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STRATEGIC MERGERS AND ACQUISITIONS IN CHINA: AN OVERLOOK AT BREMBO S.P.A. ACQUISITIONS IN CHINESE MARKET

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Abstract – 导论

在投资这个方面，并购在当下是全球最流行的投资方式之一。并购指的是两家或者更多的独立公司合并组成一家公司，通常这个过程包括一家占优势的公司吸收一家或者多家公司。并购这个词一般指兼并或收购，目的是买家公司扩大它的商业到其他市场或者加强他已经存在的商业行为。

按照买家和目标公司的不同行业，并购的类型各不相同：横向购表示两家公司处于同种的行业 ，垂直并购体现在买家公司和目标公司有供应商和买方的关系，同心并购表示两家公司营业的行业一样或者有紧密关系，特别体现在它们使用一样的生产的过程、工业机械、基本的技术等。最后，集团并购，买家公司和目标公司的行业完全不同，所以，通常买家公司利用并购这样的做法扩大其经营的商业领域。

并购的过程分成很多的阶段。首先，卖家公司要起草企业并购的商业案例。商业案例的功能是提供开始交易的所有原因和目的，并说明如何利用资源，特别是金融资源。

接下来的阶段是草拟一个关键的文件——商业计划书。商业计划书包含并购所有需的所有最重要的信息，是作为买家公司并购得以实现并成功所要进行的有步骤的实施计划。经过可行性研究，提供并购计划的实用性。

买家公司编写这些初步文件之后要找到合适的目标公司。然而，这不是一件容易的事情。买家公司要按照一定标准和要求选择合适的目标公司，比如说公司的规模和能力、经营何种行业、市场地位、资产的构成、还有它的盈利能力和偿付能力。

合适的目标公司锁定之后，两家公司必须共同起草意向书。意向书是一种不具备约束力的文件，内容涵盖两家公司签订合同之前已经达成的协议。即使如此，它也包含一定很重要的条款，如保密条款与排他性条款。一般来说，这两项条款有约束力的性质，便于两家公司都保护好它们的机密信息。

尽职调查是收购前最重要的阶段。在与目标公司达成初步合作意向后，经协商一致，尽职调查投资人或者买家公司对目标公司展开所有与本次投资相关的现场调查、资料分析等一系列活动。尽职调查主要分成法定尽职调查、财务尽职调查、商业尽职调查与研究尽职调查。其中在发展性国家的新兴市场研究尽职调查很重要，因为通过它买家公司可以发现目标公司的潜在隐性负债。

进行尽职调查以后买家公司要决定是否进行资产交易或股权交易。这种选择的关键在于买家公司要选择收购的内容，也就是说目标公司的资产或者股权。

并购后期阶段的最重要的部分就是后合并整合。后合并整合是公司的重新排列，通常是提高和激励潜在效率和协同效应的复杂过程。后合并整合阶段的主要目标在于通过双方的合力来实现价值，需要作出巨大的努力和协调。

经济方面全球化的其中一个结果是许多公司通过跨境并购这种直接投资外国公司的方式来进入全球市场。这些业务主要侧重于公司在新兴市场建立业务的潜在增长策略。如今，跨境并购是试图进入中国市场的外国公司最流行且最直接的投资手段之一。

不言而喻的是，一个国家在文化、经济与政治维度的差异性十分影响其经济环境和市场。结果便是在中国做业务的外国公司要面临更多的、全新的挑战与困难。

最近中国市场正在发生一个重要的转变。在过去的几十年中，中国成为着一个具有强大吸引力的市场，期待外国公司生产系统的进驻，从而获得可观的利润。所有增长的机遇和收益，突出体现在生产过程中与成本相关的优势上，中国市场正在不断超越现代化需求并推动市场发展趋势的转变。通过持续的内在创新和竞争力，中国市场的性质在不断变化和发展。在这个被称作新常态的趋势下，中央政府最近通过改革工业体系的性质，使其从基础制造业转向高端技术行业。随之而来的在华投资的外国公司将面临一个不断变化的市场，促使这些外国公司必须生产高质量的产品，并将最新的尖端技术带到中国。

1978 年，从邓小平发起的门户开放政策以后，外国公司通过多种投资渠道进入中国市场，但是中国政府只允许中外合资经营企业的模式，目的是让本地企业通过此合作向更发达的外国公司吸收所需的技术知识。如今，除了中外合资经营企业与中外合作经营企业之外，外国公司也可以使用其他方式直接在华投资，也就是说并购与全资外资企业。

此外需注意，中国文化对上述业务的展开有着十分深远的影响，特别是当两家公司处于谈判阶段。此时，外国公司必须记住一些中国文化中的基本概念，关系与面子，以便与生意伙伴进行良好地谈判。由于中国公司大部分属于国有，所以中央政府持有这些公司的股份。从政治角度分析，中央政府极有可能直接控制国有公司的商业活动，因此外国公司必须要理解大部分的与本地公司的业务往来均等同于与政府做生意。中国中央政府依照外商投资产业指导目录直接控制由外国直接发起的、进入本国资本市场的投资，目录中在华的外国投资分成鼓励，允许，限制和禁止几

种情况。政府在其中扮演重要的角色，所以当外国投资者通过收购本地公司并与本地公司达成战略联盟时，同时也拥有了本地公司已存在的政府的关系网。

从人力资源的方面来看，对于中国是一个极其重要的资产与优点，即使如此，买家公司也必须仔细地管理被收购本地公司的人力资源，特别是在后和并整合阶段。

在进行并购交易和实现后合并整合的所有过程和目标之后，被收购实体的治理可能是在华市场的外国投资者经营管理中最重要的一环。通过购买中国公司 25%或以上的股本，新公司实体形成了合资企业，所以外国投资者必须要与中国伙方按照规定的合资协议共同治理新的中外合资经营企业。而在共同治理的问题上，不论其部分股权的多寡或合同协议的内容规定，中方都超过其控制水平。

中国如今拥有世界上最大的汽车市场和汽车制造行业，2009 年 1 月时超过美国，售出高达七十九万辆汽车。其实从 1983 年开始，中国政府就已经允许他国汽车生产商通过与本国公司合作的方式创立中外合资企业、进入国内市场，但大部分仍由国有企业组成。虽然即使是如今对这种有所限制的投资方式——外方不得持有合营企业超过 50%的股权，但仍旧对在华投资的外国公司带来了巨大的利润。

虽然在汽车行业的市场政府保持 50%的股份作为最大限度的股权所有权允许外但是也有特例，因为国内汽车零部件的工业生产与市场得到广泛地认可，从而允许外国投资者获得 100%所有权。内部需求的增加以及过去几年中国汽车市场的巨大销量，使得外国零部件生产商来华生产产品，并供应本地及外国汽车制造商。

这是此次案例研究的公司所提交的情况，来自意大利设计与制造制动系统的全球领导者布雷博股份有限公司。从 1999 年以后，布雷博成功的投资进入中国市场。

最近一次布雷博在华成功交易是其收购中国最大的、独立的汽车零部件制造商之一亚新科工业技术有限公司。

CONTENTS

PART I

MERGERS AND ACQUISITIONS

1.1 What are Mergers and Acquisitions?

Mergers and acquisitions (M&As) are transactions in which occur, through processes of purchasing or combining, the consolidation of economical entities, business organizations' ownership, operating units and resources.

From a legal perspective, a merger is the process through two or more legal entities together with their activities and resources are combined into a single, whereas acquisition (or takeover) is represented by the purchase of the majority interest in the stock of a business entities by another. In both mergers and acquisitions assets and liability are assumed in the consolidation process by the buying party, whose purchase can concern the whole or part of the ownership equities or assets[1] of the target company[2].

M&As can be divided into two main groups: financial and strategic mergers and acquisitions. Financial acquisitions represent often opportunistic deals that are not aimed to follow any plan for developing the company's business, weather strategic M&As are based on a company's growth perspective and fit into company's strategic approach to develop its business[3].

Strategic mergers and acquisitions are an important kind of investment for organizations who want to survive and achieving growth, seeking for increasing their competitive advantage within a market, into the global or local business environment. Companies' growth-oriented strategic plans can be realized through choices on weather acquire or merge with other entities, or look for their own development through distribution

[1] See paragraph 1.3.6: **The legal structures, asset deal and equity deal.**
[2] The *target company* in mergers and acquisitions is represented by the purchasing or merging company.
[3] Coyle B., (2000), Mergers and Acquisitions, Fitzroy Dearborn Publishers, Chicago and London.

and moreover, in case of global expansion, through greenfield[4] investments in a foreign market. The choice between internal development and acquisitions is determined, in general, by the costs and the benefits derived from the operations, including considerable opportunity cost factors[5]. The objectives and the benefits a company pursue through these operations are reflected into its business strategy and business idea.

Clearly, processes such as mergers and acquisitions represent a strong tool for increasing the company's presence into a market through the value creation, and for the company's need to develop strength relative to their competitors. Such source of strength comes by enhancing the capability to shift its resources from a well-established and mature business activity to emerging business activities with a potential growth, in a sort of ongoing self-renewal process. In the latter case, the company choose to shift its resources through acquisitions instead of their distribution among existing entities[6].

Even though, considering a commercial and economic point of view, the processes of mergers and acquisitions could be considered as similar, the merger, as the unification of two or more entities, can be realized either with the constitution of a company ex novo that replaces the formal ones, *merger by consolidation*, or through the agglomeration into an already existing company (the buying party) of one or several entities. The latter, defined as *merger through acquisition*, is the most common[7]. The merger can occur between companies of the same type (*homogeneous merger*) or between companies of different type or structure (*heterogeneous merger*)[8]. As mergers and acquisitions are structurally very similar, most economic statistics and economists do not distinguish them as two types of investments[9].

[4] A greenfield investment as a type of FDI (foreign direct investment) occur when a company build or constitute new facilities in a foreign country and so create a new juridical subject, instead of purchasing or mergering with an already existing one. The latter is a case of brown-field investment, such as the M&A.
[5] Rock M.L, (1987), The Mergers and Acquisitions Handbook, McGraw-Hill.
[6] Rock M.L., (1987), The Mergers and Acquisitions Handbook, McGraw-Hill.
[7] Marchildon, G.P. (ed.), (1991), Mergers and acquisitions, The International Library of Critical Writings in Business History
[8] Campobasso G.F., (2008), Manuale di Diritto Commerciale sesta edizione.
[9] Schaffer R., Agusti F., Dhooge L.G., Earle B., (2012), International Business Law and Its Environment, South-Western College Pub.

One of the most important reason for the appealing in recent years of M&A operations, especially as foreign direct investments (FDI), is represented by the fact that they require less know-how than a start-up of a new facility within a cross-border greenfield investment, and can be concluded without the interruption of any business activity[10]. Furthermore, many companies choose to operate through brownfield investments, in preferring M&A transactions or the establishment of a joint ventures, rather than greenfield operations, considering the general faster and more direct acquaintance, in case of transnational operations, with the foreign market.

From a legal point of view, by acquiring a company the investors purchase a part or its whole share capital, thus does not create a new legal entity.

In the choice of weather pursue a greenfield or brownfield investment in a post-developing country such as China, as we will look in the next chapter, a company must consider many variables and factors that may influence the deal, such as the strong presence of the state and the governmental regulatory structures, together with a wide cultural gap between the parties. These elements represent potential risks that could negatively affect the procedures, especially regarding the post-merger integration phase, and so the outcome of the whole operation.

[10] Rock M.L., (1987), The Mergers and Acquisitions Handbook, McGraw-Hill.

1.2 Types of acquisitions strategies

The strategic effectiveness in acquisition, the value creation, consist mostly in creating a step in competitive advantage by paying for an existing business entity and integrating it with the firm's activities. The conditions for a company in opting for acquisitions are proper when the acquisition is more cost-effective than its internal development. This means that the price for the total operation must be lower than the total resources necessary for the company's internal development of a comparable strategic position[11]. Obviously, an M&A strategy can be influenced by external and internal factors, including either strategic choices in the market, as well as core, organic growth strategies[12].

Discussing about the matter of cost-effectiveness in mergers and acquisitions, it is proper to consider that such significant operations have a huge impact on companies' shareholders, employees, creditors, the management, customers, as well as the competitive firms in the market. Therefore, in assessing the ratio of costs and benefits, clearly the outcome is positive and social desirable if benefits of the transaction exceed the costs[13]. Such benefits are related, as mentioned before, to the value creation that comes from M&A investments.

A company's strategic approach consists of some main steps that could drive to the acquisition process[14], including:

- identify the corporate objectives or goals
- develop strategies to achieve those goals
- choose between organic growth[15] or M&A, regarded as inorganic growth as earlier mentioned
- select several candidates for acquisition, which covers many aspects in terms of evaluation and long-term strategic benefits assessment

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[11] Rock M.L., (1987), The Mergers and Acquisitions Handbook, McGraw-Hill.
[12] Damodaran - Aswath (2016) "Acquisitions and Takeovers", in *Transaction Advisors*.
[13] Auerbach Alan J., (2008), National Bureau of Economic Research Project Report: Mergers and Acquisitions.
[14] Coyle B., (2000), Mergers and Acquisitions, Fitzroy Dearborn Publishers, Chicago and London.
[15] *Organic growth* is the sum of processes of growth that originate from the company's existing businesses, On the contrary *inorganic growth* is represented by the growth coming from buying new businesses, as in case of M&As strategies.

- determine a value to the acquisition and make a bid
- conclude the acquisition
- plan the post-merger integration phase

According to weather the target company is listed or not on a public stock market, acquisitions can be classified as *private* or *public*. Another criteria of classifying strategic M&As is the sorting between friendly and aggressive takeover. The latter, also known as hostile takeover, takes place when the management of the target company is against the acquisition, and tends to reject the purchasing company's offer. On the other hand, in friendly takeovers companies are willing to cooperate in negotiating the deal.

Within M&As activities, according to the different strategy the acquiring company pursues, acquisitions can be classified as *horizontal*, *vertical*, *concentric* and *conglomerate*. *Horizontal acquisitions* occur when a firm acquire a target that operate in its same industry sector. The principal benefits from this type of acquisition are related to company's possibility of increasing its market power, especially in strongly competitive sector, and implementing economies of scale in production and distribution. Both these benefits derive from the creation of a long-term strategic value. *Vertical acquisitions* are realized when the acquiring and the target companies operate in an industry with strong supplier-buyer relationships. In these case, the acquisition could be conducted over a downstream supplier (backward) or upstream purchaser (forward)[16]. Vertical acquisitions usually occur when the market for an intermediate product is imperfect, due to scarcity of resources or criticality in the purchased products, or moreover when there is a need of control over production specifications of the intermediate products[17]. These types of strategies aim at a short-term value creation, as companies look for gaining an easier assets and resources disposal. *Concentric mergers and acquisitions* occur when buying and target companies are in the same or related industries, thus share same production processes, the presence in one or more markets or same basic technologies. Benefits from concentric M&As could derive from economies of scope, exploitation of shared resources, and from the opportunity of a diversification around a core of common strategic resources. *Conglomerate acquisitions*

[16] Philippe Lasserre, (2012), Global Strategic Management third edition, Palgrave.
[17] Rock M.L., (1987), The Mergers and Acquisitions Handbook, McGraw-Hill.

involve companies with totally different businesses and so are usually aimed at carrying out a big diversification program, that could be productive (the development and enlargement of the products portfolio), geographical (the presence in a different markets), or pure conglomerate (starting a completely new businesses)[18].

In brief, the following are the sum of potential benefits gained through strategic M&A operations:

- obtain *economies of scale:* the reducing of the total production costs with the growing of the scale and size of production operations.
- reduce the *transaction costs*
- exploit *shared and complementary resources*
- reduce *the fiscal impact*
- invest *the surplus of liquidity*

M&A operations consist of two main stages: the *pre-acquisition phase* and the *post-acquisition phase.* The first stage is related with the planning and the decision-making processes, including the negotiation phase, whereas the latter concerns all the processes involved in the integration of the merged company. Both these two main phases are crucial, and the evaluation processes during the pre-acquisition phase steps are important to assess the financial and strategic value of the M&A operation.

[18] Rock M.L., (1987), The Mergers and Acquisitions Handbook, McGraw-Hill.

1.3 The pre-acquisition phase

1.3.1 Business case

The *business case* is a document redacted within the first steps of a business project. Its function is to provide the reasons for starting the project, and it is normally redacted in the form of written document or presentation.

The logic behind the business case is to justify the dispensation of resources, such as money and financial resources, for the realization of the giving business deal. A business case often provides detailed information such as, behind the reasons on the basis and the goals of the project, its background, the costs of the operations, the commercial options, the expected benefits against the potential risks and the timing. Normally such information furnish the basis for the approval of the project by the stakeholders[19] and the sponsors, who need to evaluate the value of the business projects and their potential ROI (return on investment), and then address it to the management, the project managers and the decision makers[20].

[19] "Primary stakeholders, or simply stakeholders, are all the recognized individuals from whom the business' survival depends on: shareholders, employees, customers, suppliers and government agencies. However, in a broader sense, stakeholders are every well identifiable that can influence or be influenced by the activity of the organization in terms of products, policies and production processes." Definition proposed by Freeman E. R., (1984), translated by Martinelli A., in L. Hinna (2002), Il bilancio sociale, Il Sole 24 Ore, Milano, p. 104 .

[20] ExecutiveBrief Staff, (2009), Building a Project's Business Case, in *Project Management Best Practises*, https://pmhut.com/building-a-projects-business-case.

1.3.2 Business plan and feasibility study

The *business plan* is a formal statement that summarize the contents and features of a business or entrepreneurial project. The major contexts of use of the business plan are related either to the internal management of the company or to the external communication. In the latter case, the business plan provides the documentation to submit to external stakeholders, particularly to potential new financial investors for the project.

A well-drafted business plan is useful to provide a pathway toward the generation of profit for an existing or new business. Its principal functions are several: serving as guide for a company's business, as model or plan to follow in the conduction of a project both internally and externally; representing a documentation useful for seeking financing and capitals, considering that potential new investors need to understand how their investments will enhance the company's profits and, for sure, their ROI.

Especially in case of business operations in a foreign market, the business plan is a strong tool for evaluating the potential of a deal, and is useful to provide the standards to follow in developing the operations in that marketplace[21]. In addition, it provides the documentation to present to the regulatory entities.

The *feasibility study* is a sort of business plan that analyse the potential benefits, costs, foreseeable strengths and weakness of a planned transaction or project. It is a results-oriented plan, whose aim is the evaluation of the possibility of success of a strategy and its foreseeable negative or positive outcomes. Such assessment is useful in determining the realization of the project. Through a good feasibility study, the acquiring company is able to balance the risks and returns coming from the operation.

The analysis the feasibility study provides is usually composed by graphics and strategic planning tools, such as for instance a SWOT analysis. Two main criteria are

[21] Pinson L. (2004). Anatomy of a Business Plan: A Step-by-Step Guide to Building a Business and Securing Your Company's Future (6th Edition), Dearborn Trade, Chicago.

usually applied to determine the feasibility of a business operation: cost required and value to be reached.[22]

[22] Feasibility studies as a tool for successful co-operative business enterprises, (2015), in *grossarchive.com*, https://www.grossarchive.com/project/1796/.

1.3.3 Finding a target company

The process of finding a company to acquire or merge with is crucial and is based on the drafted plans the buyer is following within his acquisition strategy.

Once the acquirer has drawn up the strategy, he needs to assess the potential target candidates that can bring the maximum value to the operation. The research of the target company goes through the analysis of many factors, in order to determine whether the company is suitable and fits into the strategy[23]:

- *Size of the target and the its competence*: the set of skills a company carries and its core competencies like the managerial quality, the involvement and commitment to cooperate with the partner, the specific know-how.
- *Target's nature of industry and its position in the market*: The future company's growth rate is mainly related on its present competitive position in the market and on the state of the industry in which it operates. This last aspect is particularly relevant, because in case the industry happens to be in a stagnation or declining phase it can largely affects the growth rate of the company.
- *Company's asset composition*: the evaluation of tangible and intangible assets of the target company, together with the appraisal of the assets-in-place[24] and the growth opportunities, that are the sources of company's present value.
- *Profitability and solvency:* the resources, the size and the positioning factors are not enough if the company is not profitable and cannot, according to its solvency ratio, able to carry on its operations into the foreseeable future[25].

Besides these evaluating factors, in assessing the profile of the right target to choose, some dimensional variables must be take into account, especially when is the case of cross-boarders M&As. As explained further in the next chapter, these external factors are mainly represented by the cultural gap between the parties involved in the transaction, the political-legal system and the economic system of potential target's domestic country. Such

[23] Rock M.L. (ed.), (1987), The Mergers and Acquisitions Handbook, McGraw-Hill.
[24] the property in which the company has already invested. Definition provided by www.nasdaq.com.
[25] Krishnamurti C., Vishwanath S.R. (eds.), (2008), Mergers, Acquisitions and Corporate Restructuring.

elements may heavily affect the strategic choices of the acquiring company.

1.3.4 Documentation: the letter of intent (LOI)

After the identification of the target company, the first step regarding the documentation in M&As is often represented by the *letter of intent (LOI)* or *memorandum of understanding (MOI)*. The letter of intent consists in a preliminary document in which both the parties, the acquiring company and the target, usually agree upon several conditions. The draft of this document, which formally represents a declaration of intent by the parties, often happens during the negotiation phase of the contract. Due to its preliminary nature, many agreements between the parties inside the document have a non-binding value. Although, the letter of intent includes some binding obligations that are usually in the form confidentiality and exclusivity clauses, for the protection of the exchange of private and confidential information[26]. The confidentiality and exclusivity obligations bind the parties in view of the starting of a process of *due diligence*, which represents the tool for analysing the well-being of the target and involves many external professionals, as well as managers from both the parties.

Regarding M&A operations, usually the parties sign a letter of intent after agreed upon the overall project, and delay the conclusion of the agreement until many further steps, like the due diligence, have been concluded[27]. It is very important, although the document has non-binding nature, that the language of the LOI must be clear and unambiguous.

[26] Studio Legale Chiomenti, (2013), Quadro di Riferimento Legislativo e Fiscale Per Gli Investimenti In Cina.
[27] Bortolotti F., (2013), Drafting and Negotiating International Commercial Contracts, International Chamber of Commerce, Paris.

1.3.5 The importance of the *due diligence*

Such a fundamental step in the pre-acquisition phase is the *due diligence*. The due diligence is the process of investigation and evaluation conduct by the acquiring company toward the target before signing the contract. The goal of a careful due diligence is to acquire as much as possible data and information the buying company needs, in order to assess the legal and financial background of the target company.

The due diligence is a measure of prudence and, in simple words, helps in guarantee that the acquirer gets exactly what he is paying for[28].

In the context of an M&A operation, the process of due diligence on the target company is crucial to identify and evaluate the potential risks behind the acquisition, by investigating on whether or not there are any problems regarding target's previous business operations. Those risks can concern many aspects of the target, such as company's activity, its history, its financial situation and even how the company is conducting its current transactions[29].

On the basis of the narrow object of investigation, the due diligence can be divided into different categories, including *the legal due diligence*, *financial due diligence* and, especially in case of acquisitions into emerging markets, *investigative due diligence*.

The legal due diligence's objective is a clear assessment of potential legal exposure and risks derived from the target business activity, basically including contracts, key commercial agreements, eventual lawsuits against the company, internal employees and labour agreements, intellectual properties documents. Financial (and accounting) due diligence concerns an analysis of sources of data about the target's financial situation, like audited financial statements, historical financial informations (monthly or quarterly), publicly available financial data, interview with the financial management and external auditors. This process of due diligence can produce important data for the acquirer about the target company's earnings, and can be useful, especially in dealing with equity deal operations, to uncover hidden liabilities that may potentially lead the purchasing company

[28] Urs E. Gattiker, (2009), Merger and Acquisition: Effective Information Security Depends on Strategic Security Metrics, https://www.researchgate.net/publication/242595403

[29] Pisacane G. – Zibetti D., (2011), Acquisizioni e Fusioni in Cina, Guida Pratica agli Operatori Italiani.

to debts exposure[30]. Investigative due diligence is important to assess whether or not there are covered issues regarding target previous operations, such as problems related to bad management's outcomes, to welfare payment to employees, documentation problems, land security matters etcetera. Investigative due diligence is required especially in emerging markets, such as China, in which domestic companies internal and external dynamics, unformal business relationships and accounting data may not be clear due to lack of transparency and scarcity of detailed information provided.

Further analysis on the market in which the target company business operates, by recurring for example at research over customers, competitors and market data, are part of the commercial due diligence. Usually a strong due diligence exercise includes investigation over all of these areas, within a unique integrated service.

The due diligence for cross-border acquisitions deals in emerging markets is quite critical for several reasons, such as, besides the lack of accurate and accessible data, the differentiation in accounting standards and political obstacles.

[30] Boufarah B. – Lamm B., (2016), M&A: The Intersection of Due Diligence and Governance, in *On the Board's Agenda, US*, https://www2.deloitte.com

1.3.6 The legal structures, *asset deal* and *equity deal*

The most important strategic choice related to an M&A operation, after a prudent due diligence, is represented by the object of the acquisition, which could be represented by the target company's equities or its assets. The first is known as *equity deal*, whereas the latter as *asset deal.*

Both these choices in acquisition include positive and negative aspects, or better advantages and disadvantages, depending on a lot of variables and factors, such as the size of the acquiring company, its business, the strategic plan the company is pursuing. The acquisition through asset deal and equity represents the core of the operation's structure, and the purchasing company need to evaluate several determinant factors and risks regarding both the options.

The equity deal allows the buyer to purchase the shares of the target company, thus more rapidly the control of the company's tangible and intangible resources like clients, licenses or goodwill[31]. Equity deals can limit the time and fiscal impact of the transaction, while on the other hand the buyer may be charged with some hidden liabilities from former commercial activities undertaken by the target company. This scenario is far less likely in case of operations on the assets. The arise of this situation represents a big threat in dealing with acquisitions into Chinese market, as explained is the next chapter, as Chinese companies could easily hide past misdoing reflected on a potential high financial or commercial debt, together with liabilities related to welfare and social security requirements to the employees[32]. Such potential financial risks could be limited through careful operations of fiscal and legal due diligence, as already mentioned.

Asset deal operations can involve part or the whole target company's tangible and intangible assets. Transactions over the assets are considered logistically cleaner because prevent the investor from eventual hidden liabilities. Advantages from asset deal operations may be represented by the fact that the buyer can basically choose the assets to purchase in

[31] The *goodwill* is an intangible asset derived from the acquisition of a company by another for a premium value. It can be represented for instance by the value of target's patents, customers relations, good employee relations, or brand name. Definition provided by www.investopedia.com

[32] Studio Legale Chiomenti, (2013), Quadro di Riferimento Legislativo e Fiscale Per Gli Investimenti In Cina.

the transaction, assuming in case only the liabilities that are *current* and excluding from the deal unwanted assets and liabilities. However, asset deals produce a heavier fiscal impact.

1.4 Final steps in acquisition processes: the post-merger integration (PMI)

The phase of post-merger integration (PMI) is by nature a crucial aspect involved in M&A transactions. PMI is the process of assembling and reorganize different organizational systems, their assets, human resources, tasks, the supporting information technology system, into the new acquired or merged entity. PMI's goal consists of achieving, through these rearranging process, new efficiency and synergies so that the company starts efficiently a new business life.

It is very important for the acquirer to actively manages all the processes within the PMI in order to create optimum value, whereas by underestimating the complexity of this phase and creating unidentified synergies, especially in overseas environments, the player may obstruct the value creation that must be achieved by undertaking PMI.

During PMI processes, the acquiring company must deal with plenty of factors and variables that influence the success of the whole processes of integration. For this reason, the purchasing company should start even from the negotiation phase of the deal to address the potential issues in PMI.

The PMI phase is realized basically in two main sequential steps that lead to the integration of the companies: *transition management* and *strategic consolidation*[33]. The first step occurs during the time needed for acquirer and the merged company to establish a cooperative relationship. The closing phase of the M&A deal usually may lead all the stakeholders involved in the process to a state of uncertainty. Thus, during the transition management phase is very important the focus on partners mutual purpose and understanding. This matter in a cross-border deal is mainly represented by the leverage of cultural gap between the two parties, in a sort of creation of a new common culture that must reflect company's values[34]. Keeping in mind this perspective, a further important step consists in creating an executive team capable of leading the integration process and

[33] Lasserre P., (2012), Global Strategic Management third edition, Palgrave.
[34] For Mergers, It's a Small World after All, (2011) CNN Money.com, http://money.cnn.com/2011/02/15/markets/the buzz/index.htm

managing the interface confronts between the parties. The best integration team to be appointed must be formed by corporates who are able to understand, within an intercultural framework, both the culture of the buyer and of the acquired company.

Another aspect to take into account is the behaviour toward the entity's employees. Showing respect and attention for the acquired company's employees, which may feel a sense of uncertainty after the deal, is a necessary behaviour for the acquirer. Moreover, during the transition management phase the acquiring company needs to make efforts in reducing the stakeholders' eventual concern about the level of success of the M&A, in order to establish credibility at the basis of the new starting cooperation.

The strategic consolidation is the last part of the PMI phase. It consists basically in the definition of the respective strategic roles of the acquired or merged company. In case of cross-boarders M&As, in this phase the acquired company must be provided with its new strategic identity within the overall global, or regional, strategy of the acquirer[35].

The major goal in succeeding in PMI phase consists in the realization of value by achieving right synergies between both the parties, a struggle that require great efforts and coordination.

It is important to understand that the process of integration may be very emotional, considering that common negative perceptions in HR represented by the anxiety of losing a job, carrying the weight of new responsibilities, changes in careers etcetera are involved[36].

According to a study undertaken by The Boston Consulting Group, many global firms believe that value-generating acquisitions in foreign markets, especially in China, are unlikely successful because of the obstacles associated with the regulatory approval and the post-merger integration[37]. For this matter is appropriate for foreign firms as tool of precaution, to well define, even prior to the closing of the M&A deal, the integration strategies, the processes, and all responsibilities of the management teams involved in PMI.

[35] Lasserre P., (2012), Global Strategic Management third edition, Palgrave.

[36] Ashkenas R., De Monaco L., Francis S. C., (1998), Making the Deal Real: How GE Capital Integrates Acquisitions, in Harvard Business Review, January – February 1998, pp. 165 – 168.

[37] The Boston Consulting Group (Yang V., Liang R., Walters J, Hsu H., Kengelbach J., Hammoud T.), (2015), M&A in China, Getting Deals Done, Making Them Work.

1.5 Cross-border M&As: mergers and acquisition as FDI

The rise of globalization together with countries' major opening to direct investments from overseas, has increased the recurrence to cross-border M&As for accessing global markets.

Cross-border M&As are strategic forms of investments for firms who aims to penetrate new markets or reinforce their presence into a foreign market. These operations are mainly used by companies as potential growth strategies in the attempt of establishing their business in emerging markets[38]. Through such processes of internationalization, companies attempt to gain competitive advantages in global markets, which mainly consist in: the access to many new potential customers and related increasing of sales and profits; the exploitation of emerging countries' lower labour costs, usually for unskilled jobs in markets with a low human capital, by weather outsourcing the production phase or acquiring production facilities there.

The globalization's effects on global economy and financial business have increasingly influenced the trend toward investments into foreign markets for multinational companies. As matter effect, the shapes of investments have changed, especially in developing and in those that can be assume as post-developing country, such as China. Since its opening economic reforms, China has presented prolific growth opportunities for external players able to develop their competitive strength and survive into the market environment. Moreover, the rapid development of information technology systems and telecommunications nowadays allows the same organization to work rapidly, efficiently coordinated in different markets around the world.

On the other side, because of the instability of global economy in recent years, the uncertainty of companies who want to gain access and exploit those markets has risen. Due to this perception, besides other basic structural and strategic reasons, the faith of many companies in recurring to direct operations such as M&As, which allows an higher level of control over the investment into foreign markets, is constantly growing. In some foreign markets, such as China, this trend in recurring to brownfield investments is also linked to a

[38] Rock M.L. (ed.), (1987), The Mergers and Acquisitions Handbook, McGraw-Hill.

quite recent modernization of commercial legal framework, which make foreign investors feel more familiar with the business environment[39].

Considering the effectiveness of M&As in foreign markets and making a comparison between overseas brownfield and greenfield operations, it is proper to take into account several variables like the size of the investors, the type of business the company runs, its business agenda, the target market's conditions, and most importantly the company's knowledge of foreign market. M&As operations, even though to some extent faster than greenfield, could be more costly, especially for the payment of target's established intangible resources such as brands, know-how and technology. In addition, the costs of PMI process could be very high, especially in financing the organizational and management efforts in dealing with different cultures[40]. On the other hand, there are considerable advantages in going brownfield that may help especially small-medium enterprises (SMEs) to overcome the poor experience into the new market. Such advantages include the chance of more rapidly obtaining some vital resources that may otherwise be difficult to gain in a foreign market, like brands, knowledge, technologies. Others potential pros are the avoidance of start-up problems, an issue that could clearly be bigger for SMEs.

Hence, M&A deals are often seen as a faster and sometimes cheaper alternative to the establishment of a whole new business infrastructure, and are becoming increasingly popular as investment tool for accessing into new markets, gaining market shares, improve competitiveness and enhance operational efficiency. On a legal point of view, the greenfield implicate the creation of a new legal entity, in a start-up or a new plant, together with a lot of duties related to authorizations, licences, negotiations in purchasing the land, build new structures and facilities, purchasing the machinery and so on. M&As on the other hand implicate the takeover of an already existing legal entity, within an operation that can be concluded without the interruption of any business activity. Moreover, although greenfield operations grant full control over the governance of the new entity, such deals

[39] Studio Legale Chiomenti, Quadro di Riferimento Legislativo e Fiscale Per Gli Investimenti In Cina.
[40] Lasserre P., (2012), Global Strategic Management third edition, Palgrave.

involve sustained and costly efforts to develop the necessary infrastructures in terms of supply and distribution networks, as well as customers base[41].

These mentioned factors of course influence differently small-medium companies and multinationals, whose approach to a foreign market and environment is also related to their different capability and matured experience in investing overseas.

There is a process of addition value creation in following M&A strategies, that in the most cases comes from the consolidation of companies operating in the same business area, and from the global reach, which is the extension of the company to international markets. The additional value is created through two modalities: the short-term one-off value and the long-term strategic value[42]. The first is related to variables of costs and benefits, coming from post-merged derived cash benefits over tax shield, assets disposal and instant cost saving or debt leverage; while the latter comes from the competitive advantages obtained after the acquisition, which are, among others, differentiation capabilities like a larger market, new growth opportunities, the possibility of enhancing competencies or costs advantages through economies of scale or scope[43].

Regarding the aspect of M&As as foreign direct investment in an emerging market, many multinational companies believe that sometimes the value generated from cross-border M&As is not cost-worthy. This perception, according to research, is also related to obstacles represented by the strong regulatory systems of such countries and environmental adaptation problems. In Chinese market, adaptation issues mainly come from differences in cultural and management style, and wrong customization of the post-merger integration approach upon the market[44].

[41] EU SME Centre, (2013), Guideline: Due Diligence for joint ventures, mergers and acquisitions in China.
[42] Lasserre P., (2012), Global Strategic Management third edition.
[43] Rock M.L., (1987), The Mergers and Acquisitions Handbook, McGraw-Hill.
[44] The Boston Consulting Group (Yang V. et al.), (2015), M&A in China, Getting Deals Done, Making Them Work.

PART II
M&As AS FDI: STRATEGIC M&As IN CHINA

2.1 The evolution of the Chinese market: from low-cost based productions toward the "new normal"

In line with recent governmental policies, Chinese market is constantly changing its nature. During the last decades, China has represented a market with strong appeal to companies looking at the same time for delocalization of their production system and for gaining considerable profits. After several significant marked-oriented reform steps in recent history of China, from the opening to the global market after Deng Xiaoping Open Door policy launched in 1978, then China's access to the WTO in 2001, China's economy experienced a constant and rapid growth. Dived into the effects of globalization on global economy, for the last twenty years the country strongly relied on the manufactory sector and on an heavy export-oriented economy, being universally recognized as the world factory. China became the centre of global and regional production networks and supply chains for products with a lot of imported components, thereby netting only a small rate of domestic value-added for the internal market[45].

In this context and through these years, many have been the cost-advantages and the benefits global companies have enjoyed in Chinese market, like low-cost production and a low local competitivity by Chinese companies, often less developed and with a smaller product portfolio. Foreigner players who invested in Chinese market have benefited from their source of strength, such as more innovative products, the power of the brands and a better technological know-how together with constant innovation[46].

[45] Tong S. - Jing W (eds.), (2017), China's Economy in Transformation under the New Normal
[46] Joosten W., (2016), Multinational Companies are Entering in the "New Normal" (在跨国公司进入常态), in *FT 中文网*, 2016-01-15, http://www.ftchinese.com/story/001065589?full=y

All the growth opportunities and benefits, especially the cost-related advantages in production, Chinese market has provided in the recent past are being constantly surpassed by a need of modernization and a shift of the market toward a new tendency.

Following a revolutionary change, implemented together with recent "One Belt One Road" initiative[47][48] promoted by President Xi Jinping on the foreign policy side, Chinese market's nature is constantly changing and evolving, with an ongoing internal innovation and competitivity. Chinese government on one side is supporting investments outbound, following a path toward the internationalization of domestic companies, but more importantly is financing an internal growth of high-quality standards in production.

This internal development of Chinese market consists of a structural transformation, that can be reassumed into a shift from a labour intensive, low-cost mass production market, to a modern high-end technological and innovative production system, implemented by new governmental pro-active policies.

After more than thirty years of hyper growth and industrialization, Chinese economy starts to enter into a phase of relative maturity[49]. According to the European Chamber of Commerce in China 2014-2015 Position Paper, the Chinese golden age and the prosperous stage after the adherence to WTO in 2001 already came to the end, culminating, also due to structural problems and changes in global environment, in this new phase of stabilization[50]. Since 2011 China's economic hyper growth has started to decelerate, registering for 2014 7.4% growth, and for 2015 the lowest growth rate in 25 years in 6.9%[51]. As President Xi

[47] The *Silk Road Economic Belt and the 21st-century Maritime Silk Road,* also known as the *One Belt and One Road initiative (OBOR)* or just *Belt and Road Initiative (BRI)* is a development strategy for enhancing connectivity and cooperation between Eurasian countries. The plan, launched by President Xi Jinping in 2013 and with China as core and fostering country, includes a strong implementation and the built of infrastructures network along the road between China and Europe, on the line of countries allocated on the original Silk Road in the mainland, and a strong maritime connectivity with Southeast Asia, Oceania and North Africa countries along the South China Sea, the South Pacific Ocean and the Indian Ocean areas. The strategic plan aims at increasing the global political and economic influence of China, together with exporting its industrial capacity in excess to BRI countries.

[48] Getting lost in 'One Belt, One Road', (2016), in *Hong Kong Economic Journal*, 12/04/2016

[49] KPMG, (2016), The 13th Five-Year Plan – China's Transformation and Integration with the World Economy, https://assets.kpmg.com/content/dam/kpmg/cn/pdf/en/2016/10/13fyp-opportunities-analysis-for-chinese-and-foreign-businesses.pdf

[50] European Union Chamber of Commerce in China, Position Paper 2014/2015.

[51] Tong S. - Jing W (eds.), (2017), China's Economy in Transformation under the New Normal.

Jinping stated in 2014, China entered in a phase economic stabilization known as *new normal (xin changtai 新常态)*[52]. This sort of normalization of China's economic growth follows a trend toward a stabilization of high-quality, more sophisticated, specialized and better structured mode of production, that will be followed during the current 13th Five-Year Plan period (2016 – 2020)[53], instead of the run to unconditioned growth rate (China reached an average PIL annual rate at 9.7% from 1979 to 2014)[54]. Rather than implementing an unconditioned growth rate, driven by strong investment policies, China is planning to pursue a growth less fast but with more quality, based on a growing internal consumption and relied on the service industry. This is one of the reason why multinational Chinese companies are strongly investing overseas, purchasing ownerships of many European and American targets in sectors foreign countries consider as strategic: to gain foreign competencies, high-end technologies and know-how to bring inbound.

Chinese industry new plans aim at quality instead of quantity, the element that characterized the market throughout these years. One of the goal of the new normal policy is a development based on services industry (which in China already produce the 51% of GDP), and on, as already mentioned, a more value-added industrial production[55]. For this reason, intensive productions of highly polluting products, such as leather, are gradually being reducing and rationalizing, also looking at the environmental safeguard.

Following this trend, China possesses nowadays, besides a modern industrial apparatus, a product quality based competitive market. Chinese market presents more local multinational companies that offer high-end quality products, thus new strong competitors for foreign firms. As consequence, foreign players who want to be currently competitive into Chinese market, must be aware of these recent high-quality standards oriented changes in market environment, and so be provided with innovative and modern, often eco-friendly,

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[52] Saggu, A. & Anukoonwattaka, W. (2015). "China's 'New Normal': Challenges Ahead for Asia-Pacific Trade". United Nations ESCAP

[53] *Xinhua net* (新华网), 2015, Highlights of proposals for China,s 13th Five-Year Plan, http://news.xinhuanet.com.

[54] Tong S. - Jing W (eds.), (2017), China's Economy in Transformation under the New Normal

[55] Patti F., (2017), Fca e non solo, come resistere all'invasione cinese (senza diventare protezionisti), in *Linkiesta*, 2017-08-26, http://www.linkiesta.it/it/article/2017/08/26/fca-e-non-solo-come-resistere-allinvasione-cinese-senza-diventare-prot/35315/

products. Hence, the level of complexity of Chinese market grows, the growth decelerates but the quality of production raises[56].

China is a more complex market than before, and the deceleration of its growth is not sign of weakness, but of a maturity stage of Chinese economy, drove by government to a medium-long-term stable growth within a sustainable normalcy, likewise other mature strong economies.

According to the new developing plan “Made in China 2025”, launched from the State Council on May 19, 2015, China’s industrial system in going toward an higher value-added advanced manufacturing, through a deeply change in the aspects of its processes (industrial automation) and products (innovation)[57]. China’s industrial policies occupy great part of government’s overall developmental strategies, and this plan aims at reconstructing an avant-garde industrial system, embracing an advanced manufacturing industry model that will be able to compete in quality with other developed countries, following the example of German industry 4.0 industry plan[58]. Chinese Government is dedicated to improving the quality and efficiency of development, encouraging a condition of growth that focuses on innovation, coordination, eco-sustainability, openness and inclusiveness[59].

This ongoing structural change in Chinese market is the trend that new governmental industrial and economic policies are following, thus must be recognized by players who are investing in China.

China is already to be considered a high-end quality competitive market, with an environment much more complex than before. Foreign firms who aim to enter Chinese market need to substantially invest in innovation and qualitative better products, in order to survive in this Chinese “new normal”. For this matter, the investments policies implemented during the current 13th FYP, indicate broader opportunities for foreign investors in undertaking FDI and more importantly acquiring domestic companies with market demand and advanced technologies in the leading service sector.

[56] Stringa P., (2015), Cina, Dal Boom Economico al New Normal, in *L’ Impresa*, p. 26
[57] Noce G., (2016), Per Made in Cina 2025 un passaggio cruciale, in Il Sole 24 Ore, September 2016, http://www.ilsole24ore.com/art/commenti-e-idee/2016-09-29/per-made-china-2025-passaggio-cruciale-160316.shtml?uuid=ADwfFYSB
[58] Tong S. - Jing W (eds.), (2017), China’s Economy in Transformation under the New Normal.
[59] KPMG, (2016), The 13th Five-Year Plan – China’s Transformation and Integration with the World Economy.

2.2 The legal framework: from JVs to M&As

Throughout the years and with the constant evolution of the Chinese market, the form of investments companies undertook to penetrate the market became different.

Besides indirect way of investments, for several years since China's opening to foreign investments, the favourite direct form of foreign investment inbound been the *joint venture* (JV) with a Chinese partner. The sino-foreign joint venture consists of a special type of limited company with independent legal subjectivity established by a Chinese partner as legal person, and by at least one foreign subject as physical or legal person, who must hold at least 25% or more of company's registered capital. Partners can contribute to the capital in money, in kind or immaterial goods such as property rights, know-how or other intangible assets. The new entity is characterized by shared ownership, shared investments and operational costs, share governance and shared returns and losses[60].

Sino-foreign JVs can take the shape of *equity joint venture* (*Zhongwai hezi jingying qiye* 中外合资经营企业) or *cooperative joint venture* (*Zhongwai hezuo jingying qiye* 中外合作经营 企业), whereas the first is the most common. Under the *Company Law of People's Republic of China* with all the relative discipline, equity joint ventures in China are regulated by the *Sino Foreign Equity Joint Venture Law* (EJV Law), came into force in 1979, lastly modified in 2001 and implemented by the *Sino Foreign Equity Joint Venture Law Implementation* of 1983[61]. Both these regulations and implements were modified and updated through the years, lastly in 2001 in view of China's entrance into the World Trade Organization (WTO).

Sino-foreign cooperative joint ventures are a less popular form of cross-border investment, regulated by the *Sino Foreign Cooperative Joint Venture Law* (CJV Law) issued in 1988, lastly modified in 2000, implemented by 1995 *Implementing Regulations.* CJVs can be provided or not with legal personality, whereas in latter case take the shape of

[60] InterChina Consulting, (2011), Establishment of a Joint Venture (JV) in China, in www.InterChinaConsulting.com

[61] Studio Legale Chiomenti, (2013), Quadro di Riferimento Legislativo e Fiscale Per Gli Investimenti In Cina.

a *contractual joint venture,* that consist of a sort of contractual obligation between the Chinese and foreign parts, but does not implicates the creation of a new separated entity.

JV deals was the first, not by choice but obligation, direct investment vehicle used by investors seeking to enter into Chinese market, after the China's "Open Door" policy started by Deng Xiaoping in 1987. Clearly the goal of governmental policy in allowing at the first stage only JV deals as vehicle for foreign players to enter Chinese market, was to get access and absorb advanced technologies and management experience from more developed western companies and transfer it into the local state-owned enterprises, during a phase of lack of internal technological resources and managerial knowledge in domestic state-owned companies.

During the recent past and still nowadays, the reasons for choosing the joint venture as vehicle for entering into Chinese market are several. Since China's opening reforms to foreign investments, many have been the deals concluded unsuccessfully due to a scarce knowledge of the market and of its internal dynamics. Investing in Chinese market is such a complex operation, it requires sufficient knowledge and competencies, together with an understanding of the right, formal and informal, procedures. Also for this reason, JVs have represented one of the most used investment tools for many companies in large part uneducated to the environment of emerging markets such China, and not used to cooperate with a domestic partner. A JV agreement with a Chinese partner with long term knowledge of market is useful to get gradually acquainted with the environment and with local potential competitors. For a first-mover foreign investor this kind of deal, even if someway restrictive, may help the investor to build a solid network of business and interpersonal relationships (*guanxi 关系*). In addition, JVs represent a hub for foreign players who want to access the market to obtain in the first stage the right expertise, necessary infrastructures and networks of distribution already in place, build the proper business cooperations and mature experience before acting alone in such a complex environment, before investing independently through acquisitions.

Sino-foreign joint ventures do not represent anymore the favourite vehicle to enter Chinese market, especially in circumstances in which foreign players wish to do business alone, and seek for a more direct control over the ownership of companies and consequently over their presence in the market[62].

Since China quite recently admitted the acquisition of private and public local companies by foreign investors[63], and after its entry into the WTO in 2001, the landscape of foreign investments inbound has changed. Many foreign firms tend to follow an establish criteria entering Chinese market: first strategic alliances with local partners in order to get more acquainted with the market environment, and after they choose to undertake acquisition. As consequence, direct investments nowadays in China take increasingly the shape of mergers and acquisitions, instead of joint ventures or deals for exchanging know-how. In barely more than a decade, M&A deals in China have incremented from 69 in 2000 to more than 1.300 in 2013[64], and such investments in an existing Chinese company are the faster tool of penetrating Chinese market even for small and medium-sized enterprises (SMEs). Besides, Chinese government is constantly attracting more foreign investors through further easing of M&A restrictions and improving the investment landscape in selected sectors, such as high-tech and environmental protection[65].

This change in attitude by the Chinese government, whose politics are increasingly trying to bring market high-end technological value, resources and technical know-how into domestic market, is accompanied in recent years by an improving and modernization of the legal system. These elements, together with the issuing of many new rules for governing inbound foreign investments, are raising the faith in undertaking M&As in China, which were previously more sporadic due to this haziness of legal framework, and providing the external investors with a less unfamiliar environment. From 1990 to 2001, because of the developing and improving of market socialism, precisely “socialism with Chinese characteristic”, and with the opening to foreign investments, China has started to follow western legal and organizational models. Due to this constant development and opening of the market, is happening a modernization of Chinese commercial legal system, which is

[62] Devonshire-Ellis C., Scott A. – Woollard S. (eds), (2011), Setting up Joint Ventures in China.
[63] Cavalieri R., (2015), Letture di diritto cinese, Cafoscarina, Venezia.
[64] See Graef A., Sauerberg B., McCool M., Luedi T., Sun J., He S., Leung F., Rothenbüecher J., (2015), Creating More Value for China's M&A, in *Transaction Advisors*.
[65] EU SME Centre, 2013, Guideline: Due Diligence for Joint Ventures, Mergers and Acquisitions in China

constantly being adapted to the international legal environment. Especially in civil and commercial frame, rules began to be stabilized and regularly be applied by a more competitive administrative and judicial apparatus, and a modern Chinese commercial law (*shangfa 商法*) started to efficiently work. This evolution of commercial law in contemporary China reflected the socioeconomic change of the country, driven since the passing of Chairman Mao Zedong in 1976 from the central planning economy to the opening toward the global market[66] .

However, even though Chinese commercial law assumed more characteristics of modern western systems, the influence of the state on the economic and administrative activities is always heavy, and this important element may represent a negative aspect for private foreign companies in China, surpassed by local state-owned companies in many favourable governmental industrial policies.

Foreign investments' in China refers to the *Industrial Guidance Catalogue of Foreign Investment*, which represents the instrument through Chinese government limits foreign investments inbound, especially regarding strategic sectors. The Catalogue was issued for the first time in 1997, in a first stage to provide current governmental policies on foreign investments. Right after China's entry into WTO in November 2001, the document started to classify industrial sectors for foreign investments as *encouraged*, *permitted*, *restricted* and *prohibited*, in line with Chinese government need to guide and strictly control the inflow of investments from abroad[67].

Investment which are registered as restricted must be subjected to limitations such as shareholding restrictions, and must undergo through prior approval by the Ministry of Commerce of People's Republic of China (MOFCOM), whereas encouraged investments can benefit from governmental special incentives like lower tax rates[68].

Glancing at some changes in the directions of foreign investment along the various editions of the catalogue, it is possible to understand the government efforts to conduct

[66] Cavalieri R., (2015), Letture di diritto cinese, Cafoscarina, Venezia.
[67] Pisacane G. – Zibetti D., (2011), Acquisizioni e Fusioni in Cina, Guida Pratica all' M&A per gli Operatori Italiani.
[68] Koty A.C. – Zhou Q., (2017), China's Foreign Investments Catalogue Open Access to New Industries, in *China Briefing* 2017-07-11, http://www.china-briefing.com/news/2017/07/11/china-releases-2017-foreign-investment-catalogue-opening-access-new-industries.html.

FDIs and fit them into the plans for China's new economic structure. The last updated version of the Catalogue was officially released on June 28 and became effective on July 29, 2017, replacing the last 2015 version.

Acquisitions of local companies by foreign investors in China are regulated by the *Interim Provisions on the Mergers and Acquisitions of Domestic Enterprises by Foreign Investors,* also "M&A Rules", promulgated and came into force in 2006 and lastly reviewed in 2009[69]. The latter version, issued by MOFCOM, regulates the acquisitions on both the equities and the assets of target companies. Moreover, in 2011, the MOFCOM issued the *Circular on Issues Concerning Administration of Foreign Investments,* which together with the M&A Rules and other regulatory papers establishes that the value, the structure and the type of target in M&A deals will be relevant in the authorization process. Particularly, acquisitions with a total investment of 300 million of USD mandatorily require the approval of the MOFCOM, which acts also as anti-trust authority in this case; operations with a lower capital, except for those with particular nature or sector of investment, must be approved by MOFCOM's regional and local entities[70]. Nothing strange considering the policy of protectionism the Central Government constantly exercises on public local companies, often endowed with strategic importance.

As already mentioned, both joint venture and M&A deals in China must be subjected to a strong approval procedure by national regulatory entities, that are mainly the MOFCOM and the SAIC (*State Administration for Industry and Commerce of the People's Republic of China*), and in case of specifically regulated sectors by other appointed governmental authority[71]. To reinforce the protective fingerprint on local industry adopted by Chinese government, back in 2006, right after China's opening to foreign acquisitions, the MOFCOM issued a decree aimed at enhancing and centralizing the approval power by administrative authorities, in order to safeguard those assets properties from potential private acquisitions[72].

[69] www.leggicinesi.it
[70] Studio Legale Chiomenti, (2013), Quadro di Riferimento Legislativo e Fiscale Per Gli Investimenti In Cina.
[71] Pisacane G. – Zibetti D., (2011), Acquisizioni e Fusioni in Cina, Guida Pratica all' M&A per gli Operatori Italiani.
[72] Studio Legale Chiomenti, (2013) Quadro di Riferimento Legislativo e Fiscale Per Gli Investimenti In Cina.

The acquisition of a Chinese target company's equities by a foreign investor, clearly in an industrial sector allowed by the Catalogue, brings to the conversion of the local entity into a FIE (Foreign Invested Enterprise), that will take the shape of an EJV, with the foreign party holding the 25% or more of the of company's share capital. Therefore, the new entity is regulated under the EJV Law. This aspect is very relevant in view of the governance of the acquiring entity, because the foreign investor will be subjected to a joint venture agreement with Chinese partner, and thus to reciprocal logics of rights and obligations within the new company's governance policy.

Since M&A transactions in China slightly differs from other countries due to formal differences in regulation processes, it is important to build a skilled team composed by individuals who have a knowledge of Chinese legal and regulatory systems together with an acquaintance with the local culture and language.

2.3 Social impact and cultural barriers

China's culture, economy, history and politics: all these unique dimensions, which represent factor of differentiations from the rest of the world, are reflected into the market. From the investor's perspective, the different way of approaching the business, handling difficulties, relating with people, conducting the communication processes with stakeholders or with public parties may represent factors of unfamiliarity with Chinese culture. Culture is a complex and multidimensional aspect that affects, besides all the other dimensions, people's identity and behaviour, moreover in business relationships. Despite the fact that globalisation brought changes and elements of western culture in Chinese society, cultural gaps still represent a thick veil in between China and the West.

Due to cultural and structural differences in the Chinese business environment, it is realistically complicated assess the risks of making a deal successfully in China. Foreign companies must be ready to face a totally different environment compared to western markets, and align their expectations in order to avoid frustrations and lost battles in front of the challenges the market arises.

Although the M&A market in Chine in the last decades developed quickly, conducting a deal in China differs consistently from the standard procedures applied in many western countries, and undertake business operations with a Chinese target is not comparable to the same operation in different established western markets. Even for multinational firms, which have a strong experience in assessing strategies and planning deals overseas, China's environment represents a unique combination of elements and variables, a totally different world.

Contemporary Chinese culture consists of a sum of major elements: traditional culture heritage, communist ideology and, most recently, western values. Traditional Chinese culture on the other hand embraces many different schools of thought, such as Confucianism, Buddhism, Taoism, which strongly affect the present though and behaviours[73]. The most influent heritage is represented by Confucianism doctrine, the pillar

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[73] Fan Y., (2000), A classification of Chinese culture, in *Cross Cultural Management Journal,* Vol. 7, num. 2, 2000.

of Chinese culture that provides the norms at the basis of Chinese interpersonal behaviours, which must be followed to form an harmonious society[74].

In terms of the steps foreign players need to undertake to execute an M&A deal in China, the process goes through the normal agenda and basic methodology, like signing up the LOI, undertaking due diligence exercise, negotiating transactions and then going to the very closing steps. However, the local feel of doing a deal in China is different because the local culture is reflected in organizational behaviours inside the target, which will approach the transaction with a different mindset[75]and perspective. Hence, there are numerous sort of frustrations and challenges involved for the foreign player in getting a deal successfully done.

Many aspects at the basis of Chinese culture are reflected in the behaviour of Chinese businessmen and managers and in their way of thinking and conducting deals. Starting from the negotiation phase with the target, the stage in which the contacts with Chinese target is more intense, is crucial to take into account some concepts on the basis of Chinese culture, whose heritage is always present in conducting business in China.

First of all, negotiations in China is often a day-to-day relationship with the partner, and may continue until the last minute even after the deal has been officially closed. For this matter, a “yes” may not represent the reach of an agreement between the parties. In China’s business sphere the word sometimes may have more value than the contract itself, and the signing of a contract for Chinese party may not stop the transformation and its evolution, because in Chinese perspective a deal, and even a contract, is considered as an always ongoing process[76]. This is the reason why in many cases the seller which keeps holding a minority stake in acquired company may exercise some leverage in the governance.

The etiquette in China is very important. The rituality, by traditional heritage, represent a constant element in every aspect of Chinese society, from the daily life to business activities. Therefore, in doing business and negotiate with a Chinese target, the

[74] Pye, L. W., (1972), China: An introduction, Boston.
[75] Jones G.R., (2009), Organizational Theory, Design and Change, Sixth Edition, TBS.
[76] Jullien F., (2008), Pensare l’ Efficacia in Cina e in Occidente, Editori Laterza, Bari.

foreign player must follow the right gradual steps, whereas getting immediately to the point may not be considered as good behaviour for Chinese part[77].

Apart from the concepts of relationships or networking (*guanxi 关系*) and preserving the face, the reputation (*mianzi 面子*), both always present in China's daily life and business sphere and took for granted for many insiders, another more interesting and less assumed perspective concerns the dichotomy between law *(fa 法)* and relationships *(guanxi 关系)*.

There is a different hidden conception of legality in China, whereas the law in the books or the jurisdiction is many times surpassed by the *guanxi* and by different "unofficial" systems of rules. This problem is structural and lies in the traditional function of law in China, which by tradition and for China's political structure does not cover the same important as in the western society. From an historical perspective the law has never been considered in China as a technical, independent and impartial system of guarantee, but as an instrument subordinated in the hands of the government and occasionally useful to maintain stability, harmony. After the opening reform processes China went through the last thirty years, with modernization of institutions and juridical apparatus, Chinese government put emphasis on the constitution of the principle of "rule by law" (*fazhi 法治*). This term means a State governed by law, together with the recognition of the principle of legality. However, in China the contradiction resides in the socialist nature of the State, which embraces structurally the principle of the non-separation of powers, therefore there is no authority of control over the State, which is the unique actor in both issuing laws and at the same exercising control.

In terms of commercial and business activity, many Chinese companies, in large part state-own enterprises (SOEs), by nature does not give the same important to the contracts, as already mentioned, and to all the juridical aspects of business activity, but at the contrary tend to rely on systems "unwritten rules"[78]. For this matter, it is a normal practise that in case of litigation in China, the legal system is channelled toward the recurrence to

[77] Brahm J.L., (2007), The art of the deal in China, Tuttle Publishing.

[78] Cavalieri R., (2015), *Fa* (Legge) v. *Guanxi* (Relazioni): La Legalità alla Cinese e L' Operatore Italiano, in La Cina non è Ancora Per Tutti, Barbatelli C. – Cavalieri R. (eds.).

alternative dispute resolution (ADR) practises, mediation in particular, quite as representing an established empirical limit to the "government by law" principle[79], which still remain much more theoretical than practical.

These structural, cultural, different ways of conceiving law in China may represent a source of threat for foreign players with a poor knowledge of Chinese cultural heritage. These elements considerably affect the governance with a Chinese partner of acquired entities: the cultural gap between Chinese and western management arises potential issues within the governance[80].

Another challenge arisen from cultural differentiation during the negotiation phase is the negotiation of the documents, a process that may result quite complicated in case of dealing with unsophisticated sellers that are not used to conduct business with foreign investors. Hence, language issues, time differences could interfere in the whole process, which may become quite emotional.

Considering the timing issue, the time involved in trying to source a good M&A deal in China could be quite long. An important step is to build up a good acquisition team, in order that they can evaluate how company's business strategy is applicable to the circumstances, at a favourable price to pay also in terms of transaction costs and time needed to overtake the approval procedures. In the research of the right target for acquisition, the team must go out in loco to suit and persuade targets, which might be interested in divesting to you at the price that you can leave with. This kind of work requires good personalities who already have a strong experience or knowledge of Chinese cultural, political framework, with local knowledge and native language skills.

For these reasons, in managing the negotiation phase in acquisition deals is important to be prepared to Chinese environment, be resilient, and invest a lot of time.

Due to these issues coming from difference in cultural environment, it is also extremely important to estimate the risks coming from the operation carefully, and prepare every step by means of an attentive due diligence exercise. Therefore, once identified a

[79] Cavalieri R., (2012), Between Justice and Harmony: Some Features and Trends of Chinese ADR from a Western Perspective, in Opinio Juris in Comparatione, Vol.1/2012, Paper n.4
[80] Cavalieri R., (2015), Letture di Diritto Cinese, Cafoscarina, Venezia.

target then the buyer must go through processes of undertaking due diligence, and investigating about whether there are problems regarding target's previous operations. The due diligence is an extremely critical phase during the building process of an M&A deal in China, whereas the most common problems arise structurally from the lack of adequate information data and transparency. The principal source of this issue is often linked to the different way of approaching operations and internal differences in management style of Chinese companies, which might be unfamiliar with common international practises. On the other hand, during the economic boom and incredible growth of Chinese market, many Chinese companies focused on developing and increasing their business in a climate of excessive laxity by government and regulative authorities. The consequence is that these companies always managed with an unorthodox style the governance and many aspects related to the accounting, which are essential for foreign investor in order to assess many aspects in conducting the acquisition[81].

Due to these structural problems, any due diligence operation in China basically appears more complex than in other markets. Therefore, it is appropriate for foreign investors to undertake not only basic due diligence procedures, including legal and fiscal due diligence normally required during any M&A operation and whose results allow to choose the most suitable transaction strategy, but most importantly a detailed investigation due diligence[82]. The investigation due diligence aims at eliminating risks deriving from potential target's hidden anomalies and irregularities, by confidentially inspecting company's internal and external business or informal relationships.

Main issues an overall operation of due diligence could reveal over a M&A deals in China can concern for instance land titles, ownership of shares, payment of taxes, underpayment of welfare payment to employees, land security issues and so on. In front of such evidences arisen from the due diligence report, investors may decide on whether taking further steps into the deal and in case how to conduct the negotiation phase with the target[83]. Therefore, a careful work of due diligence, in international contest assigned to the

[81] Pisacane G. – Zibetti D., (2011), Acquisizioni e Fusioni in Cina, Guida Pratica all' M&A per gli Operatori Italiani.
[82] EU SME Centre, (2013), Guideline: Due Diligence for joint ventures, mergers and acquisitions in China.
[83] Yong K.P., (2013), Due Diligence in China, Beyond the Checklist, Singapore.

services of one of a big accountancy firms with long experience on the Chinese market, commonly assesses all the real business risk behind an M&A deal.

In many cases, for these matters already mentioned and due to a frequent lack of useful documents, that sometimes may be difficult to access because hold by governmental authorities, the due diligence in China requires more time than the same operation carried on in different developed markets. However, following requests over more transparency by foreign regulatory entities and by European Commission after recent interest by Chinese companies in acquiring European targets, China is trying to enhance national companies' transparency degree in order to comply with international standards[84]. With the modernization of collecting data technologies and new impositions in implementing transparency, domestic companies, which for the large part are state-owned, should normally be provided with publicly accessible data.

The threats in successfully conclude a deal in China are represented by the external, social, cultural, economic and political factors that foreign companies must face entering in the market, as mentioned before. Culture represents only one factor, but is important because by analysing cultural differences is possible to explain relative differences in management behaviours or organisation systems. Other factors influence a country's culture in different levels and are reciprocally affected by culture[85].

During both in the making process of M&A deal and the governance of acquired entity in China, it is crucial to focus on cultural differences because they affect the way of approaching problems and solutions between the parties. Foreign players must understand those factors of distance and exploit them for its own interest, recurring for example to strategic alliances or adopting intercultural approach to manage the processes of integrating operations.[86]

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[84] Wang B., Zhang M., Ma J., (2016), Why Chinese Overseas M&As are Slowing Down? (中国海外并购步伐缘何放缓?), in FT 中网络, http://www.ftchinese.com/story/001069134.

[85] Fan Y., (2000), A classification of Chinese culture, in *Cross* Cultural Management Journal.

[86] Zhu Z. - Huang H., (2007), The Cultural Integration in Process of Cross-border Mergers and Acquisitions, in *International Management Review*, Vol. 3 No. 2, 2007.

2.4 Political environment: the strong presence of the State, burden or potential resource?

Besides the cultural gap and all its outcomes in Chinese business, another aspect even more critical for foreign companies entering into the Chinese market is the political framework. People's Republic of China's Government structure sees the undiscussed leadership of the Communist Party granted by the Constitution, which holds in its hands all the powers and complete authority control. Even though the last review of Constitution in 1999 stated as we mentioned the permanence of the principle of legality[87], the principle of un-separation of powers principle still prevail, comporting at the same time the absence of a controlling authority over the action of the Party.

China's government dominant ideology since Deng Xiaoping reforms, the "Socialism with Chinese characteristics" bases its economic principles on the socialist market economy, in which dynamins of market economy and central planning are combined. Despite the opening of its boundary to the private sector and to foreign investments, China remains effectively a planned economy, thus all economic actions and business dynamics rely on the Central Government policies, which impose de facto the market internal rules.

One outcome of the strong dirigiste nature of Chinese government is its wing of protectionism toward local companies, with a logic of intercorrelated actions between central and local governments, private and public companies, banks, auditors. China works as an homogeneous system of interpersonal relationships, of *guanxi*, thus in doing business foreign players must assume that there is no boundary between government and companies, element we take for granted in western systems whereas the separation of powers is effective[88]. While Chinese government drives from the back the strategic role of national companies, both publicly hold and private, on the other hand, political ties represent for Chinese companies other informal ways of connections with both government officials in

[87] Cavalieri R., (2015), Letture di diritto cinese, Cafoscarina, Venezia.
[88] Patti F., (2017), Fca e non solo, come resistere all'invasione cinese (senza diventare protezionisti), in Linkiesta, http://www.linkiesta.it

different levels of administration, central and local, and officials in regulation agencies, such as tax or stock market administrative entities.[89]

Therefore, in doing business in China, foreign players must always assume the presence of an, not even such invisible, actor: the State, which, by exercising control over local enterprises, controls the market. Back before the economic reforms, under the command economy system[90], a Party's committee was inside every state-owned company. Along with the transformation toward the planned socialist market economy, in 1988 was officially approved by law the principle of separation between the ownership and administration of state-owned enterprises[91], by which the party does not supposed to have any power of control over the administration of economical publicly-owned entities.

Central Government's influence is express no more through Party's direct interference in companies' private administration, but rather through the issuing of governmental regulations and official economical plans. Such tools of control in the sphere of investments and business activity are for instance the issuing of the *Industrial Guidance Catalogue of Foreign Investment,* as well as the Five-Year Plans the Government promotes to establish a guideline of national economic development. It is important to not forget that China, since its opening to the globalization of the market, has always looked at the develop and modernization of the own national industry sector and companies first, by putting in act a strongly selective policies in allowing only determined forms or sectors of investments, or in deciding to which kind of investors allow the access in the market [92] .

Another political and social element affecting the business environment in China is the high level of corruption, which is a direct consequence of the concentration of powers in the hands of the single Communist Party. Despite many anti-corruption campaigns promoted in recent years, the last launched by President Xi Jinping after the 18th Party

[89] Li J.J., Poppo L., Zhou K.Z., (2008), Do Managerial Ties in China Always Produce Value? Competition, Uncertainty, and Domestic vs. Foreign Firms, in *Strategic Management Journal*, 29 (4), pp. 383 - 400.

[90] In a command economy system the central authority, besides determining which good to be produced, how produce it, the prices at which it should be sell on the market and for whom to produce, also publicly owns the industrial sector. Definition provided by Schug M.C., Lopus J.S., Morton J.S., (1997), From Plan to Market: Teaching Ideas For Social Studies, Economics, and Business Classes, p. 15

[91] Cavalieri R., (2015), Letture di diritto cinese, Cafoscarina, Venezia.

[92] Cavalieri R., (2015), *Fa* (Legge) v. *Guanxi* (Relazioni): La Legalità alla Cinese e L' Operatore Italiano, in La Cina non è Ancora Per Tutti, Barbatelli C. – Cavalieri R. (eds.), Edizioni Olivares, Milano.

Congress in 2012, the phenomenon of corruption still perpetrates inside politics and business dynamics[93].

A great number of Chinese multinational companies are state-owned or with share ownerships hold by the local governments. This aspect strongly influences deals between foreign investors and local companies, because conducting a transaction in China is as already mentioned is often like dealing with the government itself. Furthermore, considering that China has this unique political, economic and social apparatus, it is crucial for foreign players in business operations to observe the rules in the political game of China, without being directly involved in political circumstances[94].

This asymmetric vision in leading the economic activity between western models and China could represent the cause of a lack of preparation for foreign players in conducting M&A deals in China, whose phases, from the negotiation with the target to the governance, are deeply affect by those complex political dynamics. Foreign players must be aware and prepared in facing those dynamics.

Another step in dealing an M&A particularly hard to approach is the government approval of the deal, which may cost a great amount of time. By purchasing equities in a PRC registered company, investor must to go through a foreign investment approval process, including anti-trust clearance, that may take significant amount of time. Institutional barriers could be an equal or even more serious obstacle to overtake, because there are many regulatory stakeholders involved in the Chinese approval processes [95]. Even more, mainly because of the country political structure, regulatory entities miss autonomy and transparency. Also for this matter the separation of powers in political and administrative systems is an issue raised several times by many Western observes[96].

The presence, the burden of the State in China's market environment may represent, if not a threat, a factor to be exploited and a source of more competitiveness for foreign players. Therefore, keeping in mind this perspective, it is important for foreign investors

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[93] Yan. S, (2004), Corruption and Market in Contemporary China, Cornell University press, p. 12
[94] Reuvid J., Li Y., (2006), Doing Business in China, GMB Publishing.
[95] The Boston Consulting Group (Yang V. et al.), (2015), M&A in China, Getting Deals Done, Making Them Work.
[96] Cavalieri R., (2015), Letture di diritto cinese, Cafoscarina, Milano.

who undertakes M&A deals in China, to build the right alliances within Chinese unique system of interests-based interrelationships, also through acquisition of local targets which carry on their back this sort of networking advantages. Here comes again the concept of *guanxi*, or better *guanxi wang 关系网* (network of relationships), that can be seen in this light as a true form of social investment, a social capital for foreign players in Chinese market.[97] Identify the right target could be favourably influential over the approval processes, which can require as mentioned before a lot of time.

It is also true that due to these political and structural differences, the foreign part must sometimes accept conditions that might appear strange in another environment, or has to move, as explained previously describing cultural differentiation, following procedures and schemes far away distant from his normal way of conducting business, in other words out of his comfort zone.

[97] Buttery E. A. - Leung T. K. P., (1998), The difference between Chinese and Western negotiations, in *European Journal of Marketing*, 32:3/4, pp.374 – 389.

2.5 HR in China

Human resources in global context are influenced by some environmental dimensions, like education-human capital, political-legal system, economic system, and most important culture[98]. The historical transformation of China from an agricultural based country to one of the biggest industrial economy in the world, together with subsequent changes and evolutions in culture and society, such as the improving of educational system, strongly affected the education-human capital of the country.

Human capital comprehends all the productive capabilities of individuals like skills, knowledge and experience that, through labour force, produce economic value[99]. After this change in nature of Chinese market, which hosted great inflow of overseas investment inbound, some of the professional skills have evolved, together with the need of a different skilled labour force. This labour force must suit with the demand of medium and large companies which compete in a global market environment, thus in a context of managing high complexity[100].

Managing human resources in an international environment is a big deal, even more for foreign players who achieves growth in Chinese market through processes of M&A. However, HR in China are a critical aspect and a source of success for foreign companies, by representing a strong tool of gaining competitive advantage inside a market. One important challenge in fully exploiting HR value after M&A deals, is the complete integration of the personnel into the new formed entity. Integrating the personnel comports its identification with the company and the consequent instauration of a process of common growth. Managers need to find a way to efficiently coordinate the old and new personnel and improve their work performance, and this does not represent a simple matter[101]. Some of the main challenges foreign players may face in these integration processes and in

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[98] Noe R.A., Hollenbeck J.R., Gerhart B., Wright P.M., (2016), Human Resources Management: Gaining a Competitive Advantage, Tenth Edition, McGraw-Hill.
[99] Goldin C., (2014), Human Capital, in Diebolt C. – Haupert M. (eds.) *Handbook of Cliometrics*, pp. 55-86.
[100] Pontiggia A, Hu L., Savorgnan M., (2013), China's Human Resources Development: Recent Evolution and Implications for the Global Market, Working paper n. 29/2013.
[101] Barbatelli C., (2015), Le Risorse Umane in Cina e La Loro Fidelizzazione, in La Cina non è Ancora per Tutti, Barbatelli C. – Cavalieri R. (eds.), Edizioni Olivares, Milano.

successfully managing HR in China are represented by the following: understanding the cultural differences in managing local employees, assessing differences in local legal environment, dealing with HR administration functions (including all the processes of labour costs, the recruitment, formation, appraisal performances and retribution systems), and lastly organizational development. As cultural aspect strongly influences the behaviour of people, organizations must be aware of cultural differences and conceptions in relating with Chinese employees, thus be able to adjust management styles according to cultural variables.

Regardless the fact that China is quite opened to global environment and is absorbing effects of globalization on culture and management, local sociological concepts still and will always heavily affect the attitude of Chinese personnel inside the organization. The already mentioned concept of "face" (*mianzi*, 面子), the reputation to be preserved, must be always present in the mind of foreign managers while relating with local workers, which in large part unlikely will change their mindset toward an intercultural approach.

Another crucial aspect is to build a loyalty relationship between the personnel and the company. As vertical and personal relationships are at the basis of such a strong hierarchical culture, it must be assumed that for Chinese personnel sometimes loyalty toward managers could be more important than loyalty to the company itself[102]. Not understanding properly cultural differences could cause frictions between the local and foreign parties in managing HR, frictions that may influence the outcomes of the whole integration phase. The communication with the employees is very important since every step of M&A deal, in order to fulfil the process of consolidation, so the transition toward new designed organizational and managerial structure, by allowing them to feel part of it and not a foreign intrusion.

Another cultural issue in HR in China is represented by the language, which sometimes influences as variable the filling of positions in choosing personnel able to communicate with employees but unprovided with other necessary skills, or vice versa.

[102] EU SME Centre, HR Challenges in China, http://www.eusmecentre.org.cn/

Considering the legal environment, foreign companies need to carefully assess all the differences regarding labour policies and regulations and comply with them, in order to avoid legal concerns.

Recruiting employees in Chinese market could be a critical matter for foreign companies, especially regarding high qualified talents. The improvement of educational system caused that many young workers in China are entering in labour market, although their competencies often still does not match with foreign employers' work demands, which increasingly include specific skilled employees[103]. This situation arises into a market that internally is constantly becoming more complex and is witnessing at the same time the rise of number of foreign companies with a lack of local talents with both domestic and international capabilities.

These factors may influence the acquiring strategy of the foreign company as well, which on the basis of a shortage of needed high-end skills in the target, and on the basis of its allocation, can weather transfer human resources recruited elsewhere or assign directive function to expatriate personnel[104].

Another issue in HR in China may be represented by some influential dynamics in hiring personnel, specifically the pressure by government or administrative structures to hire more local personnel than a company needs.

On the organizational development side, common problems could arise from negative behaviour in cooperation by the Chinese partners, for instance the unwilling to communicate with the foreign general managers or board of directors, the distortion of information to workers report by Chinese managers in charge of the communication with local personnel, and a consequent stagnation of reconstructing processes[105].

Efficiently deal with local management and invest in improving company's human capital are key points in successfully conduct a business in a foreign market, even more in China. This is the reason why HR-based evaluations can be significant in designing

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[103] Pontiggia A, Hu L., Savorgnan M., (2013), China's Human Resources Development: Recent Evolution and Implications for the Global Market, in *Working paper* n. 29/2013.

[104] Barbatelli C., (2015), Le Risorse Umane in Cina e La Loro Fidelizzazione, in Barbatelli C. – Cavalieri R. (eds.), La Cina non è Ancora per Tutti, Edizioni Olivares, Milano.

[105] EU SME Centre, HR Challenges in China, http://www.eusmecentre.org.cn/

acquiring strategy for a foreign player into Chinese market. Thus, is crucial to align the HR function to achieve the organization's strategic objectives, and moreover building efficiently cohesive cross-cultural and flexible teams in managing HR within the new acquired entity.

2.6 Post-merger Governance

After all the structural process in building an M&A deal and the fulfil of PMI goals, the governance of the acquired entity represents maybe the most important aspect for foreign players in Chinese market. The dynamics involved in the governance are clearly such complex in China, not only for the constant presence of environmental differences, from cultural, politics and legal, that can be handle with a valuable managerial team, but especially for the matter of cooperation with the Chinese part. Due to the fact that China's corporate governance standards are quite low, foreign investors must assess that the outcomes of this cooperation can either positively or negatively influence the governance of the acquired entity.

By purchasing the 25% or more of share capital of a Chinese company, the new foreign invested enterprise (FIE), with either majority or minority share ownerships hold by a Chinese part, will take the shape of a sino-foreign equity joint venture.

The governance of a company structured as JV represents a delicate aspect in China. It is regulated within the JV agreements between the parties, the company's article of association, and inside the shareholders' agreements. Clearly dynamics in the governance of a JV with a local partner are different from the dynamics determining the governance of a *wholly foreign-owned enterprise* (WFOE), which represent a vehicle of foreign investment in China that does not require the presence of a Chinese part, at the moment that entity's share capital can be totally hold by the foreign investor.

The highest body in governing the JV is the board of directors (BOD), in which every party's representation must be proportional to its contribution to company's registered capital. The BOD prerogatives are established within the JV article of association. Since EJVs are mandatorily regulated under the EJV Law and its implementing rules, some corporate actions such as the increase of decrease of company's register capital, amendments in the article of association, the purchasing of equity shares or the merger or division of the companies must be decided by unanimous approval of the BOD, in order to protect the minority investors [106]. This element is very important because it gives the right

[106] The 2010 Dechert Guide to Foreign Investments in China.

of veto to the minority shareholder in pondering such strategic decision within governance of the company, and consequently limits to a certain extent the power of the foreign party even in case of holding the majority share.

Besides contractual rights and formal obligations between the parties within an EJV agreement[107], several dynamics in governance are embodied into informal procedures or tendencies the Chinese party often carries out, following its own personal guideline dictated by difference mindset and perception of business. One of these issues concerns the level of control of the new entity, which does not represent a simple matter within the governance. While having a good Chinese partner could positively impacts the easing and speed of approval processes and bring relatives market-access benefits, on the other hand his impact on the governance could be problematic.

One source of divergence could derive from the level of control exercised by Chinese part within the governance. In many cases Chinese partner tends to exercise more management control over the company, regardless of his portion of equity share or contractual agreements. No matter how much ownership the foreign player can hold in acquiring Chinese firms or its position as majority shareholder, the influence local player exercises in the governance and management is heavy. One of the reason is conducted to behaviour of Chinese target company's staff in retaining its previous practises, goals and loyalties. [108]. Although the foreign player could try to manage the problem of control trough constant communication with the Chinese party, it is opportune to fix properly the structure of JV inside the agreements and try to keep a good relationship with the local partner, keeping in mind that a good cooperation with local player is always profitable. Furthermore, many problems related to the control of the entity could be face by building synergies and finding a common ground with local partner on decisions regarding for instance the appointing of rotating principal managerial roles, or the division of important duties, in order to build reciprocal trust and at the same time reduce Chinese part's level of control.

[107] Cavalieri R., (2015), Letture di diritto cinese, Cafoscarina, Venezia.

[108] InterChina Consulting (2011), Establishment of a Joint Venture (JV) in China, www.InterChinaConsulting.com

Besides, many governance decisions regarding the business activity of the company, such as approval of business, investment or financial plans are usually decided by majority, which does not represent a problem for the foreign player in case of holding the majority share. Clearly, in case of minority stake hold by foreign investor, a common strategy would be at the contrary to negotiate that some strategic choices must be decided under unanimous approval by the EJV board of directors, in order to protect its position as minority shareholder from bad corporate decisions. On the other hand, possessing the majority-share ownership in the acquiring company, even though confers more board seats, it often does not guarantee the owed control over the governance. This is a typical scenario regarding the governance of a company structured as EJV in China, as the level of control as mentioned is always compromised by the involvement of Chinese partner[109].

Differences in culture, as previously observed, obviously are reflected in local companies' ways of conducting business and in management practises, both factors that influence the Chinese party's approach to the governance. Elements of potential misunderstanding between the parties could especially lie in differences in management style. The existed management in Chinese target, whose structure typically is strongly hierarchical, tends to follow a more adaptive management philosophy instead of a planning approach, thus prefers to observe the evolving of situation or current market conditions and then take quickly decisions[110]. This kind of approach often does not match with long-terms strategic plans foreign management could pursue. Furthermore, structural differences in corporate cultural values, which are influenced by national culture and industry culture, between the acquirer and the target may cause frictions.

Understanding these sources of distance in partner's way to approach management and governance dynamics is a worthy effort the foreign part must invest its time into, at the same time pushing the Chinese party to reciprocally understand, already from the first step of integration phase, his culture and priorities [111].

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[109] Musso F., Bartolucci F., Pagano A., (2005), Competere e radicarsi in Cina, Aspetti strategici e operativi, Franco Angeli, Milano.
[110] Jullien F., (2008), Pensare l' Efficacia in Cina e in Occidente, Editori Laterza, Bari.
[111] The Boston Consulting Group (Yang V. et al.), (2015), M&A in China, Getting Deals Done, Making Them Work.

Decoding and flat differences from the start of cooperation with Chinese partner and strongly impose the defined roles within the entity, could be useful tools in preventing misunderstandings and avoiding such pitfalls in governance.

PART III
CHINESE AUTOMOTIVE AND AUTO COMPONENT MARKET: BREMBO S.P.A. CASE HISTORY

3.1 Automotive Industry in China

China today is the world's largest automotive market and automotive manufacture, after surpassing US in January 2009 with 790.000 vehicles sold[112]. Among all the domestic car manufacturers companies, the market is dominated by the so called "Big Four": SAIC Motor, Dongfeng, FAW and Chang'an.

Since it was appointed as national pillar industry in 1986, China's automotive industry's growth has been attentively managed by Central Government, which has been the main actor of this rise by pursuing the goal of developing a domestically driven industry[113].

Starting from 1983, Chinese government has allowed to foreign automotive producers the access to the national market through the establishment of sino-foreign joint ventures in cooperation with Chinese domestic companies, in large part formed by state-owned enterprises (SOEs)[114]. The restriction on this vehicle of investment imposed that foreign party could not claim more than 50% stake in the JV. This controlled approach to the participation of foreign investors in such deals was in first place aimed at building a robust national automotive industry, by allowing domestic companies to absorb through the JV more advanced technological skills and know-how from foreign partner, thus sources of competitiveness that was missing within the local market, in a relative short period of

[112] RIA Novosti, (2009), China Becomes World's Largest Car Market, in *Sputnik News*, 2009-02-06, https://sptnkne.ws/dEdZ.
[113] Chin M., Wang Y., Xin H., (2015), China's Auto Industry Explained.
[114] State-owned enterprises in China are often owned and managed by the central or local governments.

time[115]. The JV was the best vehicle to adopt in order to access such technical knowledge, due to the level of cooperation structurally required under the new entity between the local and foreign equity holders, in a perspective of foreign multinationals as instructors for Chinese partners. These kinds of arrangement within China's run to modernization of industrial sector represented the core of the so-called "exchange-market-for-technology" strategy for national automotive industry development, in a sort of granting market shares for transferring technological know-how process.

Hence, the 50:50 sino-foreign equity joint venture still represents the basic policy strategy for technologic transfer inbound in exchange of the access to the market. Considering this factor, since the openness to JVs for foreign manufacturers and China's entry into the WTO in 2001, the automotive market has been filled up with partnerships between national and foreign companies, that formed, together with other players involved in the automotive components production, a network of supply-based business relationships. During the years and enjoying these protectionist policies, Chinese automotive companies enjoyed substantial growth and high profits, always supported by the sustain of central government, while many foreign big auto manufacturers, after Chinese government imposed for many years high duties on foreign imported vehicles into internal market, moved in large part their production to China[116].

However, the goal in absorbing technological know-how and manufacturing capability during the years has been achieved only in a limited extent, considering that foreign players have always guarded their best technologies and strategic assets from Chinese players[117]. One of the reason of such failure in achieving technological knowledge through JV structures can be conducted to the lack of efficient intellectual property (IP) protection policies for external players in Chinese market, and in the potential interest this element arises in favour of domestic companies' unhealthy competition. This matter embodies one aspect of the dissociation between *law in the books* and *law in action* in

[115] Chu W.-W., (2011), 'How the Chinese government promoted a global automobile industry, in *Industrial and Corporate Change*, Vol. 20, Num. 5, pp. 1235 – 1276.
[116] McCaleb A., (2015), China's Automobile Industry: Development, Policies, Internationalization, in *Ganskie Studia Azji Wschodniej* 2015/8, pp. 163 - 172
[117] McKinsey&Company (Chin M., Wang Y., Xin H.), (2015), China's Auto Industry Explained.

China, thus still represents a controversial missing element in the path of modernization of the market the country is following[118]

After Chinese government based its pro-active industrial policies in national automotive market exclusively on sino-foreign joint ventures, all foreign automotive manufacturers in China consist of JVs. Especially due to the reasons mentioned before, the benefits in retaining the JV policy as entry-mode for foreign manufacturers has been under debate recently by governmental authorities and policy makers[119]. Some entry-policies for foreign automotive manufacturers changed with the issuing of the 2015 Foreign Investments Industrial Guidance Catalogue. The percentage of share ownership in the JV hold by foreign players remains the same, cannot exceed the 50%, but in addiction the foreign part is not allowed to establish more than two joint ventures in manufacturing the same category of vehicles. However, the foreign player jointly with his Chinese JV partner could merge or acquire other automobile manufactures in the market. This edition of the catalogue included the 2004 the Automotive Industry Development Policy, (*qiche chanye fazhan zhengce 汽车产业发展政策*), which was issued by the NDRC (National Development and Reform Commission) to comply with WTO obligations and to impose guidelines for the large-scale development of the industrial sector, and more importantly introduced restrictions about the number of JVs [120] . More important, from this edition of the catalogue the manufacturing of complete automobile was put for the first time into the "restricted" category, while investments on R&D in key technologies, manufacturing of automobile engines and other key parts, electric motors and batteries for new energy cars was classified under the "encouraged" sectors[121]. Some of these provisions have been revised within the latest edition of the Catalogue, in force from July 2017, that has introduced less restrictive rules in automotive manufacturing sector, particularly no more limitation of maximum two joint ventures for pure electric cars producers in China, plus, in

[118] Cavalieri R., (2015), Letture di Diritto Cinese, Cafoscarina, Venezia.
[119] McKinsey&Company (Chin M., Wang Y., Xin H.), (2015), China's Auto Industry Explained.
[120] China foreign investments: New catalogue revises which industries are accessible to overseas investors, Web http://www.nortonrosefulbright.com/knowledge/publications/130091/china-foreign-investment-new-catalogue-revises-which-industries-are-accessible-to-overseas-investors
[121] McCaleb A., (2015), China's Automobile Industry: Development, Policies, Internationalization, in *Ganskie Studia Azji Wschodniej* 2015/8, pp. 163 – 172.

automotive components market, companies that manufacture electronic network technologies and other electronic devices for the input and output of control systems or EPS electronic controllers, are not anymore limited to JVs[122]. This policy in promoting the production of NEVs (new energy vehicles) and relative high-tech components underlines the propension of government toward the attraction of technologic innovation and R&D investments into the market, a perspective that fit into the "new normal" policy and follows at the same time a more sustainable production.

Is important to underline the relevance that covered the new energy automotive sector inside the 12th Five Year Plan of 2012 – 2015, having been recognized as one of the seven strategic emerging industry. At this concern China issued, besides the "Made in China 2025" developing plan mentioned earlier, the "Energy Saving and New Energy Automotive Industry Plan 2012 – 2020", a policy whose aim is clearly the fast development of new energy auto industry. Chinese government's ambition sees domestic manufactures to become market leaders in e-mobility in the foreseeable future[123].

From another point of view, the restrictions on the production of complete auto vehicles and the confirm on the 50% maximum share ownership in JVs for foreign players are a signal of a turning point of China, which is pursuing a different goal in gradually fostering the development of Chinese automotive brands, at the expenses of new foreign automakers' investments inbound. One logic under these strategic decision is to push foreign players to establish partnership with domestic companies in those mentioned new encouraged sectors, such as production of new electronic devises and R&D areas, with the aim of attracting new foreign expertise and technology for these newly incentivized strategic industry sectors[124].

The importance central government always gave to the develop of automotive industry has been the signal of how much the growth of this sector is important for the whole

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[122] Taylor Wessing, (2017) From July 28, 2017: Opening the Market? China's 2017 Negative List For Foreign Investments, 2017-08-03 Web https://china.taylorwessing.com/en/from-july-28-2017-opening-the-market-china-s-2017-negative-list-for-foreign-investment

[123] Shirozu N. – Jourdan A., (2017), China sets 2019 deadline for automakers to meet green-car sales target, Web http://www.reuters.com/article/us-autos-china-electric/china-sets-2019-deadline-for-automakers-to-meet-green-car-sales-targets-idUSKCN1C30ZL

[124] McKinsey&Company (Chin M., Wang Y., Xin H.), (2015), China's Auto Industry Explained.

national economy. Through the years, its huge dimensions and the intense internationalization process this market went through under governmental pro-active policies, lead the internal environment became much more competitive. The export of vehicles manufactured in China, especially passenger cars, as well enjoyed a big growth.

On the other hand, although only by establishing JV alliances with domestic producers, foreign players in automotive industry enjoyed considerable success in China, by fully exploiting the potentialities of the world's largest vehicle market. China represents one of the most lucrative market for foreign automotive manufacturers, whose success derives from the recognized higher-quality production compared to local brands, and more prestige.

Thus, the auto market in China is dominated internally by local brands for low-quality, basic and economy vehicles, while on the other hand foreign brands' sales volume consists mostly of more expensive high-end quality vehicles, sport cars or luxury vehicles[125]. Chinese automotive manufacturers, which through these policies achieved big growth and unprecedent competitiveness, are now looking for international expansion. After the Go Global Policy launched at the beginning of 2000s, domestic automotive manufacturers have been pushed toward expansion in foreign markets through FDI both in developing countries, for reaching new customers by selling low-end quality Chinese brands' cars, and in developed country, for accessing advanced technologies in order to gain competitiveness power against foreign advanced global brands, internationally and locally. Thus, Chinese automotive companies' OFDIs (overseas foreign direct investments) are strongly dictated by strategic-asset seeking needs, such as high-tech exports, intellectual property rights, high-educated labour force, managerial knowledge and brands[126]. Chinese automotive companies looking for internationalization aim at enhancing the quality and safety of their produced cars and, at the same time, building an international brand awareness.

[125] Gerrits M. et al., (2014), The Battle for Automotive Brand Loyalty in China, in *The Boston Consulting Group Perspectives*, September 17, 2014, Web https://www.bcgperspectives.com/content/articles/globalization_center_consumer_customer_insight_battle_automotive_brand_loyalty_china

[126] A. Amighini, (2012), Chinese FDI in the European Automotive Sector, in Ciravegna L. (ed.) Sustaining Industrial Competitiveness after the Crisis: Lessons from the Automotive Industry, London, pp. 114 – 133.

The escalation in China's internal vehicle industry mostly came from the car market, which represents the fastest growing sector in recent times[127]. The rise of the car market on a global perspective went together with the economic growth of China. China's economic growth turned out into the increasing of Chinese people's wealth together with the rise of pro capita income, both driver factors of such rapid escalation in passenger vehicles' sales into internal market. Many wealthy people today are able to buy a car, and the purchase of automobile in China became a status symbol after the economic growth[128]. The demand for cars from individual consumers highly contributed to the growth of domestic producers[129].

A reflection of the new wealthy standards Chinese population reached on a larger extent is represent by the recent trend toward certain expensive models of cars, such as sport cars or SUVs. This trend has been proved by the interest expressed few months ago by Chinese SUV producer company Great Wall Motor in attempting the purchase of the FCA's Jeep marque.

Chinese outbound flow of investments during the last years overcame the investments inbound, and, despite of government's recent restrictions, Chinese OFDIs in automotive and auto component industries reached over €29 billion since 2008[130]. One of the most notorious case of European automobile manufacturer brand acquired by a Chinese player is the purchase of the Swedish Volvo cars by Geely Automobile in 2010. After Volvo closed the current year first semester with a big growth in operating profits and revenues respect last year's same period, the two companies recently announced a new JV agreement in the foreseeable future, reinforcing synergies in order to share current and new technologies and

[127] Chu W.W., (2011), How the Chinese Government Promoted a Global Automobile Industry, in *Industrial and Corporate Change*, volume 20, number 5, pp. 1235 – 1276.
[128] Rampini F., (2005), Il Secolo Cinese, Arnoldo Mondadori Editore, Milano.
[129] McCaleb A., (2015), China's Automobile Industry: Development, Policies, Internationalization, in Ganskie Studia Azji Wschodniej 2015/08, pp. 163 – 172.
[130] Moss T., (2017), China Aims to Take Over Car Industry, One Part at Time, in *Fox Business,* 2017-06-18 Web http://www.foxbusiness.com/features/2017/07/18/china-aims-to-take-over-car-industry-one-part-at-time.html.

improving their scale economies, also in view of Volvo's conversion toward the producing of new generation electrified vehicles[131].

The Italian most expensive acquisition in automotive industry sector is represented by 2015 purchase of Italian tire maker Pirelli undertaken by China National Chemical Corp. for about €7.1 billion, holding currently the 65% share ownerships of Pirelli's sole shareholder Marco Polo Industrial Holding S.p.A.

[131] "Volvo Realizza Utili Boom e Rafforza Alleanza con Geely.", *Il Sole 24 Ore* (2017), July 20, 2017. Web http://www.ilsole24ore.com/art/motori/2017-07-20/volvo-realizza-utili-boom-e-rafforza-alleanza-geely-160813.shtml?uuid=AEnZTR0B.

3.2 Automotive component industry: Brembo S.p.A. case history

After China's entry into the WTO, in automotive manufacturing industry central government maintained the 50% stake as maximum share ownership allowed for foreign players, while on the other hand, within the 2004 Automotive Industry Development, the automotive component sector was recognized as permitted, thus liberalized by allowing the 100% ownership for foreign investors. No legal restriction was imposed by regulation on foreign investments in auto component industry, whereas FDIs could be realized either through JVs of WFOEs.

The market logics explained before that led the majority of big foreign players in automotive manufacturing industry to move their production to China for export and internal market, brought as consequence also a sort of contagious relocation of auto components manufacturers' production. Since big foreign automotive manufacturing companies' vertical market apparatus is mostly represented by foreign auto components producers, many of those players, in order to supply their clients, followed them in relocating the production in Chinese market, exploiting at the same time the huge dimensions and the related growth opportunities of China's automotive aftermarket.

The increase of the internal demand and the huge number of vehicles sold in Chinese internal market throughout the last years, have been further important driver factors in leading the success of automotive components industry, and a source of growth for foreign OE (original equipment) suppliers, which grabbed this opportunity through investing into the goldmine of Chinese market.

Chinese automotive industry, due to the governmental policies we mentioned before, saw the birth of many strategic partnerships during the years between foreign auto manufacturers and domestic companies. Although, many foreign players faced difficulties in finding strategic domestic suppliers for long-term partnerships[132], principally because in an industrial sector such as the automotive manufacturing, in which high-quality product standards and IP protection are strongly required, find domestic partners which matches

[132] Lockström M. et al., (2010), Antecedents to Suppliers Integration in the Automotive Industry: A Multiple-case Study of Foreign Subsidiaries in China, in *Journal of Operations Management*, May 2010, Vol.28(3), pp.240-256.

with these features is quite difficult. The supply-chain relationships in Chinese automotive manufacturing between foreign auto manufacturers and local supplier are limited, especially due to the lack of collaborative capabilities, managerial skills, shortage of innovation and R&Ds competencies in Chinese part[133]. On the other hand, foreign brands in auto components manufacturing industry are generally considered to be of a superior quality compared to Chinese brands, offering a portfolio of high-quality superior products and dominating many core technologies in Chinese automotive components industry. This is an important matter considering that auto components suppliers remarkably influence the buying automotive firm's competitiveness in terms of quality, costs and innovation[134]. These factors are sources of growth opportunities in Chinese market for foreign automotive components producers.

Besides these inter-organizational needs of matching coordination and product quality standards, other variables must be taken into account in assessing the business dynamics affecting automotive components foreign players in Chinese market. As claimed earlier, China's market is a system of strong interrelated relationships between state and local players in companies, banks and financial institutions (most of whom are state-owned). The strong dirigiste print and the priority of central government toward the support and development of local state-owned companies, together with the cultural weight of localism and clientelism-based relationships, determinate the predominance of solid long-dated business cooperation's networks within vertical markets' industries, especially within the supply-chain dynamics, principally between domestic players. This network of business and entrepreneurial relationships is hard to penetrate by foreign players also for a matter of local *guanxi*, price competitiveness and products' low-quality standards[135]. This central, political element in China's market dynamic clearly is in contrast with the principles of

[133] Holweg M., Luo J., Oliver N., (2005), The past, Present and Future of China's Automotive Industry: A Value Chain Perspective, in *Internal Journal of Technological Learning, Innovation and Development*, pp. 1 - 43

[134] Lockström M. et al, (2010), Antecedents to Suppliers Integration in the Automotive Industry: A Multiple-case Study of Foreign Subsidiaries in China, in *Journal of Operations Management*, May 2010, Vol.28(3), pp.240-256.

[135] Simonelli U., (2015), Il Convitato di Pietra: Il Macrosistema Cina e Le Aziende Nella Memoria Professionale di Un Manager Italiano, in Cavalieri R. - Barbatelli C. (eds.), La Cina non E' Ancora Per Tutti, Edizioni Olivares, Milano.

non-discrimination and equal treatment in production conditions for foreign investors that China broadly assumed after entering into WTO in late 2001, but as already mentioned the law in the books, or at least the formal commitments, often in China does not match with the action. In such framework based on internal domestic business relationships, foreign player again must be able to gain strategic alliances with domestic players integrated in such networks, as reported further in this work's case study.

Under another perspective previously already discussed, Chinese market is undergoing through a process of innovation and modernization in many of its industrial sectors, where the required improvement of quality standard and the orientation to a value-added production under the "new normal" are forming a more global, sophisticated, thus more complex environment. It is true that the general shift to high-quality production benefits foreign auto components producers, but it is also important to underline that this new level of complexity means also the presence of more and new competitive players in Chinese industrial sectors. New and already established players into Chinese market must be able, especially in liberalized industries such as the auto components manufacturing, to distinguish and outline their presence by bringing in the right capital investments, strategic assets, right expertise, technological know-how and high-end innovation[136].

[136] Stringa P., (2015), Dal Boom Economico al New Normal, in *L' Impresa* 1/11/2015.

Brembo S.p.A. investments and acquisitions into Chinese automotive components market[137]

Brembo S.p.A. is an Italian company global leader and innovator in design, development and production of braking systems, components of cars, motorbikes, machinery and industrial vehicles, for the OE market, after-market and racing. The company is specialized in design and manufacturing braking systems for high-performance cars and motorcycles, as well as for commercial vehicles in European, American and Japanese markets, and recently branched out into design and production of safety systems. Brembo's braking systems are chosen by large part of the most popular world automotive manufacturing brands as OE (original equipment), and the company provides many brake components, such as calipers, drum, rotors and brake lines for automotive aftermarket.

Brembo represents an Italian excellence in industry on the world stage. Brembo's headquarters are based in Stezzano (BG), and today the company operates in 16 countries on 3 continents, counting on 24 production and business sites, and a pool of about 7.700 employees. Moreover, Brembo sells its products in over 70 different countries. The company controls the whole production system from raw material to the distribution in quite all the market in which operates[138].

Brembo's investments in China followed a gradual approach, by building at a fist stage joint ventures with domestic partners, and culminating in 2015 with the acquisition of the majority stake of Asimco Braking Systems (Langfang) Co. Ltd., a publicly-owned company based in Langfang, in Chinese north Province of Hebei.

Brembo, present in China since 1999, set up a first joint venture in 2000 in Nanjing together with Chinese Yuejin Motor Group for the constitution of Nanjing Yuejin Automotive Brake System (NYABS), specialized in the production of braking systems for cars and commercial vehicles. In 2005 the company starts its second deal in China by constituting together with SIMEST, a public-private Italian merchant bank, the joint

137 **Some of the contents and information regarding this case study was provided by the courteous cooperation of Brembo S.p.A. General Counsel Mr. Umberto Simonelli, and of President and CEO of Brembo Asia Pacific and General Manager of Company's Performance Division Mr. Mario Almondo.**

138 See www.brembo.com

venture Brembo China Brake System Co. Ltd. (Brembo China), based in Beijing and currently held for the 67,74% majority stake by Brembo S.p.A. The entity operates as a Brembo's subsidiary and is specialized in the manufacture and sale of brake components, supplying most of the European and Asiatic auto manufacturers with productive plants in China's eastern area [139]. In 2008, after 7 years of cooperation with Nanjing Automobile Group Crop. (NAC), Brembo purchased the 70% majority shareholding in NYABS, in order to expand company's presence in Chinese market. Moreover, after the integration between NAC and SAIC Motor, one of the "big four" state-owned Chinese automakers and one of the first producer of cars and commercial vehicle in China, NAC transferred its 30% stake in NYABAS to Donghua Automotive Industrial Co. Ltd., a JV formed by SAIC and a subsidiary held by NAC[140]. In 2010, Brembo Nanjing Foundry Co. Ltd. purchased a cast iron foundry from Donghua Automotive Industrial Co. Ltd., joint venture member of SAIC. This operation allowed Brembo to contribut to the installation and opening in 2012 of an integrated production centre in Nanjing, complete with foundry and machining plant for brake calipers and discs for automobiles and commercial vehicles. Through this operation the company consolidated its strong foothold in China, as this facility currently provides the Chinese market with braking systems that meet Brembo's standards of performance, style and comfort[141]. Lastly, in 2015 Brembo acquired Asimco Braking Systems (Langfang) Co. Ltd.'s 66% stake for approximately €86 million. The remaining 34% stakes of Asimco's share capital is held at present by the state-owned company Langfang Assets Operations Co. Ltd., controlled by the Municipality of Langfang[142].

Currently Brembo's main customers in China are mostly represented by European, American and Japanese automotive manufacturers, such as BMW, Daimler, VW, Volvo, Iveco, MG and Mitsubishi.

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[139] Brembo S.p.A., (2005), Brembo Avvia La Sua Seconda Iniziativa Produttiva in Cina, SIMEST Socio Finanziario al 40%, 08/07/2005, Curno (BG).

[140] Brembo S.p.A., (2008), Brembo Continua a Crescere in Cina e Acquista la Maggioranza della Partecipata Cinese NYABS, 04/02/2008, Stezzano (BG).

[141] Brembo S.p.A., (2012), Brembo Inaugurates New Nanjing Production Centre, 25/04/2017, Nanjing (China).

[142] Brembo S.p.A., (2015), Brembo Grows in China. Acquisition of the Control Stake of a Brake Disk Producer, /29/09/2015, Stezzano (BG).

According to the words of Mr. Simonelli, due to the importance and growing high level of complexity of Chinese market, China has not to be considered anymore as an extension or outpost of the company but rather a prior market in which create internal value and competitiveness. Brembo's approach to Chinese market was based from the start on a substantial preparation in facing the market environment. Company's growth in China went through a gradual process of getting acquainted with the market by realizing a first joint venture agreement, then direct acquisitions.

The company carefully acknowledged how the cultural differentiation, mix together with the other environmental differences, creates not only a framework with unique internal rules, difficult to face for the foreign player, but also a way of thinking and perceiving business differently from western people. The importance of being able to hold the right alliances locally is a core concept present in Brembo's strategic mindset for Chinese market. Thus, the support from a domestic player that "knows the rules of the game" and is used to the environment is fundamental in conducting business China. From its first steps in Chinese market the company realized alliances in this sense, starting from the deals in Nanjing and Beijing. Clearly, also in Brembo's case the governance of the entities represents a critical aspect coming with the consolidation of partnerships with local players.

The process of negotiation for the Nanjing deal, Brembo's first joint venture in China, put already the company in front of typical issues arisen facing a local partner, one of which is represented by the process of contractually establishing the terms of a progressive acquisition during the time, as Mr. Simonelli explained[143]. Is a frequent scenario in China the difficulty or impossibility to recur at call and put options, provisions that give one party the right to sell or purchase the other party's shareholding stakes at a specified price (the strike price)[144], for the reason that Chinese are not inclined to a forward approach of the contractual relationships, but tend rather to operate on the basis of the current evolution of business situation.

[143] See Simonelli U., (2011), Cina: Un Caso di Negoziazione Tra Ieri e Domani, in *Economia & Management*, 2011/06.

[144] Definition provided by Investopedia, Web http://www.investopedia.com/exam-guide/cfa-level-1/derivatives/options-calls-puts.asp.

Brembo's approach to the first JV agreement with a domestic player was aim at initially containing the risk, thus hold a minority share and gradually proceed, after a better understanding of Chinese market, to acquire the majority share ownership in 2008. The manager enlightened the difficulty of achieving growth in Chinese market context as minority shareholder in the JV, thus with heavily limitation in entity's governance.

The issue concerning governance dynamics in partnerships with domestic players, the reduced level of control even in scenarios of majority ownerships, must be faced by maintaining good relationships and achieving compromises with Chinese partner. The compromise in China is seen, under the big umbrella of the *guanxi*, as a good choice and a tool for gradually building trust between the parties. A well-fed and respectful relationship, taking into account the logics of "preserve the face" earlier mentioned, is nothing but a strategic resource, weapon, in China. This is true, as Mr. Simonelli stated, especially if the partner is represented by the State. embodied in local governments or governments' controlled entities or subsidiaries, like in the case of Asimco. The presence of the State in China does not represent an exception, and is opportune to consider that the State in China is the most powerful player in the market.

The focus in this case study is mainly on Brembo's recent acquisition of Asimco. Asimco Meilian Braking Systems (Langfang) Co. Ltd. was founded by ASIMCO Technologies group, which was established in 1994 and became one of the largest independent producers of auto components in China and leading company in automotive component industry. Asimco, located in Langfang in Chinese Hebei Province, is a cast iron foundry and machining plant for the manufacturing of brake discs for passenger cars. The company supplies nearby car manufacturers, which consist mostly of JVs between European and US customers with domestic companies[145].

According to General Manager of Brembo's Performance Division and CEO of Brembo Asia Pacific Mr. Mario Almondo, the deal allowed Brembo to expand its presence in the market, but most importantly to achieve derived benefits in holding a strategically relevant player in Chinese automotive components market. As Mr. Almondo stated, the

[145] Brembo S.p.A., (2015), Brembo Grows in China. Acquisition of the Control Stake of a Brake Disk Producer, 29/09/2015, Stezzano (BG).

strategic importance of Asimco lies on one side in company's geographical position into the market. Asimco is situated in an area filled with many OEM premium manufacturers, element that cover large importance in Brembo's market strategy. Secondly, in terms of public reputation, of technology available, even though not high-end technologies but in its context valuable assets, and of technical know-hown, Asimco was considered as one of the best target in Chinese market, recognized as a good and healthy company. In addiction and more importantly, Asimco held in its customer portfolio many European and US big players in automotive manufacturing, including, FAW Volkswagen (a JV established in 1991 between FAW Group and Volkswagen Group), a very important target customer for Brembo. For this matter, by strategically acquiring a direct deep-rooted competitor in Chinese auto components market, although not endowed with such strong competitiveness but rather with valuable assets, the company at same time purchased its underlying market, having identified Asimco as a good hub for establishing supply-based business relationships with such new important customers.

Regarding the governance in Asimco, the composition of the new BOD is clearly pondered on the partner's subscribed share capital, whereas Brembo is the majority shareholders. The distribution of company's roles has been arranged during the negotiation of the JV, assigning the key roles of power on the basis of Brembo's majority shareholder position, and at the same time without diminishing the presence of the minority shareholder, also considering that the partner is an entity held by local government. The state-owned Langfang Assets Operations Co. Ltd. holds the 34% stake of Asimco, which even though minority share, in China is relevant at the point that the partner is able to either facilitate or strongly obstacle the governance of the JV on the basis of the quality of relationship and cooperation between the parties.

According to Mr. Almondo, those risks within governance of the JV in China must be predicted through a good work in building cooperation and getting alone with Chinese party, for the reason that a good cooperation with such powerful partner, the local government, represents an added value and an opportunity for the company, which can benefit from all the networking and environmental benefits, for instance an easier approach in the approval processes. Obstacles in the governance depend on what has been stipulated during the negotiation phase, another critical phase of M&A deal, whereas the documents that regulates the cooperation between the parties, such as the JV agreements and the shareholder agreements, has been drafted. Clearly as already mention, during the negotiation phase the company must find an equilibrium between making its own interests and achieving its goals from the deal on one side, and on the other acting carefully without damage the reputation of the partner, which represents not only the local company but the State, thus always acts in the interest of the Party. For this reason, the negotiation was conducted taking into account not only the legal and technical aspects, but most importantly the intercultural approach, which for a multinational firm like Brembo is a normal and structural value. On the legal aspect, the acquisition as usual in an international context was conducted following the standard principles internationally recognized as Anglo-Saxon "best practises", assuming some exceptions in the procedures that consist in China for instance in not recurring at mechanisms of predetermined forward intervention on the contract, such as the put and call options, which in China are neither regulated as previously mentioned.

The phase of due diligence, which in Chinese context is always critical for the availability of detailed and trustable data, included a first transitory phase, between the subscription of the preliminary agreement, and some warranties from the seller recognized as "reps and warranties", which usually last for a determined period after the closing of the deal.

In Asimco, the cooperation between the parties within the governance has been consolidated during the process of post-merger integration. Asimco came already from an international framework, considering that the US Bain Capital purchased the controlling share of ASIMCO Technology in 2010. Therefore, for managing the PMI phase Brembo confirmed the local Management and the corporate structure excepting for the Chief Financial Officer (CFO). In addition, the company created an Italian managerial team with the goal of integrating Asimco procedures to Brembo's standard, gradually and by single area of competence.

Regarding the management, according to Mr. Simonelli is very important to entrust the local team with the most important management functions, in order to assure a right flow of authorizations in management decision and exercise strong control by the Parent company. Another important element after the concluding of the deal, according to the manager, is to blind the banking policy.

In governing the Chinese entity is fundamental to give essential importance to the BOD meetings, whereas the parent company, in Brembo, must impose control over the governance and at the same time create paths and logics of cooperation with the partner, trying to plant and feed the roots of reciprocal trust. As enlightened by Mr. Almondo, getting alone with the partner in China is strategic, is a need, just for the fact that without having a good relationship with the heads of the local administration, partner in Asimco, is nearly impossible to conducting the business.

The increasing growth rate of Chinese market and Brembo's strategical necessity in dynamically interact with customers, both domestic and foreign, brought the company to actively invest in constant innovation also through R&D presence into the market, and by implementing the use of new technologies and materials. Since Chinese government is actively promoting investments in high-tech sectors and the production new more eco-friendly energy vehicles in auto market, Brembo is reinforcing its presence into Chinese market also through innovation-oriented investments, thus developing new solutions that fit into the area of major interest of Chinese government and reflect its policies toward sustainability requirements in industrial production[146].

In consonance with Mr. Almondo's words, the ultimate goal of Brembo in China is to constantly consolidate and enhance the company's fingerprint into the market. The considerable investments the company has undertaken during its twenty years long presence in China, remark the importance of China in Brembo's global strategy, considering that China represents company's third domestic market after Europe and US. Company's future direct investments in Chinese market will be conducted in the form of acquisition at the presence of suitable and valuable targets, which would add further value

[146] Archibugi D. - Filippetti A. (eds.), (2005), The Handbook of Global Science, Technology, and Innovation, Wiley Blackwell, Chichester.

to Brembo’s core business as in the case of Asimco, or in the shape of greenfield dictated, on the basis of company’s strategies, to the need of building new industrial facilities in loco.

The acquisition of Asimco, in final analysis, represented a successful deal for Brembo for several reasons. The takeover, by further reinforcing company’s presence in Chinese market, allowed Brembo to gain additional new strategic customers by increasing company’s market share, and on the other side to strengthen company’s reputation as solid partner for the already existing customers. Moreover, the incorporation of Asimco into Brembo’s industrial system added further industrial capacity and value to the company, thus an additional source of competitiveness for present and future business in China.

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