

# InterChina Insight

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## M&A in China

A Corporate Survey by InterChina

By Jan Borgonjon, Barry Chen and Jennifer Wong | April 24, 2013

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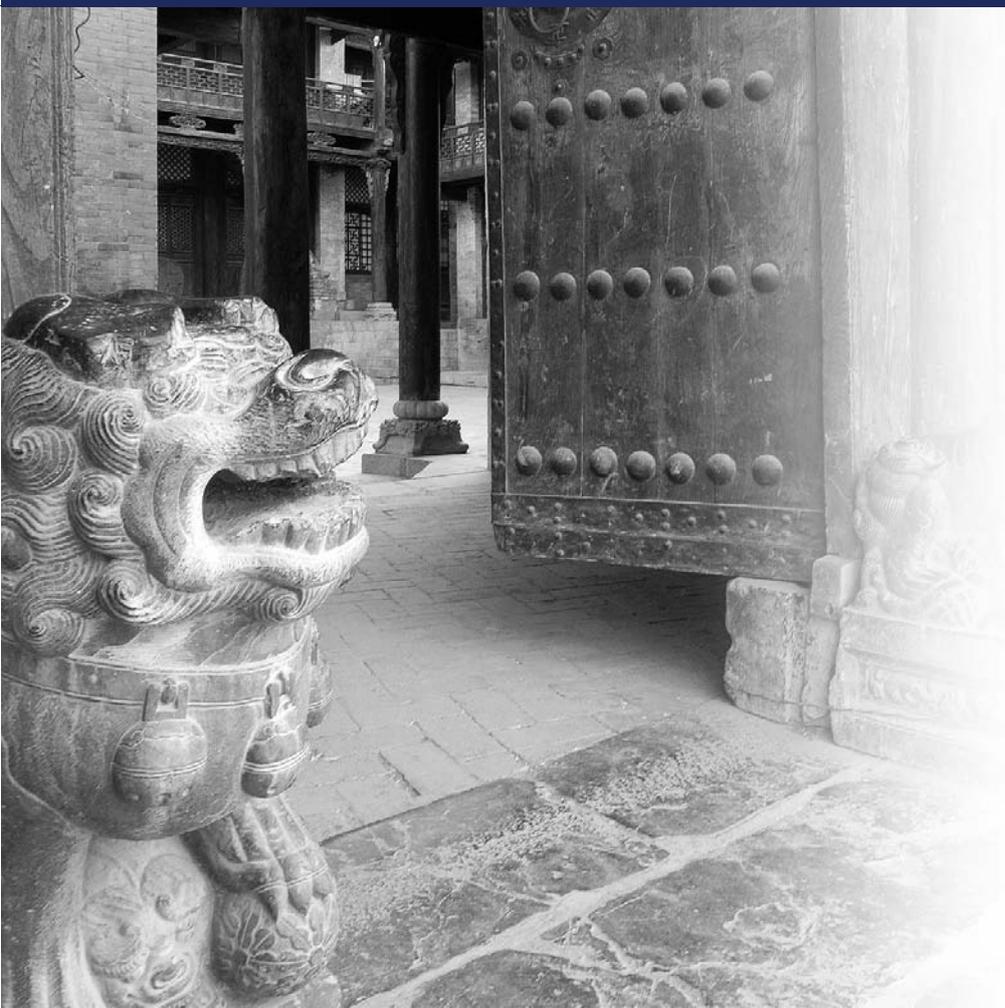
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## Background – M&A in China 2012/2013

Total M&A value in China in 2012 decreased in line with global trends, although the number of deals increased. M&A volume in China remains small at around 5% of the total global activity – in addition a large part of the transactions - over two thirds - are domestic. There are large differences across sectors with important activity in sectors such as medical devices, auto components and food, but little or no activity in other sectors, such as logistics, hospitals or travel services.

However, entering 2013, we expect that this situation is about to change, and that we are at the initial stages of a protracted consolidation process which will play out over the next 5 to 10 years, at different levels of intensity and speed depending on the specific sector. We have explained the reasons and the expected dynamics of the incipient consolidation process in detail in a previous article (InterChina Insight, September 25, 2012, 'Riding the Consolidation Wave') and we will therefore not enter into details here. This consolidation process will provide enormous opportunities for growth but of course will also create challenges for survival in an increasingly competitive market where size will become increasingly important.

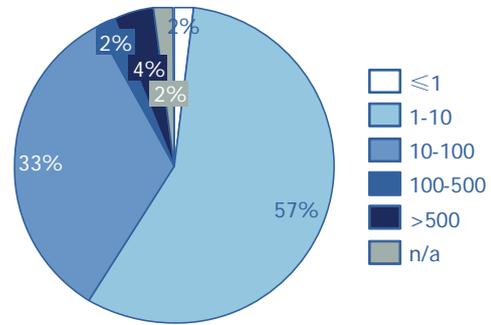
The survey results presented below provide a picture of how some of the leading companies in China view the M&A opportunities created by this consolidation process and how they go about their acquisitions.

### Survey results

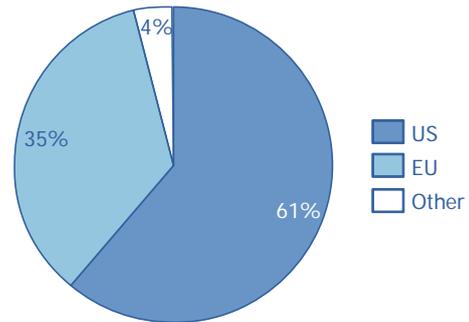
During May to September 2012, InterChina surveyed 52 multinational corporations, of which 61% are US based and 35% European. Most of these companies have long experience in China, are relatively large, are among the leading companies in their segment and have prior experience in acquiring companies in China. Therefore our sample is biased towards companies which are well established in China and we believe that given the leadership position of most of these companies in their respective sectors in China, this survey provides a good picture of what the trendsetters in China are doing and what the benchmark is for other companies.

### InterChina M&A Survey – Companies Surveyed

Company revenue (USD billion)



Country Origin

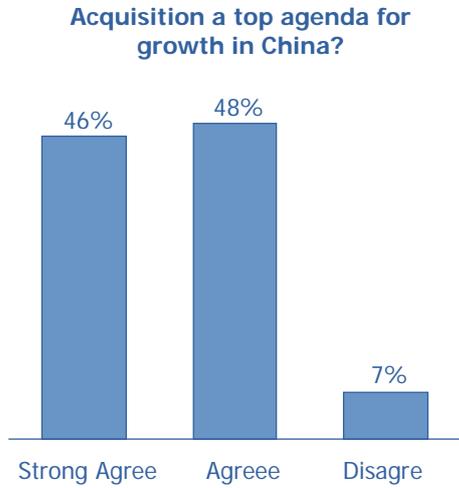


## Company Strategy in China: M&A increasingly important

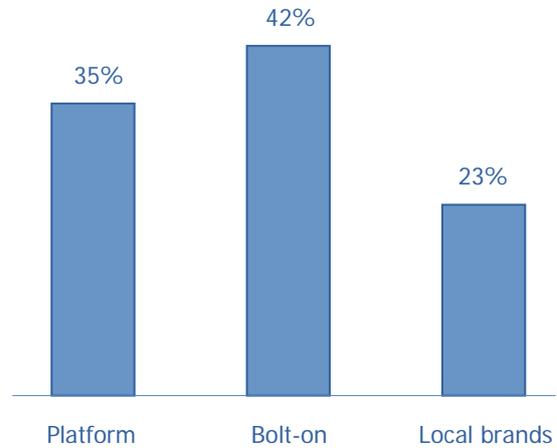
The majority (94%) of respondents either strongly agree or agree that inorganic growth is part of their growth strategy in China. This is a marked increase over a few years ago, and reflects that acquisitions have moved to the top of their corporate agenda. 35% of the respondents closed five or more transactions over the last 5 years, which is a high level of activity and seems to indicate that there are many serial acquirers in China. We consider this a substantial change to the environment a few years ago, when acquisitions were one of several growth options and often not the preferred one. Coincidentally, domestic Chinese companies (particularly listed companies) also increasingly use acquisition as part of their growth strategy. The implication is that we face a more competitive deal environment on one hand, and better exit channels for companies which want to be sold on the other hand. Given the increased competitive environment, acquisitions may be the only catalysts for a game change strategy to build a relevant revenue and product portfolio in China.

In terms of the acquisition objectives, there is a relatively equal distribution between platform acquisitions (acquiring a platform in China from which to grow further), bolt-ons (additions to existing business in China) and the acquisition of local brands. The high number of companies considering minority investments (43%) probably reflects the increasing acceptance of not having complete control, in the case of strong targets who do not accept a majority. Sometimes minority investments are also due to regulatory or approval requirements. Not surprisingly, the vast majority of acquisitions are directly related to the core business, and we expect this trend to continue as the competitive pressure in China further increases.

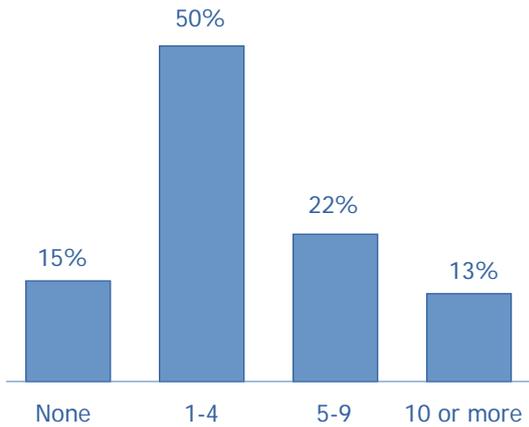
*Are acquisitions at the top of the agenda for growth in China?*



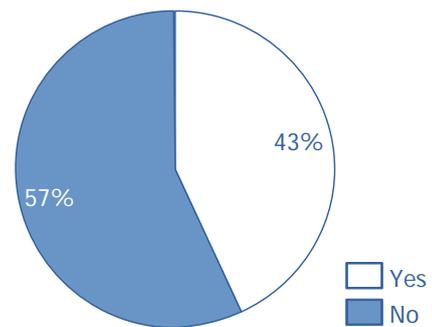
*Strategic Motivation for M&A in China*



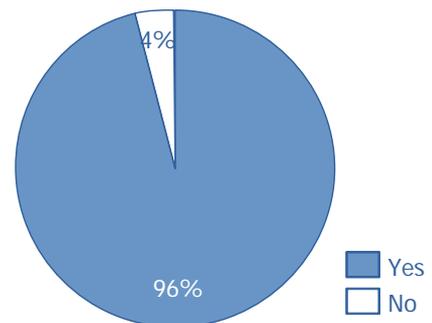
*Transactions Closed in the last 5 years...*



*Consider Minority Investment?*



*Acquisition in China directly relates to core business?*

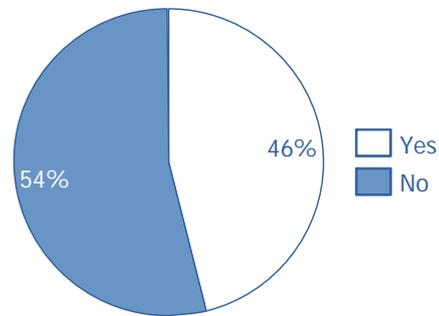


### More resources dedicated to M&A in China

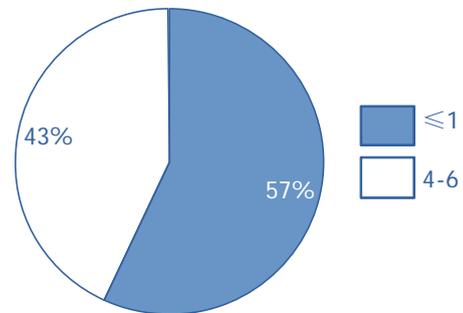
Given the increase in activity, more companies are dedicating resources to their M&A activities in China. Just over 50% of respondents have a dedicated corporate development team in China. Although the teams are currently small, most less than 6 people, we have reason to expect more dedicated resources as companies focus expansion strategies in China. The other half of respondents do not have a dedicated corporate development team in China and maintain their M&A function centralized in headquarters. In all cases the transaction execution is handled by the in-house team (global and China based if available) and outside advisors, although the mix can be very different depending on the available resources. The key reason for corporations to staff the M&A function in China is to be close to where the activities are. The challenge is to retain and find experienced corporate development professionals. Multinationals also have to weigh the issue of fixed vs. variable costs (in case there is no constant deal flow). Therefore, leveraging external resources is still considered as key to success, and more cost effective in many cases.

### Do you have dedicated resources in China?

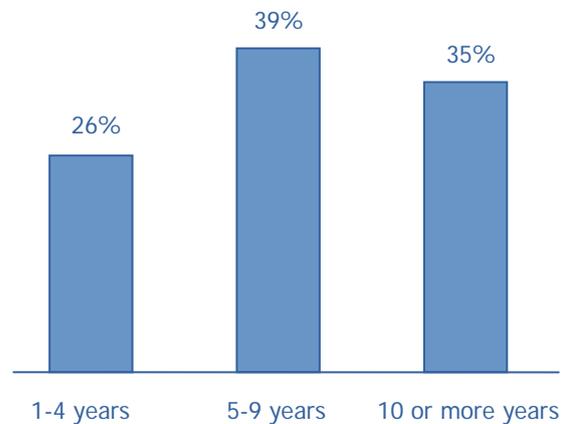
Dedicated Resources?



Number of staff?



Average Years of Experience



## Internal network is most popular for Deal Sourcing

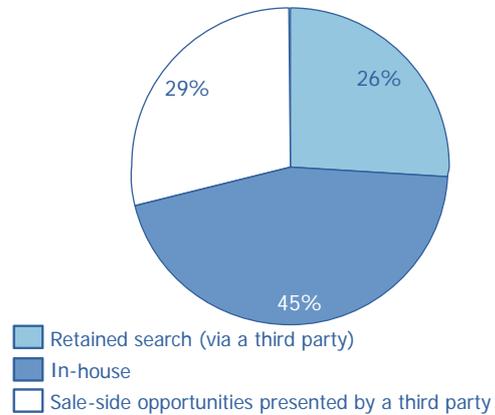
The most popular method for deal sourcing is in-house which includes information from existing clients, industry leads, networking, strategic marketing, etc. Success here is of course dependent on the availability of quality in-house resources. Knowing the market and the right contacts greatly increases the likelihood of successfully sourcing deals.

However, sourcing targets remains a primary challenge for multinationals. This indicates the limitation of solely relying on internal network for sourcing deals. The absence of sale-side channels and opportunities also restricts one of the more popular deal sourcing channels of mature markets. Therefore, using third party advisory firms can be a great compliment to achieve efficient deal sourcing.

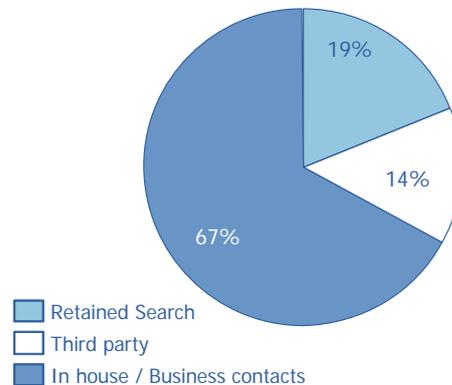
Excessive valuation expectations and unacceptable business practices are considered the main obstacles in indentifying good targets. However size and availability (willingness to sell) are contributing factors to the difficulty in finding the right targets which remains a top challenge when conducting transactions in China. Finding sizable targets used to be one of the main obstacles for inorganic growth in China, but our survey responses may reflect the growing acceptance of companies to acquire smaller targets or particular business lines with potential to grow.

## What is the common channel for sourcing deals in China?

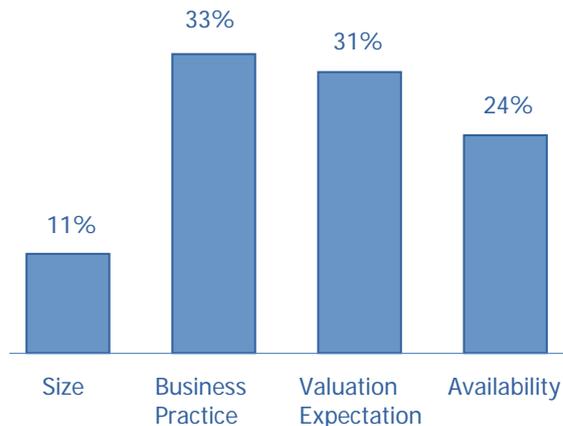
Deal Sourcing Method



Most Effective Channel



## What are the challenges in identifying the right targets?



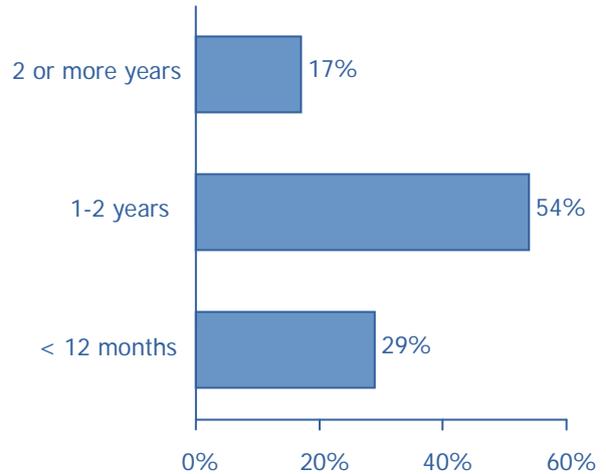
### Key Transaction Challenges

Key challenges are evenly spread among finding the right targets, valuation, and due diligence. Also, internal buy-in seems to be more challenging than external approvals which are not seen as a key obstacle.

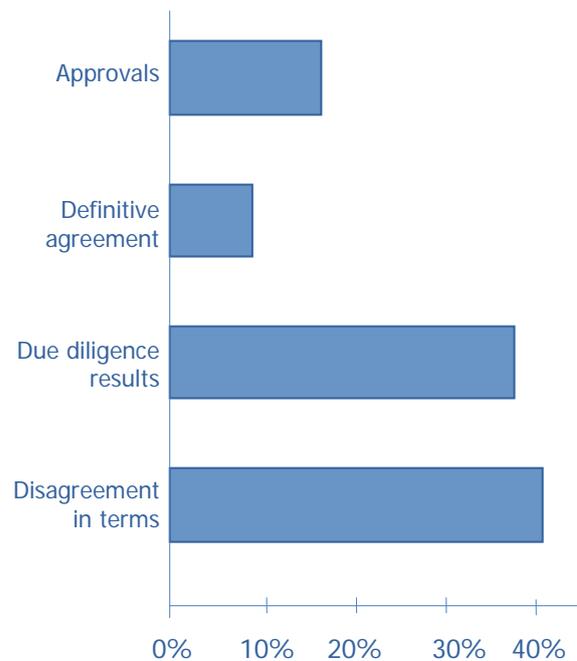
Another significant finding is that the deal cycle is typically less than 2 years, and in nearly 30% of the cases less than 12 months. This confirms our experience that the transaction cycle is getting shorter. In addition, the probability of closing a transaction significantly diminishes if negotiations go beyond 2 years. More Chinese targets demand specific timelines and sometimes require “monetary commitment” during or before critical deal milestones such as for instance Due Diligence.

The top reason for deals failing during the negotiation process is disagreement in terms, followed closely by due diligence results. Once moving into the definitive agreement stage, the odds are generally good for deal completion. Once the deal is completed, integration is going well in 75% of the cases, significantly higher than the international average, although acquisition objectives are not always being achieved (only in 60% of the cases).

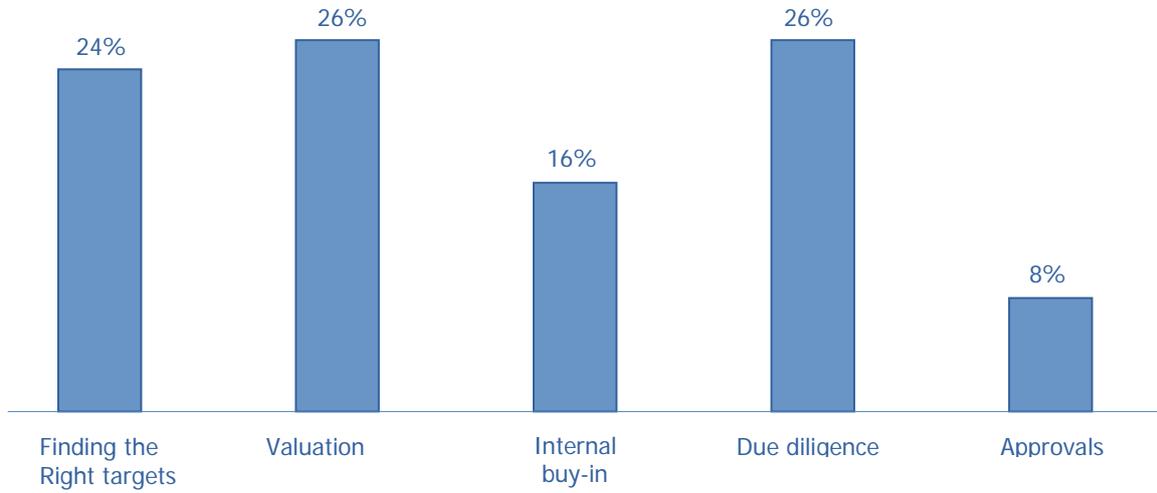
### What is the length of deal cycle?



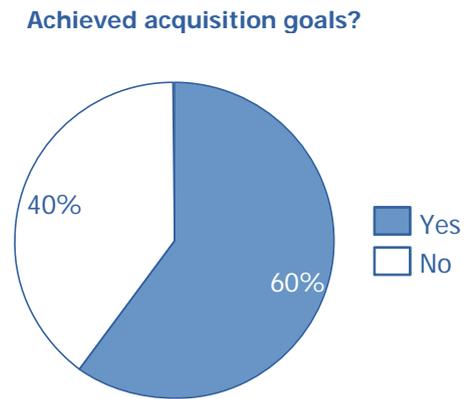
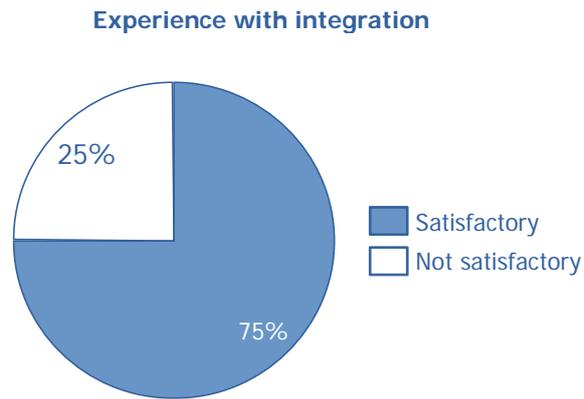
### At what stage do transactions fail?



*Top challenges in doing transactions in China*



*What is your experience with integration?*

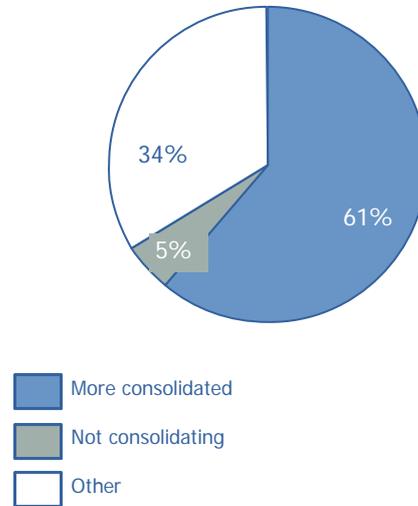


### Increasing Consolidation

The majority of respondents believe that their sector will be more consolidated in the next 5 years as their industry becomes more sophisticated and as 'easy money' is not likely to remain as readily available as before. However, there is also a recognition, depending on the sector, that a certain degree of fragmentation will remain and that there are likely to be new entrants. Most of the surveyed companies therefore expect increased competition in general, and also in the M&A field for the good targets available in the industry.

### Your view on consolidation in your sector

**How do you think your sector will evolve in the next 5 years?**



## Conclusion

The InterChina survey results presented in this article confirm the rapid changes taking place in the M&A market in China. Against a background of faster consolidation, inorganic growth is increasingly becoming a feasible option and becoming a key part of the strategy of companies with growth plans in China. Many companies are dedicating resources in China to benefit from this trend and are becoming more aggressive in pursuing acquisitions in China. There is an increasing acceptance of minority transactions which was not the case a few years ago. The nature of the deal process is also changing and overall speaking becoming less difficult for approvals. However, many obstacles remain, such as finding the right targets, valuation, and due diligence. Deal length, a key concern until recently, is getting shorter. Negotiating deal terms (often because of valuation issues or risk related issues) and unexpected due diligence findings have now become the major challenges to conclude a transaction successfully. Most companies surveyed also believe that consolidation will speed up within their sector.

We consider that the results we have presented here provide a reliable indication of the expected trends in China and should be highly relevant for all foreign companies with a presence in China. In order to maintain or strengthen one's competitive position in China inorganic growth will no longer be just an option, but a must. This will open a wide range of new challenges and opportunities for Chinese and foreign companies alike, for which, however, few are prepared. As we explain in more detail in a previous article (InterChina Insight September 2012) strong local based leadership, existing operational capabilities, direct dedication from top management and a well planned and proactive acquisition approach will be the keys to success in the consolidation process.



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