

A Brief Discussion on the Causes of Enterprise Merger and Acquisition Failure

-- Taking Wanda Group's Acquisition of Legendary Pictures as an Example

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ABSTRACT

In the past 20 years, with the development of economic globalization, the trend of mergers and acquisitions among enterprises has been significantly strengthened. Various types of enterprises are carrying out horizontal, vertical or cross-field strategic mergers and acquisitions, hoping to seize market share through synergies, reduce the resistance brought by competitors or improve the industrial structure of enterprises, so as to maximize the value of enterprises.[1] However, looking at the development history of mergers and acquisitions, the performance of most enterprises after mergers and acquisitions fails to meet the original expectations, and even some enterprises will be heavily in debt. In view of this phenomenon, most Chinese scholars pay attention to the micro pricing behavior of enterprises, and there are few researches on the macro level. Therefore, this paper adopts the method of combination of directional and quantitative, through Wanda's failed acquisition of Legendary Pictures to illustrate the main macro reasons for the failure of most Chinese enterprises in M&A and the risk of M&A, and puts forward suggestions for the future development of M&A among enterprises.

Keywords: *Mergers and acquisitions, Macroscopic reason, Risk*

1. INTRODUCTION

Some studies show that companies are in a better position if they prefer to merge with another company and if they don't acquire any other company first.[2] The failure rate of mergers and acquisitions is as high as 60%, and in China it is even higher, reaching 80%. In the increasingly fierce merger and acquisition wave, whether enterprises can survive the merger and acquisition and increase profits has become the focus of theoretical discussion.[3] However, the focus of the theoretical circle is on the pricing of enterprises. As for the financing of M & A, it only uses western theories for reference and does not combine with the reality of China deeply. For the integration after merger and acquisition, most focus on the system innovation and corporate culture, but rarely discuss risk prevention. Therefore, it is necessary to fill the blank of macro causes of merger and acquisition failure, so as to provide useful help for more enterprise mergers and acquisition in the future.

2. THE MAIN MACROSCOPIC REASON FOR MERGER AND ACQUISITION FAILURE

2.1 The Timing of the Merger Failed to Take into Account Economic Trends

The development of the economic situation has certain rules, and the merger and reorganization of enterprises should be consistent with the development of the economy. Most Chinese companies rely on the growth of the economy, while very few rely on their core competitiveness. Growth is very important when most enterprises depend on the general trend of development. When China's GDP growth rate is 6-7%, if the enterprises do not grow, after ten years the enterprises will completely disappear. Moreover, a country's GDP growth slowdown usually leads to a devaluation of its currency. This will be very unfavorable for the country to conduct overseas acquisitions. The empirical studies of western

economists have proved that M&A is positively correlated with the economic cycle.

However, according to Gu Wenjun, a Chinese academic, a study of mergers and acquisitions by Chinese companies shows that this is not the case in China.[4] According to Dealogic, the failure rate of cross-border acquisitions by Chinese companies in 2009 and the rate at which announced cross-border deals were withdrawn, rejected or allowed to expire. It was the highest in the world at 12 percent. That fell to 11 percent in 2010, but

is still the highest in the world. By contrast, only 2 percent of US and 1 percent of UK companies failed to make overseas acquisitions in 2010. Compared with the bottom of previous years, China's GDP in 2009 was in the stage of economic recovery, so there would be great risks in investment at this time. Therefore, one of the reasons why many enterprises fail in M&A is that they fail to grasp the best opportunity.

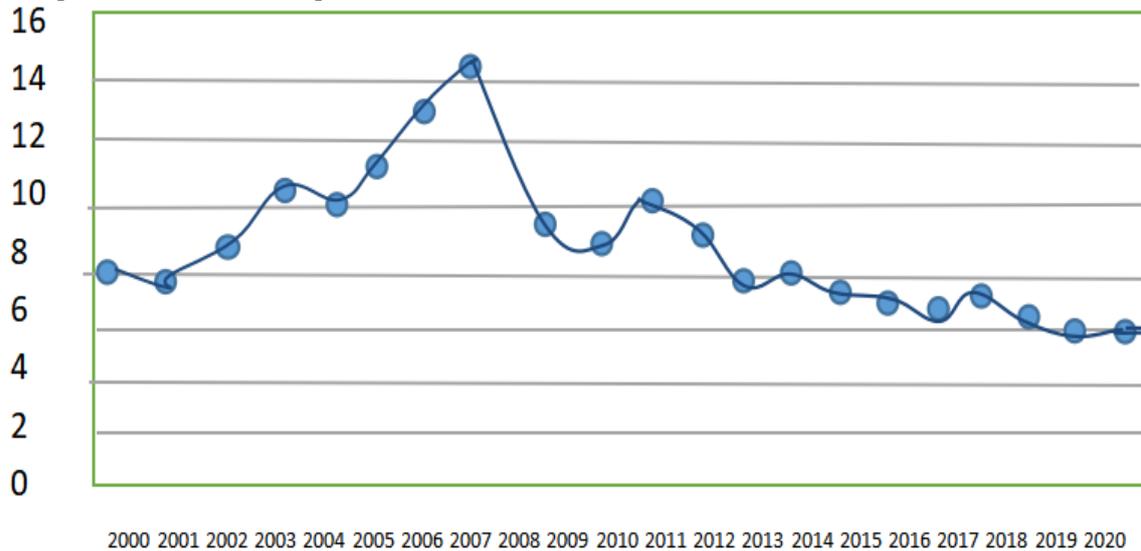


Figure 1 China's GDP growth trend chart from 2000 to 2020

2.2 The Merger Failed to Achieve a Win-Win Situation between Buyer and Seller

The fundamental motive of enterprise merger and acquisition is the nature of pursuing profit and realizing the maximum value of the enterprise. However, in the process of merger and acquisition, enterprises are more concerned about the value they can obtain from the acquired party, and seldom consider how to better empower the acquired party after the merger and acquisition when formulating the strategy[5]. For a long time, cross-border mergers and acquisitions have been an effective means for Chinese enterprises to enhance their capabilities on the road of globalization. However, the various motivations adopted by these enterprises in cross-border M&A often have different effects on their performance [6] If the two sides can not realize the win-win value of the enterprise, the merger will fail one day.

2.3 Misestimating the Value of the Target Company

Due to the lack of due diligence, enterprises often only see the profit side of the acquired company and have no clear concept of the operation logic of the acquired company, leading to some enterprises' blind confidence

that they can take over the whole business after the merger.

3. CASE INTRODUCED

3.1 Company Introduction

China Wanda group has developed into an international large enterprise group covering port logistics, petrochemical, rubber tire, international trade and other industries. Wanda Group has interests in commercial real estate, culture, Internet technology and finance. Wanda Group Co., Ltd. ranks 28th in the list of China's top 500 private enterprises in 2020.

Legendary Pictures is an American independent film production company founded by Thomas Tourre in 2000. Its parent company is Legendary Entertainment, headquartered in Burbank, California, USA. The company struck a deal with Warner Bros. in 2005 to co-finance and produce 40 films. His major works include Inception, Batman and so on.

3.2 Merger and Acquisition Process

On January 12, 2016, China's Wanda Group acquired Legendary Pictures for less than 3.5 billion US dollars in cash, which is the largest cultural acquisition case by a

Chinese enterprise abroad so far. Legendary Chairman and CEO Thomas Tourre will remain in his role and continue to run the company on a day-to-day basis.

3.3 Mergers and Acquisitions Results

On the "Chinese style" deep, legendary pictures did not show the bright eye, instead been in the market, such as might be expected, look to the Chinese market although "Great Wall" flagship "Chinese elements", but it is covered with Hollywood heroism mode of products, in the Chinese market sales encounter cold, only 1.2 billion, us box office is poorly (less than \$50 million us box office), faced with huge losses of \$75 million. In early 2017, Legendary founder, chairman and CEO Thomas Tourre announced his resignation. The main reason was Wanda's dissatisfaction with his management and ability to run projects like "Great Wall" and "Pacific Rim 2".

4. CASE ANALYSIS

Wanda's acquisition of Legendary took place in 2016. The level of interest rates has a strong influence on the conclusion of international deals.[7] Influenced by the European crisis, the world economy recovered slowly in 2016 and was still in a low-speed growth trend. At this time in addition to the appreciation of the US dollar, all regions in the world are in the economic downturn, currency devaluation. In addition, at the Central Economic Conference in 2016, China also proposed to cut overcapacity, destocking, deleveraging and reducing costs. At this time, Chinese enterprises should better ensure the stability of cash flow. Under the comprehensive economic situation at home and abroad, it is inappropriate for Wanda to invest and acquire Legendary Pictures in the United States at this time.

While the case was seen as a sign of Wanda Group's foray into Hollywood, it has since sold 91 percent of its shares in 13 cultural tourism projects and 77 hotels to Sunac China and R&F Real Estate for a total of 63.75 billion yuan. It has since sold 37 Wanda stores to Suning. The sale, all and Wanda Group after the acquisition of Legendary Pictures profit and loss linked. The motivation of Wanda Group's acquisition of Legendary Pictures is to use the IP resources of Legendary Pictures to build relevant industrial chains and greatly enhance Wanda's core competitiveness and voice in the global film industry. However, for a group mainly engaged in real estate, its experience and ability to operate the cultural industry is relatively lacking. That would not generate a relatively high value for Legendary after the acquisition. Therefore, Wanda's single win will not contribute to the overall success of the merger. In addition, a study has shown that the effect of mergers and acquisitions between enterprises is transmitted to cross-industry effect is farther than the same industry, for a longer time.[8]

Legendary is a volatile company. Although Legendary has produced several well-regarded films in the past, it was a different company at the time of the acquisition. Legendary is a product of the Hollywood system, and the Chinese version of Hollywood films created after being acquired by a Chinese company is difficult for audiences to accept. Studies show that countries with greater cultural differences are more difficult to operate after mergers and acquisitions.[9] Poor integration after the merger also contributed to Wanda's losses.

5. RISK TIPS AND RECOMMENDATIONS

Wanda's acquisition of Legendary Pictures shows how important it is for companies to do a good risk assessment before an acquisition. For cross-border mergers and acquisitions, enterprises should pay more attention to the differences in the economic situation between the two countries at that time, striving for the best time to take the M&A action. In cross-border mergers and acquisitions, attention should also be paid to the cultural differences between the two countries and whether the products of the enterprises have the opportunity to be well integrated into their own countries. In addition, enterprises should pay attention to the risk of information asymmetry between the two parties in the process of cross-industry M&A. The enterprise should investigate the current situation and future development prospects of the acquired industry in advance, make a decision that can be mutually beneficial and mutually complementary, and provide valuable skills and value to the acquired company. At the same time, we should also avoid the agency cost problems such as the loss brought to shareholders in order to pursue the maximization of corporate interests. In addition, enterprises should be cautious in making mergers and acquisitions that are not related to their main businesses, so they do not have to adopt such a high-performance betting mode to avoid such risks. In today's increasingly intense merger and acquisition wave, enterprises should be rational investors, comprehensively analyze the benefits and risks before the merger and acquisition, and make the most appropriate decision.

6. CONCLUSION

The high failure rate of M&A in China is not only related to the micro perspective of M&A, but also related to the macro level when enterprises make decisions. It is closely related to the macro economic environment at that time, the macro motivation of M&A and the macro investigation of target companies. Therefore, when making merger and acquisition decisions in the future, enterprises should combine the macro with the micro, combine the foreign experience with China's national conditions, and consider the interests and risks.

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