



Pathways to success for Chinese companies expanding overseas



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If early indications are anything to go by, then 2016 is set to be another record year for China's outbound foreign direct investments (FDI) with \$100bn of announced M&A transactions worldwide in the first three months of the year*. Accelerating the pace of Chinese deals overseas are initiatives such as the Government of China's **One Belt One Road** (OBOR) initiative that, inspired by the Silk Road trade path from China to Europe, is set to build a huge economic corridor that takes in almost two-thirds of the world's population and accounts for one-third of the world's wealth.

Backed by considerable financial resources, OBOR is set to open the doors to new trade, investment and economic opportunities between China and countries in Asia, Middle East, Africa and central and Eastern Europe. Certainly, the initiative is a major plank in China's 'going global' objective that has already seen many Chinese companies take to the international stage as domestic growth slows.

In particular, the US and Europe have proven popular destinations for large private, listed and state-owned Chinese enterprises, with companies such as Huawei, Alibaba, Midea, Fosun and Haier now part of the business landscape in both regions. Yet significant challenges remain for Chinese companies that have their sights set on overseas expansion. More recently, state-owned Chinese enterprises (SOEs) are facing greater scrutiny in Europe over merger thresholds with failure to file for approval of a deal leading to sizeable fines. In the US, a move by Chinese investors to acquire a stake in Dutch company, Philips, was blocked by the US on security issues due to the fact that Philips has several US government contracts. And increasingly, unsolicited bids from Chinese companies looking to expand overseas are facing protracted and costly takeover battles.

Even after a successful takeover or merger, there can be further ongoing challenges relating to culture and operational differences. **So what pre- and post-acquisition pathways can Chinese companies take to improve their chances of success overseas?**

*A report by the National Committee on U.S.-China Relations and research firm Rhodium Group. <http://rhg.com/notes/chinese-fdi-in-the-us-tripling-down-on-america>

Different structure, different market, different challenges

It's important to understand that there is no standard formula for success and success in China does not always replicate overseas to the same level. Much will depend on the target country and whether the planned deal is a merger, a takeover or a greenfield investment. Factors such as whether the acquiring company is state-owned or private also come into the mix. Each format will have unique challenges. For example, a Chinese SOE tends to be more compliance-aware than their private or greenfield counterparts that may see sales as the number one objective. It's important to assess the weakness and strength of each structure against what regulations and business practices prevail on a country-by-country basis. A feasibility study that goes beyond the sales financials will allow Chinese firms to plug any gaps more effectively.

Make effective use of public relations

While the international business world is getting more familiar with dealing with Chinese companies, there is still a lack of understanding on many aspects of Chinese business and culture. Getting your message across to a wider audience beyond the boardroom is key. Once consumers understand the size, strength and expertise that Chinese companies possess, there is likely to be much better trust at the outset. A well developed public relations story not only helps to avoid misunderstandings at an early stage in the investment process, it also provides the foundation on which to build a relationship and smooth communication channels with a wider range of stakeholders including employees, consumers, taxation authorities including other regulatory bodies and the press.

Nurture leadership and talent on both sides

Many younger Chinese leaders have often been educated overseas, speak different languages and have travelled extensively. This international mindset helps with a greater understanding of issues such as work/life balance, compliance requirements and strict employment laws that is useful and often necessary in order to avoid friction with the overseas workforce both at pre- and post-acquisition phase, particularly in the US and Europe. However, the sheer level of acquisitions by firms means experienced Chinese personnel are increasingly being headhunted resulting in a lack of consistency that can often slow the acquisition process or create compliance backlogs further down the line due to high staff turnover. This in turn leads to less long term collaboration with other management departments within the Chinese organisation as staff often plan to move on anyway within a few years.

Equally, it is important that there is business consistency at the target company to ensure levels of trust and communication are maintained. So retaining local management to achieve the right mix between local and Chinese culture is an important consideration. Nurturing leadership and talent in both the Chinese firm and takeover target will allow for a more consistent relationship with advisers and regulators and improve chances of commercial success locally.

Place equal importance on profit and compliance

Having a mindset that favours profit and loss over compliance issues, particular as growth rates in China are slowing, often results in 'fire-fighting' situations as they arise. Worst case scenario, this can result in a major loss of business reputation as

clients and suppliers refuse to do business with a company deemed to be non-compliant. It's a case of attributing equal importance to tasks that focus on sales and growth to those tasks required for completing compliance and regulatory issues to the expected standard. In an overseas expansion scenario, this can be tricky as the focus will often be on the financials. However, by ensuring that equal importance is given to sales and compliance appointments at the outset, either internally or through the expertise and local knowledge of trusted third-party advisors, it is possible to achieve a better balance between the two functions and avoid a fire-fighting mentality.

Managing expectations

Too often the focus is on pre- and post-acquisition costs or the cost of setting up a greenfield business, rather than the total cost of doing business overseas. However,

there is a range of hidden costs depending on the target country involved that Chinese firms need to take into account when embarking on overseas expansion. For example, in certain countries the requirement for company tax filings is not only monthly, but also only through approved local advisors and their IT systems which all adds to the ongoing cost of doing business in that country. In countries such as the US and Europe there are embedded costs relating to labour laws such as notice periods, health and insurance contributions that need to be taken into account. The probability of potential one off costs relating to regulatory oversights and takeover battles should also be factored in. In some countries the level of growth can outweigh the total cost of doing business, but in low growth regions it will mean the return on investment is less. It's a question of managing expectations on the level of return you are likely to achieve taking into consideration the total costs involved.

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