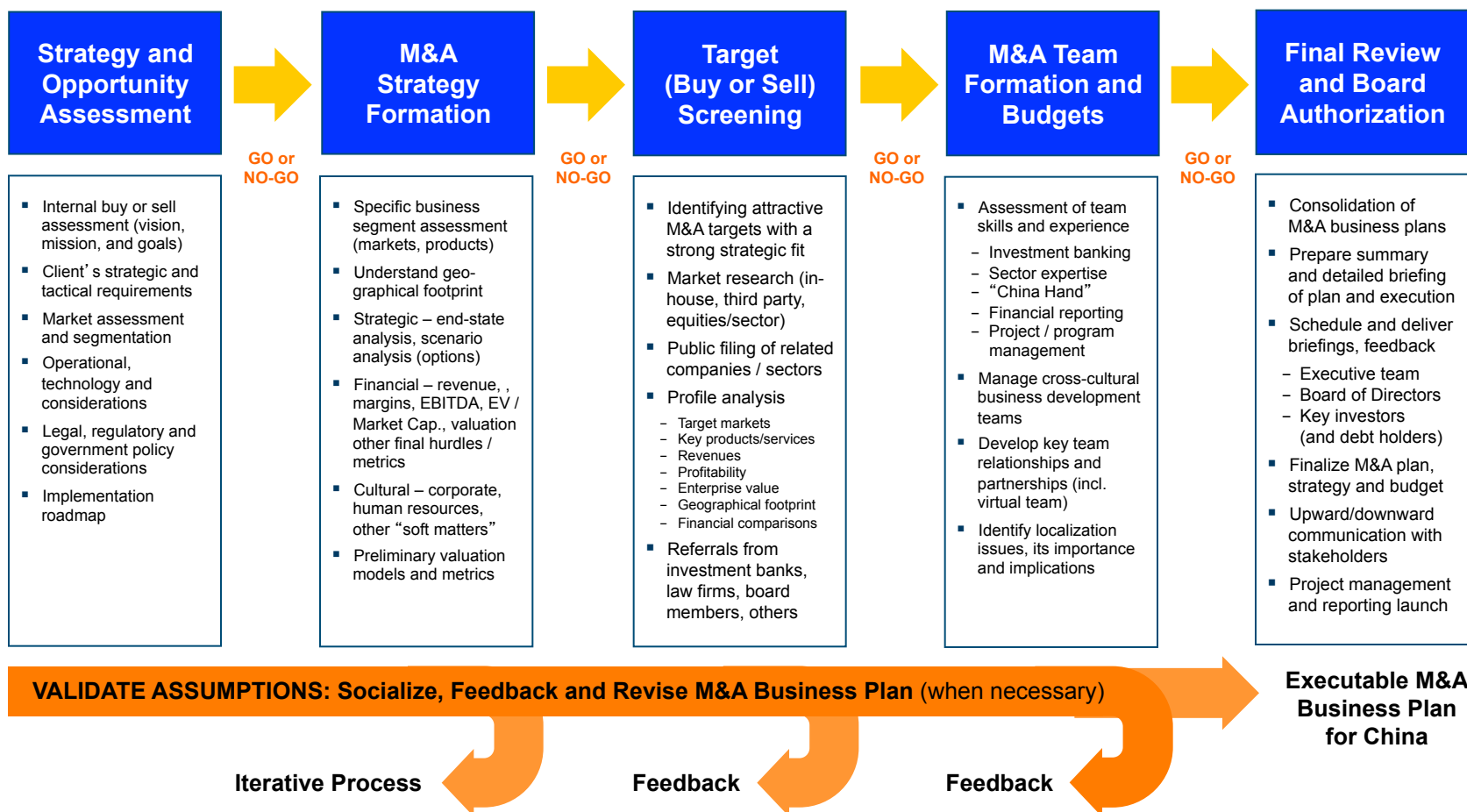
	Western Generalization	Chinese Generalization
Initiating the Negotiation Process	Informal “fly-ins” as part of regional trip for a “get to know you” exercise. Some-times through “cold calls”. Little thought given to rank, age or experience.	Usually a formal courting “get to know you” process (wrong person can kill a deal). “Guanxi” (connections), “Zhong-jian Ren” (intermediaries) are important.
Exchange of Information	Person on-the-ground has full authority (senior or mid-level) to exchange information. Starts with “strawman” proposals revealing elements of its strategy.	Liaison with limited authority through a process of exploratory info-gathering. Revealing strategy is unlikely in early stages in that it can leak to competitors.
Method of Negotiation	Deductive linear process (e.g., in/out of scope through Term Sheet, then Equity or Contractual Agreement). Negotiation style can be aggressive and impatient.	Inductive (holistic) thinking, discussing all issues simultaneously. Emphasizing the “whole package” over details. Focus: “Renji Hexie” (interpersonal harmony).
Terms of Agreement	Heavily reliant on legal “rules based” system where documents override the essence of an agreement. Focused on forging a “good deal” or “transaction”.	Relationship (and legal) based with a culture of avoiding conflict and compensating for weak rules and few lawyers. Focused on long-term relationship.

- Notes: 1. “Fly ins” from outside of China (including Hong Kong) are sometimes considered the equivalent of “interlopers” due to general wariness of foreigners.  
 2. Guanxi describes the basic dynamic in personalized networks of influence, and is a central idea in Chinese society: for Westerner, can be good and bad (unethical) types.



# Pre Deal Consulting/Advisory (if required)

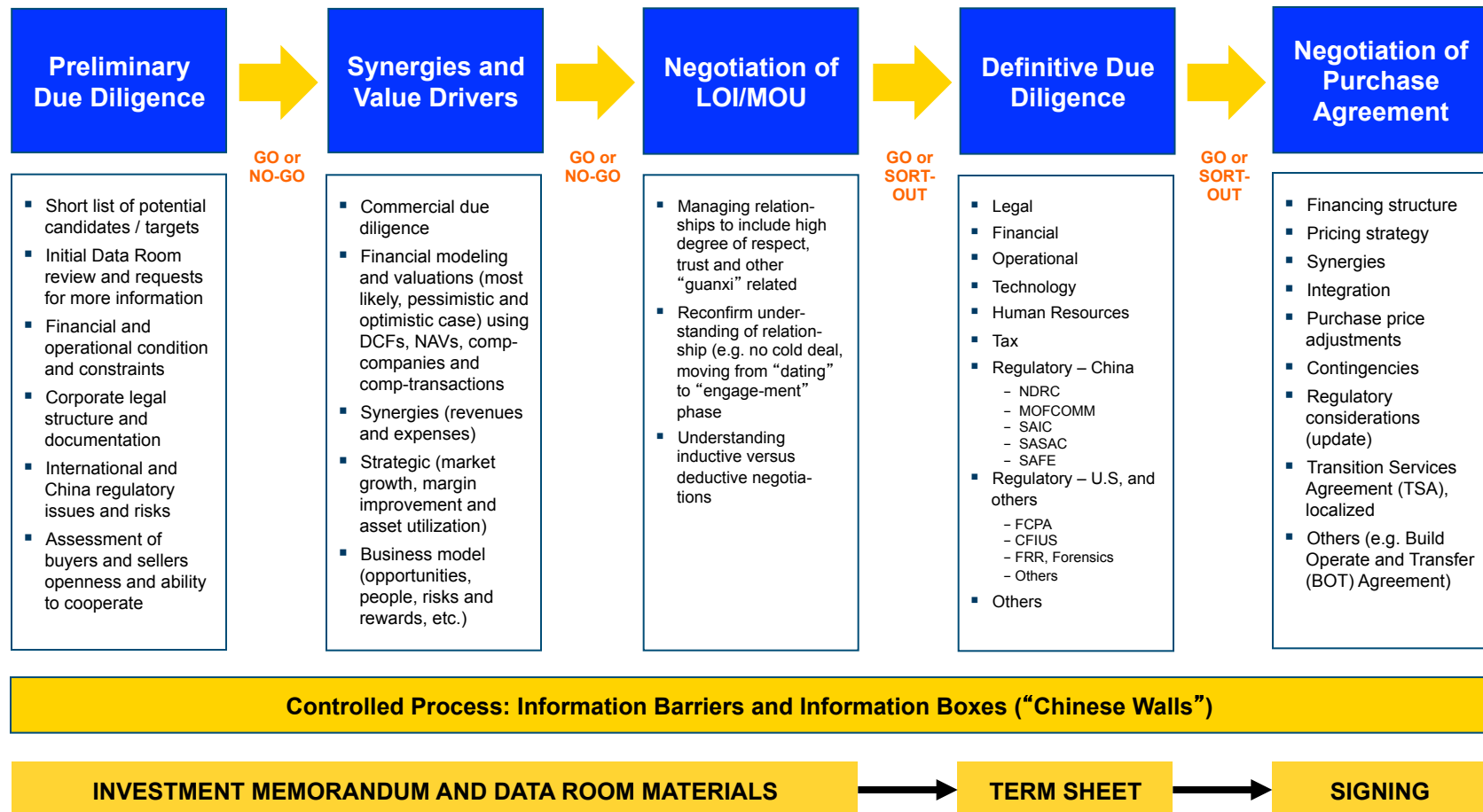
*China cross-border M&A planning includes combining some key business-cultural nuances with “Western-style” methodologies and processes, integrating critical elements with project management. Wilton Partners draws on our global and local M&A experience to deliver on these requirements to greatly improve success.*



*Note: M&A buy and sell-side is NOT differentiated as, due to the lack of experience on the Chinese side, considerable handholding is required from the Western counterpart.*

# M&A Negotiation to Signing Process

*Successful Chinese M&A deals are anything but simply transactional. They rather require a deep and broad cultural understanding. Chinese CEOs and their management teams generally rely on relationships versus legal sophistication, yet they are highly competent in understanding their business.*

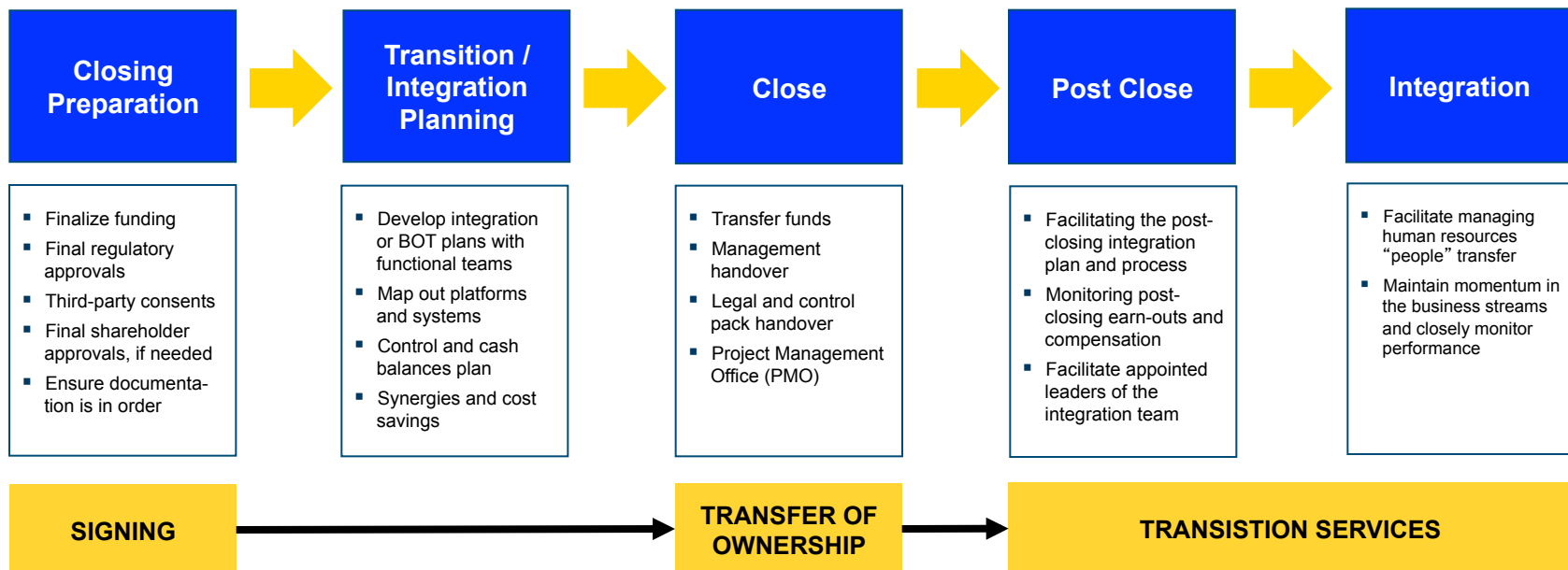


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# M&A Closing to Integration Process

*China's unique operating and regulatory environment, critical integration issues and general complexities of doing business in China are often the reasons for poor execution, including the lack of proper due diligence (buy and sell side), poor protection of IPR, and poor communication across key stakeholders in a "transaction".*



- Western-style legal transfer and integration process (e.g., Transition Services Agreement or "TSA") rarely suffices in its own right, requiring relationship and trust building with stakeholders – avoiding a litigious environment.
- Cultural integration is also a serious consideration yet is rarely examined thoroughly until late in the M&A process. Common mistake is to view Chinese companies as similar to those in Hong Kong or other Asian countries.
- Notwithstanding government bureaucracy Chinese suitors can be extremely pragmatic and ideal business partners.

*Note: M&A buy and sell-side is NOT differentiated as, due to the lack of experience on the Chinese side, considerable handholding is required from the Western counterpart.*

# Issues & Risks: Outbound (Chinese Buy Side)

*Despite government bureaucracy, Chinese acquirers can be extremely pragmatic and ideal business partners...but it is important to note, while China is used to cooperating with foreigners in China, Chinese find it difficult investing offshore – reflecting years of social, political and economic seclusion.*

Element		Issues & Risks
1.	Lack of Experience in Formal Western Style Investment Processes	Successful Chinese M&A deals are far more than transactional and starts with both the buy and sell-sides developing a deep and broad understanding and motivations of each other. Chinese CEOs and their management teams generally rely on relationships over legal sophistication
2.	Perceived (and Real) Concerns of Foreign Political Backlash	Buy and sell side evaluation of potential political implications needs to be done well in advance. e.g., CNOOC's attempt to purchase Unocal in 2005 is still on the minds of many Chinese. Analysis should be as comprehensive as practical and must go beyond obvious issues
3.	Openness Towards Cultural Understanding and Communications	Most cultural obstacles are best addressed with early and consistent collaboration and partnership with local players to ensure interests are aligned. Ignoring local traditions and methods at your own risk. For example, Guanxi, Face, Harmony and other Chinese business customs
4.	Limited Understanding and Managing of Local Regulatory Processes	Complying with foreign laws can be overwhelming for Chinese companies during both the deal-making process and post-closing integration phase. Laws such as the Foreign Corrupt Practices Act can pose pre-closing due diligence disclosure issues or post-closing compliance obstacles.
5.	Pre Closing Integration Planning	Closing cross-border transactions are usually a major milestone for Western companies. But for most Chinese, in order for such a deal to be successful, post signing process is just as important. For example, Western-style legal transfer and integration process (Transition Services Agreement or "TSA") rarely suffices in its own right, requiring relationship and trust building with stakeholders.

# Issues & Risks: Inbound (Chinese Sell-Side)

*Quality of Chinese financial statements, professional staff, supporting infrastructure and documented business processes are lower than Western investors are accustomed and need to be mitigated.*

Element / Issue	U.S. / Europe	China
1. Financial Information Transparency	High.	Limited, Low, if any.
2. Average Duration for Due Diligence	1-8 weeks.	3-12+ weeks.
3. Preparation Time Required by Target Company before Due Diligence	Minimal.	May require extensive assistance, sometimes with the help of the buy-side.
4. Basis of Financial Statements	U.S. GAAP or IAS.	PRC GAAP.
5. Audited Financial Statements	Reputable standards.	Typically not reliable from a U.S. GAAP or IAS perspective
6. Extent of Related-Party Transaction	Varies: typically fully disclosed.	Usually extensive: inadequately disclosed.
7. Disclosure of Contingent Liabilities	Usually transparent.	High risk area and rarely disclosed.
8. Automated Accounting Systems	Typical.	Evolving: large dependence on manual processes.
9. Representations and Warranties	Normally reliable.	Limited to Untested.
10. Enforceability of Indemnification Claims	Strong: backed by courts.	Untested: may need to consider holdbacks.

*Source: Ernst & Young and Wilton Partners analysis.*

# Pre Entry Strategy: What We Can Learn From Others

	Description	Example	Outcome
Cold Turkey	Foreign firm knows what it wants and meets short-listed companies. Expectations are that a deal will be completed within 3-6 mos. Foreign and Chinese firm sign LOI/MOU.	Companies used to “quick transactions” supported by world-class lawyers and “Big 4” accountants – as they’ve done so in Asian Tiger countries and even Japan (Note).	Foreign firm committed capital but since had misunderstandings with the Chinese partner. Finds limited legal remedy. Costs many times more to fix (or close) the business.
Chicken Little	Foreign firm agrees to enter China but, while unsure where to start, is encouraged by China’s “feeling the stones” approach (Note). Sets-up equity or contractual Joint Venture.	Company that understands “China is different” and has been able to identify a local partner willing to experiment. With limited capital or “skin in the game” it will pace itself.	Limited sense of mission results in local teams being disenfranchised with operations not managed well. Regulatory, reputational and other issues arise that will limit opportunities for the foreigner in the future.
Perfection	Foreign firm that plans to wait until the conditions are right (policies, legal, regulatory, etc.) so they can negotiate predominately on their own terms and conditions.	Financial, media, healthcare and other sectors that currently have restrictions for foreign entry with the thinking they will wait for the rules to change in their favor.	Opportunity never arrives as, once conditions are ripe, those firms on the ground (vs. visits from HK) and helping to develop the market are granted access, sometimes grandfathered with preferred status.
Thought Out and Practical	Foreign firm has an understanding of the “moving parts” and builds an adaptive and executable strategy with both international and local elements (incl. exit plan “prenupt”).	GE, GM, VW, BMW, Intel, HSBC, Citigroup, Siemens, GSK, LVMH, and many others, large and small firms, that learnt from mistakes – yet made a long-term commitment.	After an initial rough period, small and large foreign firms are now successful in China with significant global earnings contribution and an even larger % of future growth.

- Notes:**
1. Popular expression “cross a river by feeling the stones” refers to the policies of Deng Xiaoping to move ahead with economic reforms slowly and pragmatically.
  2. Asian Tigers is a reference to the highly developed economies of Hong Kong, South Korea, Singapore and Taiwan – reforms significantly influenced by the U.S. and British.
  3. Japanese Securities and Exchange Law was enacted by the Japanese Diet during the Allied Occupation of Japan and was closely patterned after the U.S. Securities Act of 1933 and the U.S. Securities Exchange Act of 1934. Japan, while arguably having its unique culture, many of the rules and protocols are similar.

# Executing Entry Strategy: Not So Black & White

	Best Case Scenario	Worst Case Scenario
<b>Hire Local Chinese Head “Day 1”</b>	Leverages his or her relationships when navigating day-to-day regulatory issues, negotiates the approvals for additional business activity, and wins new clients.	Local manager establishes his or her own fiefdom or hierarchy that does not work well with global-functional organization. Operation ends-up “rogue”.
<b>Hire an “ABC”, HK Chinese, etc.</b>	Comfortable with business culture with highly effective communication skills. Future candidate for moving-up in the international organization/head office.	Never connects with local staff, HK vs. PRC tensions, and becomes ineffective, possibly limiting their career within the organization so leaves to a competitor.
<b>Hire Returning Chinese Fresh from Business School</b>	Groom / develop specifically to the firms corporate culture yet able to identify with local staff. Best of both worlds.	Returning Chinese person was not able to receive enough practical experience and mentoring that is required to be a truly effective manager in either world.
<b>Deploy Tenured Manager</b>	Extremely competent manager with the prerequisite technical skills to train local staff. Local officials like the knowledge transfer and builds commercial “guanxi”	Experienced or other (Note) managers are usually deployed in 3-year rotations and at times return early as China is not to family liking or other personal matters.

- Notes: 1. American born Chinese (ABC).  
 2. Guanxi describes the basic dynamic in personalized networks of influence, and is a central idea in Chinese society.  
 3. Some foreign firm have a tendency to either deploy the wrong skill-set (e.g. managing up versus managing down) or was the only person to take the role.

# Questions?





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