Influencing Factors and Risk Control in Cross-Border Mergers and Acquisitions

Huili Liu(✉)

Faculty of Social Sciences, Mcmaster University, Hamilton L8S 4L8, Canada
Provendalili@gmail.com

Abstract. Since 2000, the fifth wave of mergers and acquisitions has swept the world, the scale of mergers and acquisitions has continued to expand, and multinational companies have continued to emerge. In the process of M&A, enterprises are faced with huge risks and challenges. This paper provides enterprises with more experience and guidance by analyzing the factors affecting M&A and the risks. This paper also introduces three methods to measure an enterprise's financial situation, KPI Balanced Scorecard, the EVA performance evaluation system, and the Z-score model. In addition, this paper also briefly introduces the successful and failed cases of cross-border M&A of enterprises, hoping that enterprises can learn from them and reduce some possible merger and acquisition risks.

Keywords: Cross-border mergers and acquisitions · KPI balanced scorecard · EVA · Royal Dutch Shell · Daimler&Chrysler

1 Introduction

As the market enters the monopoly stage from free competition, M&A has become a way of capital accumulation and concentration. After the 1990s, with the accelerated development of economic globalization and trade liberalization, cross-border M&A began to set off a wave of M&A all over the world, and gradually became the main way of global foreign investment [1].

According to Fig. 1, from 1991 to 2000, cross-border M&A sales increased by more than 10 times, while purchases also increased by more than 5 times.

This paper mainly focuses on the factors that lead to M&A outcomes. At the same time, it also analyzes the risks that enterprises may encounter in cross-border M&A and the ways to avoid and prevent them, so as to provide a guide for enterprises. Through the analysis of the influencing factors of M&A, enterprises can more accurately measure the overall financial situation and income of the acquired enterprises. In the investigation and research of actual risks, enterprises can take into account more comprehensive factors while effectively diversifying and avoiding risks.

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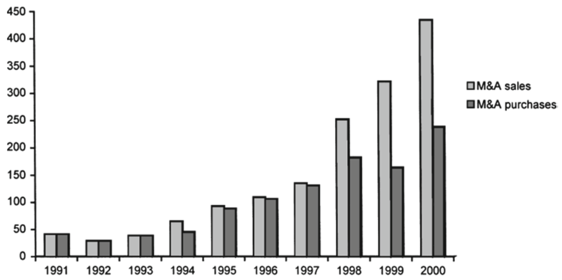

Fig. 1. Cross-border M&A (US$ billion) [2] *Source: Chen, C., & Findlay, C. A Review of Cross-border Mergers and Acquisitions in APEC. Asian-Pacific Economic Literature, 17(2), 14–38,2003, admitted by the authors.*

2 Factors Affecting Cross-Border Mergers and Acquisitions

2.1 Political Factors

The formation of political risk is due to the huge difference and uncertainty between the political environment and policy changes of the two countries in cross-border M&A. The political systems of many countries are different, which fundamentally affects the choice and management decisions of enterprises in cross-border M&A.

2.2 Economic Factors

The more similar the economic environment of the two countries are, the easier it is for enterprises to understand the background of the acquired companies and collect information in the process of merger and acquisition. Besides, with the deepening and development of globalization, the economies of various countries are increasingly closely linked. If a global economic downturn such as the "global financial crisis of 2007" occurs again, corporate M&A will also be directly affected by the economic environment.

3 Risk Analysis and the Strategy of Risk Elusion

3.1 Legal Risk

Legal risks may mainly be caused by the invalidity of some contents in the contract and the contract cannot be performed on schedule. Legal risks are more likely to occur in over-the-counter transactions. When participating in cross-border M&A, many countries may not be able to face emergencies caused by different legal requirements due to insufficient investigation and understanding of the laws and policies of the host country.

3.2 Information Risk

In the process of cross-border M&A, there may be some problems that many merged enterprises do not make a strict legal guarantee for the hidden part, or even exaggerate and cover up some information. Therefore, in M&A, enterprises should pay special attention to whether the other party may have unfair competition or negative market news. Due to the asymmetry and differentiation of internal information between the M&A parties, both enterprises should have clear market research, analysis, and evaluation of the internal and external actual situation of the enterprise, especially for the possible infringement of the rights and interests of third parties, such as patents, trademarks, copyrights, and other important rights.

3.3 Cultural Risk

3.3.1 Corporate Culture

Corporate culture is crucial to a new enterprise's economic development and prosperity. Corporate culture guides and supports the operation process of the whole enterprise to a certain extent, at the same time, it is also a great cohesion of a new enterprise to its employees. The research of Ojo also expresses that there is an inseparable relationship between corporate culture and corporate performance [2]. A cohesive corporate culture can help improve the performance of enterprises to the greatest extent and promote the development of enterprise management and operation. The ideological and cultural quality of each employee may be affected by different life experiences and family habits over the years, which means that the personality culture of new enterprise employees is diverse, and this does not help the enterprise gather faster. Having a positive and harmonious corporate culture can enable employees to capture the spirit and accomplish the development goals of the enterprise faster.

3.3.2 Religious Culture

As religious differences continue to increase in countries around the world, more information asymmetry related to religious norms, regulatory factors, and differences also begins to influence international decisions [3]. As more religious culture begins to spread, enterprises have to investigate and understand the religious culture of the leadership of the acquired enterprise in the cross-border M&A. On the one hand, a detailed understanding of the other enterprises' religious culture can avoid the friction and language barriers encountered in acquisition discussions. On the other hand, diversified religious cultures should be tolerated and understood. The acquiring company should evaluate in advance the decisions and behaviors of the acquired company that may be affected by religion.

3.4 Capital Changes Unknown Risk

3.4.1 Loan Risk

Loans may be in the early stage of every enterprise, especially common bank loans, mortgage loans, and so on. Loan pricing is driven by multiple risks, including credit risk, market risk, and liquidity risk [4]. Loans are often conditional on the borrower having an excellent credit history and a matching bill flow, which means credit risk has a huge impact on loan pricing. The loan market risk is also great, the loan interest rate will change with the changes in the international market economic environment, and this change is often difficult for enterprise managers to predict and deal with. At the beginning of enterprise financing, enterprises should carefully choose the loan method and loan companies.

3.4.2 A Shortage of Funds

When an enterprise has enough funds to support M&A activities, the capital use efficiency will also decline while financing risks decrease, which will bring some opportunity costs. On the contrary, when enterprises carry out M&A with debts, although the efficiency of capital use increases, the debt repayment risk will be greatly increased once the enterprise benefits fail to meet expectations. It is worth noting that equity financing commonly used by many enterprises is long-term and free, which reduces risks to a certain extent. Therefore, enterprises may bear greater actual risks due to the shortage of funds.

3.5 Financial Risk

The financial risk of cross-border M&A refers to the deviation between the actual value and the expected value in the process of merger and acquisition [5]. Meanwhile, the financial risk exists in the process of enterprise financing, investment, payment, and a series of enterprise integration [5]. Effectively clarifying the value of enterprise assets and reducing financial risks can reduce many financial disputes caused by accounting methods. Financial information is also a part of the comprehensive evaluation of enterprises before cross-border M&A, which can effectively avoid the financial risks to be assumed because of the actual financial management risks that the acquired enterprises may face. In addition to the comprehensive evaluation of the assets management status of the acquired enterprise by the enterprise itself, the enterprise can also conduct evaluation and analysis through third-party institutions, which may consider more factors.

3.6 Value Assessment Risk

Many enterprises do not have a long-term understanding of the transnational enterprise structure and relevant market and the acquisition foundation. In many cases, the acquired company may deliberately exaggerate its technology and earnings to influence the judgment of the acquiring company. The following are three common ways that enterprises usually use to assess financial risk.

3.6.1 KPI Balanced Scorecard

The Balanced Scorecard link measures a business's performance and metrics from four different perspectives: financial, customer, learning, and internal business processes by looking at the business's strategic vision [6]. BSC is more inclined to help enterprises achieve overall optimization rather than partial adjustment. However, BSC is only put into application by a very small number of enterprises now, mainly because the input cost of BSC is much higher than other methods, its index system is difficult to establish, and the weight cannot be positively correlated. In addition, BSC is more suitable for evaluating the performance of a company's top management rather than lower-level departments.

3.6.2 Eva

EVA is a common method used by enterprises to analyze the profitability of target enterprises. EVA is the comparable risk that which real economic profits or returns exceed or fall below the lowest rate of return available to shareholders and lenders by investing in other securities [7]. The specific calculation method of EVA is

$$\mathrm{EVA} = \mathrm{NOPAT} - (\mathrm{TCE} \times \mathrm{WACC}) \tag{1}$$

$$\mathrm{Ke} = \mathrm{Rf} + \mathrm{bi}\,(\mathrm{Rm} - \mathrm{Rf}) \tag{2}$$

Although EVA was a new method of measuring enterprise profitability, it has been quickly known by the public. Compared with the traditional calculation method, EVA more accurately analyzes the actual profit and capital cost of an enterprise, and its error rate is lower than the traditional method.

3.6.3 Z-score

Z-score was proposed in 1968 when American stock market companies were listed, which was based on a series of financial ratios and differentiation models [8]. Z-score is used to predict the financial situation of an enterprise before bankruptcy. There are four ratios in the Z-score Model, and each ratio measures the operating capacity of an enterprise in a certain aspect. Among them, the first and fourth ratios are used to analyze the solvency of enterprises, while the second and third ratios are used to compare the profitability of enterprises. The key to this model is to prove whether an enterprise is far away from bankruptcy or how profitable an enterprise is.

4 The Acquisition of Bg Group by Royal Dutch Shell

4.1 Case Introduction

In 2016, Royal Dutch Shell bought BG Group for $70 billion, a deal that made Shell the world's second-largest non-state oil company and Brazil's largest foreign oil company [9]. The acquisition of BG Group makes Royal Dutch Shell's liquefied natural gas and deepwater assets stronger, and also realizes Shell's integration and transcendence in the oil market.

4.2 Analysis of the Reasons for Success

4.2.1 Prevention of Integration Risks

After Dutch Shell acquired BG Group, they worked hard to coordinate BG Group's working methods and actively introduced methods and theories that BG Group was stronger than Shell. Different from traditional cross-border M&A, Dutch Shell has adopted different methods for operating companies in different regions of the BG Group, rather than "one-size-fits-all". What's more, Shell strives to make every employee who has worked in the BG Group deeply aware of their value and try to make the old employees better adapt to the new company after integration.

4.2.2 Have Clear and Precise Goals for Brand Positioning

Shell has been figuring out how to elevate itself into a more specialized company focused on the fast-growing LNG market and deep-sea resources. Shell is focusing on liquefied natural gas in the Australian market and offshore deepwater production in Brazil against the backdrop of a severe global oil glut [10]. The acquisition of BG Group is an excellent way for Shell to enrich its oil reserves and tap natural gas.

4.3 Enlightenment from the Successful Shell Acquisition

Shell has a clear understanding of its strategic decision-making for improvement, which directly helps them accurately select acquisition companies. Shell's continuous coordination and updating of corporate culture also greatly enhances the cohesion of employees in the new enterprise after the integration. Moreover, Shell has carried out a lot of simulations and predictions on the various risk prevention of M&A before the acquisition of BG Group, which indirectly makes them a successful cross-border M&A group.

5 The Acquisition of Daimler&chrysler

5.1 Case Introduction

Daimler-Chrysler Corporation was established in 1998, which was formed by the merger of the former German Daimler-Benz Automobile Company and the American Chrysler Automobile Company. After the merger of the two companies, it was once a very influential car manufacturer, but profits continued to decline. Until 2007, the two companies were broken up due to continuous losses.

5.2 Reasons for Failure

5.2.1 Differences in Brand Positioning

Daimler and Chrysler are completely different from the beginning of their brand positioning. The merger of a luxury car brand and a Volkswagen brand will undoubtedly lead to a series of problems of incompatibility and differentiation. Due to different brand positioning, the two companies also have conflicts in product performance and pricing. Furthermore, the publicity and consumption concepts of the two brands will also have huge differences due to the high production line and the mass production line.

5.2.2 Differences in Background Culture

The natural differences in European and American cultures make the two companies completely different in terms of management methods and styles. Daimler in Germany has a strict hierarchy and organizational form, and its decision-making process is also very complex and formatted. While Chrysler in the United States advocates a multi-functional team spirit, and its corporate culture is more inclined to free discussion and not strictly bound [11]. Coordinating a new culture is not easy because it may be cultural background differences caused by ideological levels, living habits, cultural differences, and so on.

5.2.3 Mistakes in Strategic Decision-Making

Chrysler's management would have more freedom and discretion in decision-making, choosing to mass-produce it simply because Americans prefer bulky and comfortable sedans and their pickups and SUV. In addition to the current economic environment and production research, an enterprise must also have in-depth speculation and insight into the future political situation and economic environment before making major decisions. After the outbreak of the Iraq war in 2005, oil prices rose, and their inventories were overstocked. This change has become one of the deadliest shocks after the merger of the two companies.

6 Conclusion

Cross-border M&A of enterprises can bring "$1 + 1 > 2$" benefits to both companies, but the risk prevention and control of cross-border M&A must be treated with caution. For information risk and financial risk, the enterprise should conduct a comprehensive investigation of the target enterprise and distinguish between asset evaluation and study of financial statements, and strive to fully understand the information of the target enterprise. For financing risks, companies should expand financing channels, increase market exchange rate analysis, and also borrow leveraged buyout financing. After the enterprise is integrated, it should reflect the expected problems that may arise so that the risks faced by the enterprise can be dealt with in a timely manner. However, this paper does not discuss the effective and specific practices of enterprises to avoid risks. This will also be a direction for future papers. Through the analysis and research of the actual risks encountered in mergers and acquisitions and effective ways to avoid them, it will provide valuable reference guidance for enterprises.

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