

Cross-Border M&As of Chinese Firms——A Case of TCL

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ABSTRACT

Cross-border mergers and acquisitions are a common method for companies to expand the oversea business. As the economic development of the emerging counties, more firms in emerging market started to join the international market by cross-border M&As. After China joining World Trade Organization (WTO), Chinese firms became active in the global market. To study the cross-border M&As of Chinese firms, this paper analyzed TCL to find out the characteristics of Chinese firms. And through analyzing the case that TCL merged Thomson, this paper found that the merger caused loss to TCL. According the absorptive capacity theory, this paper analyzed the causes of failure. There were mainly three reasons, overconfidence, market differences and poor execution. This paper can provide reference for scholar who tend to study cross-aboard mergers and acquisitions of Chinese corporations.

Key words: Cross-border mergers and acquisitions, emerging market, absorptive capacity

1. INTRODUCTION

Mergers and acquisitions (M&As) have attracted more and more attention by scholars because more firms have chosen mergers and acquisitions to expand their operations [1]. Merging or acquiring a business or an entire company, the acquirer can gain scale or enter to a new market rapidly. It can help acquirer to gain the scale economy and scope economy. A successful M&A can usually bring synergistic effect to the firms and make the operation more effective. Particularly, cross-border mergers and acquisitions are a common method for the corporation to enter the oversea market and deploy their internationalized strategy. In the early 2000s, the economy of China has experienced rapid growth. As China joined World Trade Organization (WTO) in 2001, China became an important participant in the global economy. In order to enter the international market rapidly, many Chinese companies chose cross-border mergers and acquisitions. This paper will choose the case of TCL, which is one of the largest scientific and technical corporations in China, to study the cross-border mergers and acquisitions in China. Under such a background, TCL appeared in international market actively and carried out several cross-border mergers and acquisitions. The case from it can help this

paper to find out the characteristics of Chinese corporations' cross-border M&As.

2. CASE BACKGROUND

2.1. Cross-Border M&As of Chinese Firms

Foreign direct investment (FDI) is an effective way for the company to gain strategic asset which can help them to build competitive advantage. Particularly, in the emerging economy, mergers and acquisitions are one of the most common methods for firms to establish competitive advantage and enter a new market [2, 3]. Corporations in emerging market has increasingly chosen oversea mergers and acquisitions to start their business in the globe market. Chinese enterprises have also been active participants in the cross-border mergers and acquisitions [4]. After Chinese government implementing the reform and opening policies the *Go Out Policy*, Chinese firms had more opportunities to join the globe economy. The companies in China, which owned a large amount of capital and were supported by the government, started to expand their international business by oversea mergers and acquisitions [5]. The number of oversea mergers and acquisitions completed by Chinese corporations was 33 in 2000 with the value of 839 million dollars, but in 2012 the number reached 146 and the value of those deals increased to 22 billion

dollars. Those mergers and acquisitions were good samples for this paper to analyze the globalization process of China. Those actual cases were also good tools for scholars to study the cross-border mergers and acquisitions in emerging market.

2.2. TCL

Formed in 1981, TCL is a comprehensive household electrical appliance manufacturer. The development of TCL exactly followed the pace of China's economic growth. In 1978, China implemented the reform and opening policies, which transformed the China's economic system from planned economy to market economy. It provided a more large and flexible domestic market for the local corporations. As the deepening of the reform, the economy of China grew at a high rate of speed. According to Chinese government, from 1978 to 2012, the annual growth rate of China's economy was 9.8% [6]. The economic growth stimulated the national consumption, which resulted in the rapidly increasing demands for electrical appliances in China. TCL was born in this condition. With the opportunities from market and the support from government, TCL has become one of the largest home appliances manufacturers. In the late of 1990s, the sales of TCL grew at 42.66% annual [7, 8].

As more and more competitors entered the household electrical appliance market, the competition in China has become intense. It resulted in a lower profit rate of home appliance industry. What's more, in 2001, China joined WTO, which removed the trade barriers between China and the world. More foreign product entered Chinese market, which also intensified the competition. However, it provided opportunities for Chinese company to expand their business oversea. The corporate strength made TCL as the one of the pioneers to enter the global market. In order to keep the sales and profit growth, TCL started its oversea strategy by established business in Southeast Asia and started its mergers and acquisitions *Dragon Plan*. TCL firstly acquired a Hong Kong-invested color TV manufacturer in Vietnam. In the next year, after TCL integrating the business, the Vietnamese company started to earn profit. After that, TCL entered different emerging market and achieved success, such as the Indian market. TCL also paid the attention to the western market. In 2002, TCL acquired Snyder to enter the European market, and in 2003, TCL entered American market by acquisition. In 2003, in order to become the leader of the color TV industry, TCL acquired the TV division and DVD player division of Thomson France and formed a joint venture TTE with Thomson France to produce and sell color TV. With those brands, TCL could enter different markets more easily. Those mergers and acquisitions did help TCL accelerate its internationalization process.

2.3. Merger with Thomson France

Thomson was formed in 1893, one of the largest corporations in France. It has merged the consumer electronics division of General Electronics and acquired a local brand RCA in the USA. From then on, Thomson forced on the production of consumer electronics and became one of the largest consumer electronics companies in the world. Now, it has been renamed to Technicolor SA, providing products and services for media and entertainment industries.

In 2003, TCL and Thomson came to an agreement, and TCL merged the TV sector and DVD player sector of Thomson. They set up a joint venture TTE, owned by TCL at 67% and by Thomson at 33%. This company was in charge of the R&D, production and sale of color TV and DVD player. After the merger, TCL became the absolute leader in Chinese color TV industry. When the TTE started its business in different market, it took an appropriate brand strategy. When selling in developed market, such as Europe, it kept using Thomson brand, which was already known by the customers. It could help it to maintain the market shares in such a mature market. However, in the merging market, such as Asia, it chose TCL as the brand. It could help TCL to promote its own brand and build customer confidences. With this flexible brand strategy, TTE entered different market easily.

This merger attracted a lot of attention and became the hottest topic in Chinese capital market. TCL became a Chinese company that could compete with the other multinational corporations. It was rare at that time. This merger seemed to be a great success. Thomson disposed its unprofitable business. TCL expended its scale and accelerated the process to enter oversea market. Whether the merger can bring benefit to the shareholders of TCL is not clear. This paper would conduct the event study to examine it with data.

3. ANALYSIS ON TCL'S ABNORMAL RETURNS

This paper used abnormal return to measure how the cross-border mergers and acquisitions impact the shareholders wealth. In order to estimate the abnormal return, this analysis referred Brown and Warner's event study methodology [9]. In this case, this paper tried to find out whether this specific merger applied by TCL Electronics is successful. It chose Hang Seng Index to measure the market and the performance of TCL Electronics Holdings Limited to measure the company. Based on the CAPM model, this paper built the model to estimate the return of TCL.

$$r_i = \alpha + \beta r_m + \varepsilon \quad (1)$$

To determine the parameters of this model, this analysis used the data in the day interval [-265, -11] to calculate the return of TCL. Using the ordinary least

squares method (OLS) to regress the model, this paper found out the relationship between the return of TCL and the return of the market, which can be used to estimate the abnormal return in this merger and acquisition.

Table 1. The relationship between the return of TCL and the return of the market

Variables	Coefficient
r_m	0.8978116
Constant	-0.0003247

Based on the model, the estimated returns can be calculated by the regression result (Table 1). The abnormal returns would be the differences between the actual returns and the estimated returns. In this case, the cumulative abnormal return, CAR (-1,1) can show the abnormal return while the mergers and acquisitions happened. In this event, when TCL electronics merged Thomson SA, the calculation result shows that the cumulative abnormal return is -2.904%. It meant that this merger brings negative abnormal return to the shareholders.

4. DISCUSSION

Based on the calculation of the abnormal returns, it can be found that this merger is a failure. The shareholders of TCL suffered loss in this merger. According to the following performance of TCL, the TCL did fail in this merger. Because the loss from the color TV division of Thomson was great, the TCL group started lost in the fourth quarter of 2004. In the first three quarters of 2005, the TCL group lost more than 1,100 million yuan and in the first half of 2006, it lost more than 700 million yuan. The lost influenced the investor confidence and made the share price of TCL fall. Considering the actual situation of this case, this paper would discuss the reasons why this merger failed.

4.1. Absorptive Capacity

Peng has introduced absorptive capacity to explain the failure of cross-board mergers and acquisitions [10]. According to Grant's knowledge-based perspective [11], the knowledge is a significant resource for company to gain competitive advantage, and the firms usually gain the knowledge from cross-board M&As when they expand their oversea business. The ability for the companies to gain the knowledge and to apply it to the commercial activity, is defined as absorptive capacity. This theory divided the absorptive capacity into three ability. Firstly, it is important to identify the valuable knowledge. When conduct cross-board M&As, the companies need to know what can benefit the business. It relies on the related knowledge which the companies have already owned. In this case, TCL has already owned rich experience in manufacturing household appliances. However, the experience in international

trade is also important. As the pioneer to implement cross-board M&A in China, TCL did not have enough experience to refer. As a result, lack of international experience could be one of the reasons why it failed. Secondly, the ability to absorb and organize the knowledge is significant. It requires the company to syncretize the new knowledge and the old knowledge, and form synergy. Meanwhile, the knowledge should be propagable in company-wide scope so that the knowledge can applicable for the acquirers. TCL may also have problems with syncretizing the knowledge. In the end, how to apply the knowledge and turn it into competitive advantage is the key step. It requires effective execution. The companies need to use the knowledge in the appropriate market and at the right time. It also required the companies own some complementary resource to help the strategy implementation. The companies need to satisfy those three conditions so that they can gain competitive advantage in cross-board M&A.

4.2. Failure Analysis

Based on the three components of absorptive capacity, this paper summarized three reasons to explain the failure of this merger.

4.2.1. Overconfidence

Overconfidence is a common bias when the investors make investment decision. The investors would believe they can do better than others. When investors are trapped by overconfidence, they will evaluate the investment improperly and will usually ignore the risk. In this case, TCL made this mistake. TCL did well in developed market but it lacked of understanding about developed market. When the consulting company provided a risk warning about this merger, TCL chose to ignore it. TCL finished the merger without a comprehensive understanding the situation of Thomson. At that time, because of the loss from TV and DVD divisions, the financial situation of Thomson is poor. Meanwhile, the brands of Thomson were becoming weak in European market and American market. It decreased the value of this merger. What's worse, TCL did not recognize the importance of the sales channels and the intellectual property, which were not transferred to the joint venture. In summary, because of overconfidence, TCL did not identify the necessary knowledge so it is hard for TCL to gain advantage from this merger.

4.2.2. Market Differences

Lack of international experience, TCL made mistakes when facing the market differences. TCL did not syncretize the knowledge well when merged Thomson. Firstly, TCL had problems with the cultural

differences. In China, working overtime was a common condition, which would not arouse great disaffection among employees. However, the employees of Thomson from France would not accept it. TCL continued to organize meeting during weekends, which caused discontent among the French employees. Moreover, TCL did not adjust the management style after merger with Thomson. The original organizational structure, the values and the corporate culture were not accepted well by French employees. What's more, because of the different economic levels between emerging market and developed market, labor costs were different and the composition of labor costs were also different. TCL did not realize this point and not adjust it human resource management. The result was that many employees chose to leave. Without syncretizing the knowledge well, TCL was hard to earn competitive advantages.

4.2.3. Poor Execution

TCL was intended to gain more profit by achieving economies of scale, when it planned to execute this merger. However, the problem was that the cost of production in Europe was much higher than in China. It was very difficult to expand the production scale rapidly. TCL could not copy the success in Vietnam and in India to the European market. TCL should be good at achieving economies of scale, but it failed in developed country. Meanwhile, the oversea expansion of TCL was too rapid, which brought stresses and made the management more difficult. It increased the financial burden of TCL. The execution was more difficult with the over-rapid business expansion. The managers did not have enough time to analyze the former M&As. Under such an aggressive strategy, TCL could not absorb the knowledge and apply it on the further execution. With the poor execution, TCL cannot succeed in this merger.

5. CONCLUSION

This paper has focused on the cross-aboard mergers and acquisitions in China. It explained the background and characteristic of the cross-aboard mergers and acquisitions in China, which were supported by the Chinese government. In order to prove the statement effectively, this paper introduced the TCL as the case to analyze. As the pioneer of oversea expansion and one of the largest home appliance manufacturers, TCL was a good representative of Chinese corporations at that period. This paper used event study to analyze the merger between TCL and Thomson. The result showed that this merger brought loss to TCL. To explain why this merger would fail, this paper introduced the theory about absorptive capacity. It found that there were mainly three reasons leading to the failure. They were overconfidence, market differences and poor execution. This paper can provide reference for scholar who tend to

study cross-aboard mergers and acquisitions of Chinese corporations. This case could also provide inspiration to the corporations in emerging market who plan to expand oversea.

AUTHORS' CONTRIBUTIONS

This paper is independently completed by Zeshen Ye.

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