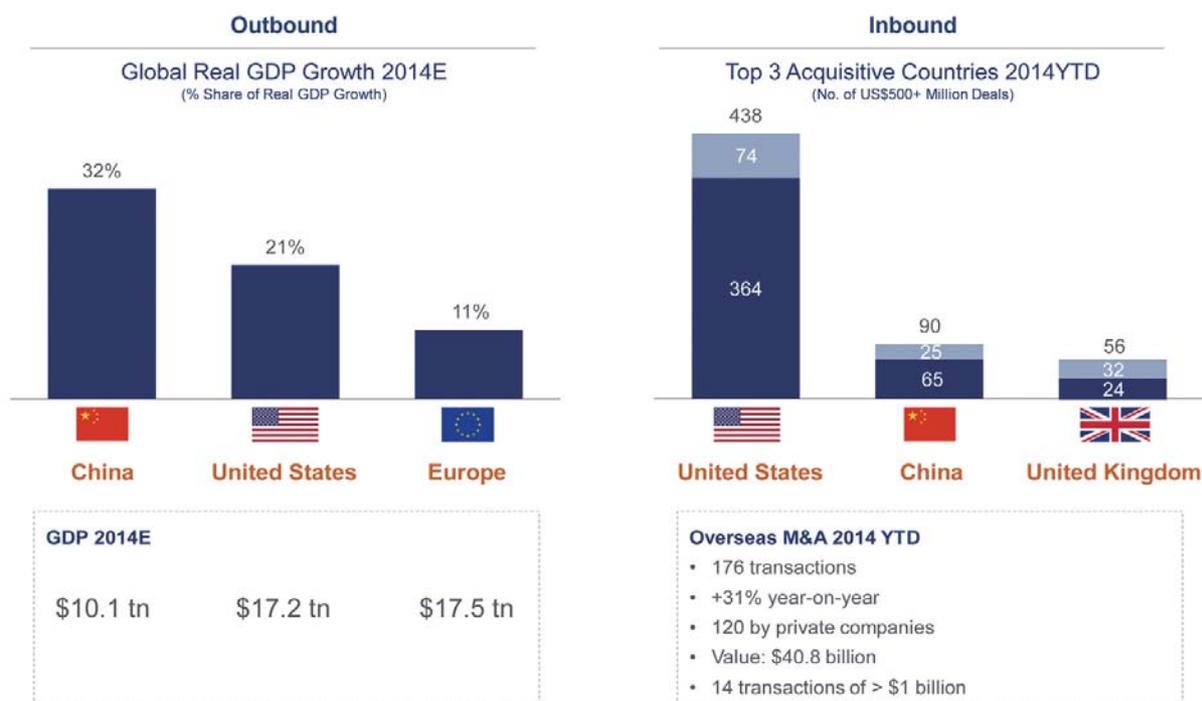


# Completing M&A Transactions Successfully with Chinese Companies in a Swiss Context

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The growing appetite of consumers in China has propelled Chinese companies to the top ranks of the global league tables for mergers and acquisitions (“M&A”). The real Gross Domestic Product

(“GDP”) growth of China in 2014 is expected to be a 32% share of the global real GDP growth. Of the top three acquisitive countries, China today takes the second place.



Sources: Handout of Citibank in the Conference hosted by Citi & NKF on Nov. 3, 2014 on ‘Completing M&A Transactions Successfully with Chinese Companies’

Chinese companies are acquiring a wide range of assets worldwide, and Swiss companies are a popular target for Chinese buyers. For example, the Swiss watchmaker Corum was recently (in 2013) acquired by Citychamp Watch & Jewellery Group Limited (formerly China Haidian Holdings Limited) of Hong Kong. Previously, in 2011, the Citychamp Group had already bought the Swiss watch brand Eterna. Also in 2011, two factories, Swissmetal Reconvilier (in the Canton of Bern) and

Dornach (in the Canton of Solothurn), were saved from bankruptcy by the Chinese group Baoshida. Another example is the industrial group OC Oerlikon’s sale of its natural fibers business unit to the Chinese Jinsheng Group.

In this article, we will address the expansion of Chinese companies into the Swiss, or generally Western, M&A market with a focus on the challenges resulting from the different cultural backgrounds.

We will also discuss certain key factors to be considered for the successful completion of M&A transactions. Although this article is written from a Swiss seller’s perspective, it discusses challenges that Western and Chinese companies commonly encounter in cross-border M&A transactions.

**Identification of Active Chinese Buyers in M&A Transactions**

There are mainly four different types of active Chinese buyers in M&A transactions. The first type is the State Owned Enterprise (“SOE”), which plays an important role due to its relatively large size. Among the well-known Chinese SOEs we find, for example, PetroChina, Bank of China, and

China Mobile. The second type is the Privately Owned Enterprise (“POE”), which is becoming increasingly active in cross-border M&A deals. Gaining access to new technology and increasing market shares are the most common driving forces. Examples of POEs are Lenovo, Hainan Airlines, and Huawei. The third type is the small but growing China-based Private Equity Firm. It recently started to increase its focus on international opportunities. Finally, the Sovereign State-Owned Wealth Funds also use M&A transactions to diversify China’s foreign currency reserves. They tend to focus on smaller but high value stakes in large companies. An example of such a Sovereign Wealth Fund is the China Investment Corporation.

**Most Active Chinese Investors in 2012—2014YTD**

Bidder Company	Type	Target Company	Sector	Country	Stake	Deal Value (US\$m)
SANY	Private	Putzmeister	Industrials	Germany	100%	468
		Palfinger	Industrials	Austria	10%	147
招商局 亚太有限公司 CHINA MERCHANTS HOLDINGS (SHANGHAI) LIMITED	SOE	Colombo International Container Terminals	Services	Sri Lanka	30%	6
		Port de Djibouti	Services	Djibouti	24%	185
武汉钢铁(集团)公司 WUHAN IRON AND STEEL(GROUP) CORP.	SOE	Terminal Link SA	Services	France	49%	539
		ThyssenKrupp Tailored Blanks	Industrials	Germany	100%	334
中国投资有限责任公司 CHINA INVESTMENT CORPORATION	SOE	WISCO International Resources	Resources	Canada	100%	737
		Eutelsat Communications	Services	France	7%	484
SINOPEC	SOE	Heathrow Airport Holdings	Services	UK	10%	726
		Shanduka Group Pty Ltd	Services	South Africa	25%	241
Alibaba Group	SOE	Thames Water Utilities	Services	UK	9%	779
		Devon Energy Corporation (five US oil and gas projects)	Resources	US	33%	2,500
lenovo	Private	Petrogal Brasil, Ltd.	Resources	Brazil	30%	4,800
		Talisman Energy (UK) Ltd.	Resources	UK	49%	1,500
Alibaba Group	SOE	ChinaVision Media Group Ltd	Services	Hong Kong	60%	804
		Singapore Post Ltd	Services	Singapore	10%	249
lenovo	Private	Kabam Inc	Services	US	NA	120
		CCE	Services	Brazil	100%	148
lenovo	Private	Omega Corporation (Certa in Assets)	Services	US	>50%	5
		Motorola	Mobility	US	100%	2910

Sources: Handout of Citibank in the Conference hosted by Citi & NKF on Nov. 3, 2014 on ‘Completing M&A Transactions Successfully with Chinese Companies’

**Other Noteworthy Outbound China M&A 2014YTD**

Bidder Company	Type	Target Company	Sector	Country	Stake	Deal Value (US\$m)
东风汽车公司 DONGFENG MOTOR CORPORATION	SOE	PSA Peugeot Citroen SA	Industrials	France	NA	720
FOSUN 复星	Private	Caixa-Insurance Businesses	Services	Portugal	80%	1,412
中国工商银行 INDUSTRIAL AND COMMERCIAL BANK OF CHINA	SOE	Standard Bank PLC	Services	UK	NA	770
久邦数码 SUNGY MOBILE	Private	Alcatel Lucent Enterprise SAS	Services	France	85%	255
Tencent 腾讯	Public	China South City Holdings Ltd.	Services	Hong Kong	9.9%	193
万向集团 WANGJIANG GROUP	Private	Fisker Automotive Inc	Industrials	US	100%	150
北京首都创业集团有限公司 CAPITAL GROUP	Private	Transpacific Industries Group	Industrials	New Zealand	100%	795
Alibaba Group	Public	ChinaVision Media Group Ltd	Services	Hong Kong	60%	804
中粮 COPCO	SOE	Noble Agri Ltd	Services	Hong Kong	51%	4,000
中国石油天然气集团公司 CHINA NATIONAL PETROLEUM CORPORATION	SOE	Phoenix Energy-Dover Project	Resources	Canada	100%	1,076

Sources: Handout of Citibank in the Conference hosted by Citi & NKF on Nov. 3, 2014 on ‘Completing M&A Transactions Successfully with Chinese Companies’

THOUGHT LEADERSHIP

### **Why Swiss Companies are Targets of Chinese Buyers**

The following factors motivate Chinese companies to undertake M&A transactions with Swiss companies:

- Switzerland offers economic and political stability and security;
- the Swiss legal and regulatory framework is favorable for M&A transactions with Chinese buyers (there is a favorable Double Taxation Treaty between China and Switzerland and, so far, the Free Trade Agreement between China and Switzerland is the only such agreement that China has concluded with a continental European country);
- Switzerland is rich in human capital and offers reliable and well educated employees;
- M&A transactions with Swiss companies allow for an efficient inroad to advanced technical know-how;
- the acquisition of companies in Switzerland offers Chinese groups relatively quick and easy access to the Swiss market;
- it is a good way to acquire recognized brands, which may provide legitimacy in the Swiss, European, and even global markets (as Chinese companies sometimes struggle with reputational issues);
- Swiss luxury goods are very popular in the Chinese market; the Chinese are fascinated by Swiss technology and, particularly, by Swiss luxury goods;
- Chinese buyers have the potential to increase the value of the acquired Swiss companies and brands by their ability to facilitate a better and more direct access to the Chinese market. For example, in 2013 Asia accounted for more than half of Switzerland's watch exports

by value (52.7%). China is, after Hong Kong, the second largest Asian market and, notably, third at world level.

### **Challenges Due to Different Cultural Backgrounds: Observations from a Western Party's Perspective**

#### a) Mutual relationship of trust and respect

Generally, the Chinese prefer to deal with people whom they know well and whom they trust. They certainly rely more on personal relationships than their Western counterparts. Western companies are therefore well advised to make themselves known to, and respected by, the Chinese. The relationship needs to be built not only between companies but also between individuals at a very personal level; building such a relationship is an ongoing process.

In meetings, a lot of small talk seems to take place from the Western party's perspective. They may be surprised that the really important part of a meeting is often postponed until the very end of the meeting and that a considerable amount of time is spent on finding common ground and understanding on minor topics. However, this approach is important to develop the relationship of trust that is necessary to do business with the Chinese.

Chinese parties put a lot of emphasis on respectful behavior. They are very careful not to expose anybody to what is commonly known as "losing face". Especially in confronting business situations, aggressive behavior from either party might damage the "face" of the other party. The level of acceptance of aggressive behavior is much lower if the counterparty is Chinese.

b) Procedural Structure

While Western parties are generally used to working based on a commonly established timeline, which describes the steps to be taken on each working group level until the signing or the closing of the transaction, Chinese parties often pursue a more flexible and less foreseeable approach. One reason is that transactions involving Chinese parties often require internal or external regulatory approval or other procedures. The timing of such approval or procedures is often difficult to predict. Consequently, clearly set timelines are less common in the approach that Chinese companies pursue. Western parties should therefore be prepared for the fact that set timelines may often not be followed.

Also, Chinese parties tend to involve advisors quite late in the process, which can result in delays. A Western party, if time is of the essence, may therefore want to insist (*vis-à-vis* its Chinese counterparty) on the timely involvement of its advisors.

c) Indirect approach

Problematic issues are often not directly addressed by Chinese buyers but rather in a cautious and discreet way. The same approach may be advisable on the part of Western counterparties in order to preserve the relationship of trust and respect. Furthermore, it is essential to be aware not only of what is said in meetings but also of what is not said and which, in fact, should be.

d) Conclusion of negotiation topics

While Western parties often assume that agreed points can be considered as definitively closed, Chinese parties often reopen negotiations on these topics. This occurs throughout the negotiation process until signing — and sometimes even after signing (eg, in the context of conditions precedent, pre-closing covenants, purchase price adjustments, earn-outs or other deferred payments). Western parties should therefore be prepared for this and remain flexible. With respect to deal items that allow a discussion after signing or even closing, such as earn-outs and other deferred payments, a Western seller should therefore consider seeking adequate security. Also, one should be aware that issues that seem to be “minor” to a Westerner may not be as “minor” to the Chinese counterparty.

e) Negotiation attitude

Chinese parties are typically very firm on their position and expect the same from their counterparts. For that reason, the taking of a firm, clear position and posture from the beginning of the negotiations is essential.

Irrespective of the above, when negotiating a deal with a Chinese party, it is often advisable to keep room for concessions, so that the Chinese counterparty can report to its superiors some “points won” that allow it to keep its “face” while making some concessions on other points.

f) Risk Perception

Based on experience from transactions made in China, Chinese buyers sometimes tend to require additional security on the profitability of the target companies and the existence of the assets on their balance sheets, such as by additional due diligence

requests (such as site visits that may go beyond the standards Western parties may be used to), or by requesting guarantees in the transaction documents that go beyond the mere confirmation of compliance with the applicable accounting standards. Western parties should therefore be prepared to spend additional time on satisfying due diligence requests and, sometimes, lengthy negotiations about the level of contractual guarantees.

g) Escalation to principals

With respect to a great variety of issues, a settlement between the highest level of the principals is necessary and an agreement concluded on the level of the advisors is often not possible. Complex and extended final negotiation rounds that use time and resources of the business principals are often required. Western parties should therefore be prepared to escalate critical issues to the principal level for final conclusion (sometimes involving a key group of senior Chinese advisors).

h) Increased professionalism

Even though Chinese buyers are generally, at least at this point in time, still lacking some experience and, hence, speed in M&A transactions (also due to language barriers, visa requirements, procedural aspects and so on) they tend to get rapidly accustomed to Western processes. Western parties should therefore be prepared for fast processing of multiple work streams with respect to different aspects of the transaction. Chinese buyers, more and more, engage highly professional and internationally experienced advisors early on in the process and keep them involved in all key stages of the transaction.

i) Dimensions of transactions

Deals with Chinese parties often have three different dimensions: business, political and administrative. It is often expected that the complete transaction team is present to make rapid deal progress and to build relationships at all levels. Also, Chinese parties often involve senior political figures as a way to enhance their image. Politicians are often present at the signing ceremony of significant transactions.

j) Post-acquisition phase

Differences in managerial styles and in corporate culture are regarded as the main reasons for past failures of Chinese outbound foreign direct investment. The post-acquisition phase is of great importance in cross-border M&A transactions involving Chinese parties. A fundamental challenge that affects the ultimate success of the integration process of an acquisition is to find the right balance between obtaining the necessary level of organizational integration and minimizing the interferences within the acquired firm's resources and competences. The chosen integration model should consider the cultural effects.

The involvement of professional advisors in cross-border M&A transactions is therefore also advisable after the transactions are closed. Their understanding of local laws and regulations, as well as their professional experience, help Chinese companies to better integrate into the new institutional environment. Moreover, assessment of local risks by professional firms can help the Chinese companies in making informed business decisions.

## Selected Legal Aspects in M&A Transactions with Chinese Buyers

### a) Approval procedures

For a Western party, the involvement of numerous different national and provincial Chinese bodies in a transaction may be rather unusual. Issues, seemingly to be of a pure administrative nature, may become tripwires. Approvals of Chinese national and provincial bodies require substantial coordination efforts, may be extremely time-consuming and can potentially have a significant impact on the closing timeline of a transaction. Experienced professional local advisors should be involved, because they best handle approval proceedings before Chinese bodies.

### b) Structures of SOEs

There is a significant difference between a Chinese party that is a SOE and other Chinese buyers. SOEs often have:

- a complex organizational structure and sophisticated corporate governance mechanisms;
- a top-down approach;
- little transparency between senior managers and middle managers.

Often only the head of the SOE team is allowed to speak in negotiations, albeit he often may have no English language skills; this can lead to communication difficulties that can make the negotiations even more strenuous.

This complex structure, which in many instances is unfamiliar to Western target companies, often diminishes the motivation of the management of the acquired company to cooperate in not only the transaction process but also in the post-acquisition integration phase. By contrast, privately owned Chinese enterprises are generally more transparent; they show a fast decision-making process and a stronger willingness to learn.

### c) Arbitration

China is party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. By contrast, China has not yet entered into many agreements concerning the enforcement of court judgments with other countries (not even with Switzerland). It is therefore advisable to subject the transaction documentation for M&A transactions with Chinese companies to arbitration proceedings in order to best facilitate enforcement.

### d) Chops, or corporate seals

In China generally, a chop (corporate seal) is required for a contract to be valid. While it may be unusual for Western parties that the Chinese parties will sign with the company's seal, this is an important aspect for the formal validation of the contract and, ultimately, for potential future enforcement of rights under the contract.

**Issues to Note**

Issue	Chinese Party	Western Party
Relationship	Very important not only between companies but also between individuals	Less important; focus is on achieving business interests
Problematic Points	Not addressed directly	Addressed directly
Transaction Details	Discussed on highest level	Discussed at a lower level
Respectful Behavior	Highly important (not exposing someone to “lose face”)	Important (but level of tolerance of aggressive behavior is much higher)
Agreed & Closed Topics	Subject to new discussions until signing and, sometimes, even after closing	Understood to be concluded in a final way
Firm Clear Position from Beginning	Highly important	More flexible
Role of Legal Advisors	Delegation of resolution of adverse positions to advisors not customary; normally, agreements are only concluded between principals	Advisors may play a more central role
Administrative Approvals of Government Bodies	Procedure usually more difficult and less predictable, not transparent, time consuming, and outcome unpredictable	Procedure normally transparent and usually of pure administrative nature
Involvement of Political Figures	Common to enhance image	Not common
Different Legal Structures of Companies Influencing Transactions	Very different legal structures (SOEs, POEs etc.) that have an influence on the transaction	Differences in legal structures less important and without significant influence on the transaction
Post-Acquisition Phase	Challenging due to different cultural backgrounds	Important but often better manageable
Arbitration Clause	Recommended since China is party to the New York Convention and has not yet entered into many agreements concerning the enforcement of court judgments with other countries	Choice between State courts and arbitration proceedings less fundamental
Corporate Seal	Necessary to make legal documents valid	Not frequently used

**Typical Clauses in Share Purchase Agreement**

Topic	Chinese SPAs	Western SPAs
Deal Structure	<p>Fixed price common</p> <p>Price adjustment clauses may be impracticable for SOE's</p> <p>Price adjustments / earn-outs / deferred payments not uncommon for POEs</p>	<p>Auctions: fixed price / locked box often seen</p> <p>Other transactions: closing accounts also very common</p> <p>Earn-outs: less common</p>
Conditions Precedent	<p>Very limited for SOEs</p> <p>Material Adverse Change (MAC) clause unusual</p>	<p>Generally limited to regulatory and third party consents</p> <p>MAC clause not unusual, often quantified</p> <p>Sometimes accuracy of representations and compliance with covenants added</p>
Regulatory Approvals	No "hell or high water" clauses	"Hell or high water" clauses often seen in auctions
Representations and Warranties	Generally limited; increased level of protection occasionally sought on specific matters	<p>For private equity sellers: generally more limited</p> <p>Strategic sellers: generally broader</p>
Representations and Warranties repeated at Closing	Often not repeated	At least core warranties are repeated at closing
Disclosure	Specific disclosure	Usually entire data room
Financial limitations	Higher, sometimes even no caps	Customarily at 10-25% of purchase price; for title, often at 100% of purchase price
Duration of Representations	Longer, sometimes unlimited	At least one audit cycle, often 18 months

### Conclusion

The expansion of Chinese companies into Swiss and other non-Chinese markets brings new challenges for Westerners as well as for the Chinese due to their very different cultural backgrounds. It is important that both parties are aware of such differences and establish a common ground to facilitate doing business. The parties should understand that not only is the M&A transaction challenging, but that the post-acquisition phase is also of significant importance.

The average Western person is not familiar with “Chinese ways”. For that reason, a chosen integration model should also consider cultural effects. However, if the cultural and institutional particularities of the Chinese business partner are taken into account, the Chinese cross-border M&A market offers significant opportunities to Swiss and other Western companies.

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