Do Home Country Institutions Matter in Cross-border Mergers and Acquisitions?

The case of China

Hebben instituties in het land van herkomst invloed op grensoverschrijdende fusies en acquisities?

Het voorbeeld van China

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List of Abbreviations

AML: Anti-Monopoly Law
AR: abnormal returns
BIT: Bilateral Investment Treaty
BRIC: Brazil, Russian Federation, India and China
BRICS: Brazil, Russian Federation, India, China and South
BTA: Bilateral Taxation Agreement
CAAM: China Association of Automobile Manufacturers
CAAR: cumulative average abnormal returns
CATRC: China Automotive Technology and Research Centre
CDB: China Development Bank
CECIE: China Export & Credit Insurance Corporation
CFIUS: Committee on Foreign Investment in the United States
CG: Corporate Governance
CNAIC: China National Automotive Industry Corporation
COO: countries of origin
CPC: Communist Party of China
DFCOI: Department of Foreign Capital and Overseas Investment
DOIEC: Department of Outward Investment and Economic
EIBOC: Export-Import Bank of China
EPS: earnings per share
EU: European Union
FAW: First Automotive Workshop
FDI: foreign direct investment
GM: General Motors
IC: investment cost
IF: institutional framework
IFDI: inward foreign direct investment
IM: international management
IOE: Industrial Organization Economics
IP: Intellectual Property
IPR: intellectual property right
IT: intellectual technology
JV: Joint Venture
L&E: Law and Economics
LOF: liability of foreignness
LOM: liability of multi-nation
LOO: liability of origin
M&A: merger and acquisition
M&As: mergers and acquisitions
MDC: Ministry of Domestic Commerce
MFA: Ministry of Foreign Affairs
MFTEC: Ministry of Foreign Trade and Economic Cooperation
MIB: Machinery Industry Bureau
MIM: Machinery Industry Ministry

MNE: multi-national enterprise
MOF: Ministry of Finance
MOFCOM: Ministry of Commerce
MOT: Ministry of Taxation
NDRC: National Development and Reform Commission
NIE: new institutional economics
NPV: net present value
OBOR: One belt, One road
OECD: The Organisation for Economic Co-operation and
OFDI: Outbound Foreign Direct Investment
OLI: ownership, location and internalization
OMAs: overseas mergers and acquisitions
P/E: price/earnings
PAG: Premier Automotive Group
PBC: People's Bank of China
PC: personal computer
PV: present value
ROA: return on assets
ROL: Rule of Law
RQ: Regulatory Quality
SAFE: State Administration of Foreign Exchange
SAIC: Shanghai Automotive Industry Corporation
SASAC: State-Owned Assets Supervision and Administration
SAT: State Administration of Taxation
SAW: Second Automotive Workshop
SDRC: State Development and Reform Commission
SETC: State Economic and Trade Commission
SOASAC: sate-owned asset supervision and administration
SOE: State-Owned Enterprise
SPC: State Planning Commission
TC: transaction cost
TCE: Transaction Cost Economics
TNC: transnational corporation
VW: Volkswagen
UNCTD: United Nations Conference on Trade and Development

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Chapter 1. Introduction

In the international M&A market, Chinese overseas mergers and acquisitions (OMAs) have become increasingly noteworthy in recent years, both in terms of total volume and high-profile deals. The average yearly Chinese OMAs deals were around 30 in the 1990s, and this number quadrupled by the 2000s (117 yearly) [1]. The rise of Chinese OMAs is especially eye-catching since the 2008 financial crisis when advanced market OMAs suffered a sharp fall. Chinese OMAs not only averted the fall, but on the contrary increased dramatically (see *Figure 3-3 OMAs yearly number US vs.UK vs. China 1990-2013*). Not only were there yearly 247 Chinese OMAs deals during 2008-2013, but also many high profile OMAs were made during this period. Furthermore, it is not only state-owned energy giant companies, such as China Petrochemical, State Grid Corp and Sinopec, etc., that made high-profile deals in international M&A markets, but also private Chinese companies, such as Geely (auto industry) and Shuanghui (food industry), have taken over targets which worth billions of dollars' from Europe and the U.S.

Similar to other countries OMAs, the rise of Chinese OMAs comes from the rise of the Chinese economy along with globalization (Shimizu et al. 2004). Powered by the domestic and global economic conditions, many Chinese companies not only focus on their domestic competitiveness, but also desire to grow their international competitiveness by acquiring markets, brands, technology and know-how (Deng 2009).

Furthermore, firms' international strategies are influenced by the institutional settings in which they are embedded (He and Cui 2012; Amal and Tomio 2014; Kostova, Dacin, and Roth 2008). Therefore, the rise of Chinese OMAs may also be due, to some degree, to the increasingly favourable institutional background of Chinese acquirers (Ren, Liang, and Zheng 2010). For instance, not only did Chinese policy makers relax the general outbound foreign direct investment (OFDI) regulations, and since 2000, Chinese companies have faced less and less regulatory constraints in their overseas investments. But also a great number of Chinese champion companies have been directly encouraged by the government to go abroad, via facilitative policies and measures. Beside the direct measures, there are also indirect measures from the government facilitating certain Chinese acquirers; for instance some Chinese SOE acquirers enjoy preferable financial assistance in applying loans for OMAs.

However, the institutional background of firms is a complex matter; how firms' behaviour and outcome are influenced by their institutional background is complex as well. Especially in the case of cross-border M&As, not only will the institutional settings in the home country influence the behaviour of acquirers but also of the targets, and other stake holders.

Therefore, this thesis aims to use China as a case study to study whether and how the evolution of the home-country institutional framework plays a role in Chinese OMAs.

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[1] Source: *World Investment Report 2014,* (UNCTAD 2014). *Annex table 11*. Number of cross-border M&As by region/economy of seller, 1990−2013. Available on the UNCTAD site, www.unctad.org/wir.

How economic activities and performance are influenced by institutions in a society has been studied in many fields since North's (1990, 1994) attempts to explain the matter from the new institutional economic (NIE) perspective. For instance, at the macro level, the NIE approach has been adopted in fields like economic history (Liebowitz and Margolis 1995), political economy (Pierson 2000) and international economics (Martin and Sunley 2006) to investigate how the quality of a society's institutions affect the efficiency of the economic performance and social welfare of such society. At the micro level, in fields like business and management, the NIE approach is employed to explore the regulative and cognitive influences on the behaviour of companies and their managers (Dunning and Lundan 2008).

This thesis attempts to incorporate both levels of NIE approach to analyse the case of Chinese OMAs. From the macro level, under the pressure of economic growth and globalization, Chinese policy makers are "obliged" to relax the overseas investment control to encourage Chinese companies to become Multi-national companies (MNCs) via OMAs; however, in order to compensate for the fact that Chinese companies lack experience and know-how in the international M&A market, policy makers are also "obliged" to use institutional tools to facilitate and "control" the young and naive Chinese acquirers. Chinese policy makers are both a "deregulator" and a "gatekeeper". This thesis will study how the institutional settings evolved in China under such a macro environment.

From the micro level, Chinese companies or Chinese origin MNCs are inevitably incentivised by the institutional changes. The goal of the institutional tools is to promote and facilitate the Chinese companies to grow their competitiveness both domestically and internationally, to what level this goal is realized is best understood by examining the reaction and performance of Chinese companies in OMAs. Therefore, this thesis will also study Chinese companies' behaviour and performance under the institutional changes.

Institutions in this thesis means "rules of the game" as defined by North (1990, 1994). Institutions consist of formal rules (e.g., constitution, policies and regulations), informal constraints (e.g., norms of behaviour, conventions, and self-imposed codes of conduct) and the "enforcement characteristics of both".

Institutional framework (IF) is used in this thesis to refer to the overall institutional setting of China in which the Chinese companies are embedded. It includes four levels of institutions as described by Williamson (2000): informal institutions, institutional environment, institutional arrangements and the market.[2] There are three Chinese IFs mentioned in this thesis, the first IF is the institutional setting of China during 1949-1978, the second one is the institutional setting during 1978-2000, and the third one is the current one that started in 2000.

1.1 Motivation for the Study

In the context of the rising number of Chinese OMAs and the change of China's institutional settings, this thesis aims to offer researchers, policy-makers, and international managers a general understanding of the likely link between the home-country institutional framework of China and the peculiarities of Chinese OMAs.

[2] Each level of the institutions is explained in chapter 4.

1.1.1 Peculiarities of Chinese OMAs

In the background of globalization, firms increasingly favour cross-border mergers and acquisitions (M&As) as their strategy to grow their international competitiveness. Managers believe that cross-border M&As, as corporate growth strategies, offer opportunities to gain competitive advantages by acquiring market, assets (tangible and intangible) or efficiency in the international market (Kang and Johansson 2000). The first cross-border M&As wave was seen in the 1990s, when the number of cross-border M&As increased six-fold in 1991-98, becoming a considerable part of all M&A deals[3] (OECD 2001, 13–15). Cross-border M&As also compete with greenfield investment and become an attractive mode of foreign direct investment (FDI), and it accounted for more than 85% of FDI by 1999 (Kang and Johansson 2000). The 1990s Cross-border M&As wave was mainly driven by acquirers from advanced markets and only a handful of emerging market acquirers participated in this wave. In the second cross-border M&As wave in the 2000s however, in contrast to the 1990s, latecomers from emerging markets (e.g. Russia, India and China) also emerged and took a noticeable share as acquirers.

Chinese acquirers emerged in the 2000s in this context. As shown in *Figure 3-3 OMAs yearly number US vs. UK vs. China 1990-2013*, Chinese companies completely missed out on the 1990s cross-border M&As wave, however in the 2000s they quickly caught up and became important players in the 2000s cross-border M&A wave. Furthermore, as shown in *Figure 3-3*, in the 2000s wave, though advanced markets' OMAs peaked before the 2008 financial crisis, the Chinese OMAs themselves showed a robust growth pattern, even more so around the crisis and it has not yet reached its peak.

On the deal level, studies on Chinese OMAs (Black et al. 2012; Gu 2011; Wang, Boateng, and Yan 2007) showed that, besides the similarities which Chinese OMAs share with advanced markets' OMAs, some interesting results differ from the mainstream Cross-border M&As literature. For instance, studies show that while advanced acquirers are driven by various motivations, Chinese acquirers tend to be primarily driven by acquiring strategic assets (Edamura et al. 2014; Wang and Boateng 2007), especially in the advanced market; Furthermore, although the mainstream literature has no unanimous conclusion on the wealth-creation effects of cross-border M&As, a few of the Chinese OMAs' studies found empirical evidence to show unanimously that Chinese acquirers earn positive returns for their shareholders in OMAs (Black et al. 2013; Gu and Reed 2013). When accepting the efficient and semi-efficient market hypothesis as the finance literature argues (Duso, Gugler, and Yurtoglu 2010), the market's confidence to some extent indicates that the Chinese OMAs increase values for shareholders.

Therefore, the rise of Chinese OMAs may not only be a quantitative matter but also a qualitative one, as it reflects growing differences from OMAs from the advanced market, and therefore it may have implications for its own kind.

[3] Depending on the country of origin of the acquirers and the targets, M&As can be classified into two groups: domestic M&As and cross-border M&As.

1.1.2 Literature Gaps

The rising Chinese OMAs which also present peculiar features posed opportunities for scholars from various fields to study the matter and these studies have yielded interesting findings as mentioned above. However, as a newly emerged phenomenon, Chinese OMAs still remain the least understood. In particular, the existing research on Chinese OMAs suffers from two main drawbacks.

Firstly, the existing studies on Chinese OMAs are fragmented; most of these studies only focused on the characteristics of Chinese OMA at a certain stage without considering how these characteristics are interrelated. Therefore, the full picture of Chinese OMAs as an emerging phenomenon has not been revealed. For instance, there are studies which have focused on the motivation (Wang, Boateng, and Yan 2007; Pietrobelli, Rabellotti, and Sanfilippo 2011; Wang and Boateng 2007), or the deal-making (Zhang and Ebbers 2010; Zhang, Zhou, and Ebbers 2011), or the post-deal performance (Wu and Xie 2010; Edamura et al. 2014); however, it appears that there is no systematic study that has connected the dots of all the peculiarities of the Chinese OMA in the whole process which consists of motivation, deal-making and post-deal performance (See *Figure 2-3 Three Stages of Cross-border M&As*).

Secondly, although the literature has compared Chinese OMAs to the OMAs from advanced markets and investigated the factors driving certain peculiarities of Chinese OMAs, there is no direct study that explored whether the "Chinese identity" [4], namely home country institutions, of Chinese acquirers has contributed to the peculiarities of Chinese OMAs. It appears that there are few studies which focus on the role of home country institutions in cross-border M&As. For instance, though FDI literature has long admitted the role of institutions in driving FDI, it mainly focuses on the quality of the host countries' institutions (Dunning 2000; Dunning and Lundan 2008), it did not study the role of home counties' institution. Furthermore, FDI literature does not differentiate between greenfield investments and cross-border M&As (Amal and Tomio 2014). However, the behaviour of companies in greenfield investment and cross-border M&As is very different. Therefore, FDI theories are often not directly applicable to cross-border M&As. The mainstream cross-border M&As literature[5] which is based on Anglo-Saxon acquirers did not give particular attention to home country institutions either, since it usually takes "home countries' identity" as given. It makes sense because the market economies as well as the rules (formal and informal institutions) of the market have been well established in these countries during the cross-border M&A waves. Therefore most of the Chinese OMAs studies which applied to existing cross-border literature

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[4] The "Chinese identity" is not a scientifically defined term in the literature. For research purposes, the scope of "Chinese identity" in this thesis is narrowed down; it mainly refers to the institutional background of the Chinese acquirers. Therefore, when discussing acquirers' "Chinese identity" in this thesis, it means the following: 1) the acquirers are incorporated in, and operating in accordance with relevant Chinese laws and regulations; 2) the acquirers, their managers, and employees as well as their operations and any other economic activities are all governed by Chinese laws and regulations; 3) besides formal laws and regulations, the above stakeholders and their activities are embedded in the informal institutions of China as well. In short, the acquirers' "Chinese identity" here means the formal and informal institutional constraints Chinese acquirers are subject to.

[5] Chapter 2 gives an in-depth literature review on cross-border M&As literature.

tend to overlook the institutional factors and mainly focus on micro level factors such as industrial, firm and deal level factors (Yao, Sutherland, and Chen 2013; Deng 2009; Black et al. 2013; Wang and Boateng 2007). However, this approach is not necessarily compatible with Chinese OMA experiences. The institutional framework of developed countries such as the US and the UK is fairly stable and predictable over a given period of time. But the Chinese companies are embedded in a very different macro environment[6], the Chinese institutional framework is still at a stage of development and adaptation.

This thesis therefore is motivated by filling the two literature gaps, firstly by providing a full picture of Chinese OMAs' characteristics and secondly by investigating the role of acquirers' institutional background on the emergence of these characteristics.

1.1.3 A Realistic Picture for the Business Practice

This thesis is further motivated to offer the business world a balanced view and realistic picture regarding the dynamics between Chinese OMAs and the role of the Chinese state as the "visible hand". In the past three decades, the relationships between the Chinese state and economic actors have evolved; The Chinese state has been liberalizing its economy towards a more market-oriented one. However, the Chinese state is still a strong actor in the economy and its long history of intervening in business activity inevitably makes the rest of the world sceptical about its OMA stimulatory measures and the sudden emergence of Chinese OMAs.

The State's interventions in Chinese OMAs were often in the "spot light" in the mass media, especially when a vast number of Chinese acquirers started buying targets in the advanced economies during and after the 2008 financial crisis.[7] Many scholars emphasize the role of state ownership and the planning economy as the main characteristics of acquirers' "Chinese identity", and the economic rationale of Chinese acquirers were often less addressed in their studies as well as in the mass media (Nolan 2012; Godement, Parello-plesner, and Richard 2011). These viewpoints argued that the new and naïve Chinese acquirers do not play by the rules of the international market because they are overly supported by the state. Therefore, some scholars (Nolan 2012; Godement, Parello-plesner, and Richard 2011) claimed that Chinese companies' business strategies are still mainly driven by the Chinese government and not necessarily backed up by sound economic rationales. This line of reasoning is also in line with public opinion[8] towards Chinese companies, which may influence Chinese acquirers negatively in practice, especially at the deal making stage. For instance, the statistics *(See Table 3-8 Deal Completion compared to other countries)* show that Chinese acquirers are not favoured by targets or targets' regulators and Chinese OMAs have low probability to complete the deals, which may not only just be a loss of the Chinese acquirers, but also cause the targets to pass over profitable deals.

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[6] In this thesis, macro environment specifically means a country's institutional framework which is explained in detail in Chapter 4.

[7] For instance, *see China buys up the world, Economist,2010, November 11th. Available at http://www.economist.com/node/17463473*.

[8] For instance, "the public in the United States and most of Europe found China's growing economic might worrisome". *Pew Research Center survey on* Rise of China. Available at: http://www.pewglobal.org/2008/12/18/global-public-opinion-in-the-bush-years-2001-2008/.

Therefore, a balanced perspective regarding the nature of Chinese OMAs is much needed, not only for research purposes but also for the sake of business practice. By analysing the evolution of the Chinese institutional framework and especially the institutions concerning Chinese OMAs, this thesis will show that the Chinese State has been adjusting its role in the process of OMAs. Therefore, when facing a Chinese OMA deal, the relative stakeholders should both consider the role of the state in the deal and the economic rationale of the deal.

1.2 Research Question

The research goal is to study whether and how the acquirers' Chinese institutional background matters to Chinese OMAs.

In order to find out the answer, the research question can be further broken down into the following questions. 1) What are the characteristics of Chinese OMAs? 2) What does the Chinese acquirers' institutional background entail? 3) Does the Chinese acquirers' institutional background contribute to the characteristics of Chinese OMAs?

While unveiling the peculiarities of Chinese OMAs in chapter 3 and introducing the evolution of the acquirers' institutional background (Chinese institutional framework) in chapter 4, an attempt has been made to analyse the possible connections between the institutional background of Chinese acquirers and the peculiarities of Chinese OMAs in chapter 5 by answering the following questions: 1) Is the timing of the regulatory changes in China linked to the timing of the rise of Chinese OMAs? 2) Is the institutional background a contributor for the acquirers' choice of their targets? 3) Does the institutional background affect the possibility for acquirers to complete the deal? 4) Does the institution background play a role in the post-deal performance?

1.3 Research Design

To realize the research goal, it is necessary to incorporate two main fields of literature in this thesis: cross-border M&As literature and New Institutional Economics literature.

The cross-border M&As literature was reviewed to build a systematic understanding of cross-border M&As. It presents the theoretical background and empirical evidence on the motivation, deal-completing and performance of cross-border M&As. It serves as a reference from which to present the similarities and peculiarities of Chinese OMAs.

The NIE literature is employed to provide theoretical insights to explain the possible influence of the Chinese institutional framework on Chinese OMAs. There are three NIE insights which are especially relevant in inspiring this thesis.

Firstly, based on the cognitive limitations of the individuals, NIE argues that in an economic activity, a great number of institutions shape the incentive structure of the economic actors by either encouraging certain motivation and behaviour or prohibiting some others to achieve desirable economic results. Based on these insights, this thesis embraces and identifies the home-country institutions which govern the economic actors as well as the multi-layer relationships among them[9]. It includes the institutions governing acquirers in its OMA activity (e.g. culture, corporate law, anti-trust law, administrative approval rules); institutions governing the relationship between the acquirer and the target (e.g. contract law); and institutions governing the acquirer's relationship with external stakeholders, including Chinese policy makers (e.g. public policy), host country agencies (e.g., investment treaties). According to NIE insights, especially the insights from transaction cost economics (TCE), we can also classify these institutions as either restrictive or facilitative. Restrictive institutions in the OMAs forbid or discourage certain actions (e.g., investment control) of certain economic actors by making such motivation and actions excessively costly. Facilitative institutions may encourage certain activities by reducing the costs of such activities (e.g., deregulation of investment constraints) or by affecting the ideologies and perceptions of managers (e.g., national pride) and condition the possible behavioural paths an acquirer might pursue (e.g., favourable financial policies of certain OMAs).

Secondly, NIE also emphasizes that not only do the institutions shape the incentive structure of economic actors but also the feedback from economic actors and economic performance will shape the institutional changes. In the context of Chinese OMAs, acquirers with bargaining power in some circumstances may have the ability to alter some formal institutions to be in line with their interests. Therefore, institutional changes sometimes are the result of bargaining between policy makers and interest groups.

Thirdly, North (1994; 2005) also argues the "path independence" feature of institutional re-configuration and upgrading and the consequences in economic performance. He argues that the transaction cost to change institutions occurs in different ways in different societies, because the new institutions are accepted and implemented by economic actors in different ways due to "path dependence". Therefore, merely imitating the best practice of formal institutions from an advanced market usually does not work in the same way in developing markets since the efficient institutional system works not only according to the incentive structures provided by formal institutions but also to the informal institutions, as well as efficient enforcement mechanisms. Path dependency is useful to understand why the Chinese policy makers in some areas imitated the best practice, for instance corporate law and IP law, but the results are unsatisfying due to the different starting points of legislation and the enforcement of such laws in China. Path dependence also provides insight to understand the cause of the "locked-in" situation of Chinese political institutions (Liebowitz and Margolis 1995). Both of which are also related to the peculiar behaviour and outcome of Chinese OMAs.

Furthermore, due to the complexity of the research agenda, theories from other disciplines such as industry organizational theory, international business, corporate law and corporate finance were also employed in this thesis. This cross-fertilization of relevant theories stands to

[9] It is important to emphasize that in an OMA deal, there is a very broad range of institutions from multiple jurisdictions may govern the deal and the relevant parties. As described in section *2.2.2.2 Regulatory Approval,* an OMA deal might be influenced by the host-country institutions, home-country institutions and depend on the deal specifics, it may even be screened by multiple third countries' institutions (e.g., merger control). But this thesis focuses on addressing the role of home-countries institutions of China, i.e., the acquirer's institutional background.

benefit from these disciplines since it may provide a different methodological approach for studying cross-border M&As. For instance, in studying the driving forces of the Chinese OMAs wave, a “reversed” deregulation theory works better. Namely, traditional theories found that the deregulation of hosting countries drives cross-border merger waves (Feito-Ruiz and Menéndez-Requejo 2011; Gregoriou and Renneboog 2007), the Chinese experience seems to prove that the home country deregulation was the main driver for the Chinese OMA wave. Another example is that although the OLI paradigm (Dunning 2000) does not explain the motivation of the merge-up Chinese OMA, a “reversed” OLI paradigm makes perfect sense to understand why both Chinese acquirers and advanced targets would embrace “merge-up” deals[10].

From the methodology perspective, both quantitative and qualitative analysis are employed to investigate the research matters. In the empirical context, Chinese OMA deals over a 24 years period (1990-2013) with 94 targeted countries were studied to investigate the characteristics of the Chinese OMA. Special attention was also drawn to the deals initiated around the financial crisis period (2009-2013). Furthermore, event study was employed to test the stock market reaction on high value OMA deals made during the 10 intensive years of OMA (2004-2013), 5 years before (and including) the financial crisis, 5 years after the financial crisis. A qualitative analysis of the Chinese institutional framework and the institutional changes related to the Chinese OMAs are also an important part of the thesis in order to analyse their impacts. Furthermore, a case study was adopted not only to apply the overall findings; it also added value to show the special opportunities and challenges a Chinese auto OMA faces within the Chinese institutional framework, especially the auto industry policy environment.

1.4 Thesis Contribution

This study marks a distinct departure from earlier studies on Chinese OMAs in several ways. Firstly, it uses the NIE as a theoretical lens to study the phenomenon of Chinese OMAs. Given the theoretical and methodological sophistication of the NIE approach, it helps to clarify several unnoticed or unexplained aspects related to the Chinese OMAs, as stated in the research questions. Secondly, this study takes a “path dependent” approach (Liebowitz and Margolis 1995) under the basic assumption that history matters. Therefore, Chinese OMAs and the Chinese institutional framework are both analysed from their starting points. The case study also investigates the Chinese auto industry and industry policy changes from a historical point of view. It shows the economic rationale for the emergence of Chinese OMAs within its evolving institutional framework, which Coase called the “capitalist” governance of China (Coase and Wang 2012). Thus, it moves the focus away from the spotlight - China is buying up the world when the world is in crisis - which has been the focus or the driver of many related studies. Thirdly, by unbundling the Chinese institutions and institutional changes towards OMAs, this study makes it possible to see the role of institutions in incentive-structure-building; therefore, it helps to understand how institutions inspired the peculiarities of a Chinese OMA at a different stage. Finally, the study goes beyond simply applying the NIE insights to the Chinese OMAs, but in an innovative way also uses the context of OMAs

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[10] Both “reversed” theories are explained in detail in Chapter 5.

to provide a balanced view of the efficiency of the Chinese institutional framework in the economic performance of Chinese companies.

The quantitative and qualitative analysis will be of considerable importance to the relevant policy makers, government officers, managers and lawyers. Because this analysis not only provides a full picture of Chinese OMA in a process-related manner, it also offers an in-depth analysis of the Chinese institutional framework from an evolutionary approach by highlighting critical aspects that need to be addressed over the process of OMAs.

1.5 Thesis Organization

The thesis is organized into 7 chapters. Chapter 2 presents a literature review of Cross-border M&As, providing an overview of theories and empirical evidence of the cross-border M&As studies. Chapter 3 presents the empirical evidence of Chinese OMA. Chapter 4 introduces the new institutional economics followed by a review of the three main Chinese institutional frameworks so far. Chapter 5 links Chapters 3 and 4, underpinning the theoretical arguments of the empirical findings. Chapter 6 presents a case study to have a reality check of the findings from previous chapters. Chapter 7 attempts to integrate the findings of this thesis and concludes the whole thesis with recommendations for further research in this arena.

Chapter 2 outlines the theoretical background of cross-border M&As based upon the relevant literature. It starts with the definition of the theme followed by a review of three main strands of literature of the theme: the drivers of the cross-border M&As; the factors that influence the completion of the cross-border M&As attempts; and the factors that affect the post-deal success and failure.

Chapter 3 places the cross-border M&As literature within the context of the Chinese OMAs. It aims to examine the similarities and peculiarities of Chinese OMAs compared to the mainstream cross-border M&As. It firstly provides an overview of Chinese OMAs based on the 4826 deals announced from 1990 to 2013, and then it explores the characteristics of Chinese OMAs in terms of driving forces and deal completion based on the data. It then investigates the stock market reactions of the Chinese OMAs by an event study of 105 high value sample deals announced between the years 2004 and 2012.

Chapter 4 firstly reviews the relevant NIE theories; it then introduces the institutions and institutional changes under the three IFs of China. It analyses the relevant institutions which have an impact on the behaviour of economic actors in the 1st, 2nd and 3rd institutional framework of China, with the emphasis on the 3rd IF.

Chapter 5 attempts to apply the NIE theories to explain the role of the Chinese institutional framework on the four main empirical findings in chapter 3. It firstly develops the theoretical argument regarding how the institutions matter via its influence on different OMAs' transaction costs. Then it analyses in detail how the relevant institutions influence the process (pre-deal, deal-making and post-deal) of an OMA.

Chapter 6 studies the case of the most ambitious Chinese OMA in the auto industry - Geely’s acquisition of Volvo. This case also showed how the auto industry evolved in China and how the industrial policy shaped the development of the Chinese auto makers and their corporate strategy. By analysing the case in detail, it shows how the institutional factors played an important role at each stage of the case. The case describes how Geely's corporate governance strategies, including the acquisition of Volvo, were always affected by its institutional background (both positive constraints and negative constraints). How Geely took advantage of the facilitative institutions and bargained its way. More importantly how Geely adapted itself when negative institutional constraints presented themselves.

Chapter 7 concludes the thesis. It summarizes the salient findings of this research, discusses the key contributions and limitations of the research. Meanwhile it also considers possible policy recommendations and a possible direction for future research.

Chapter 2. Cross-border Mergers and Acquisitions -Theories and Empirical Evidence

Although research on M&As started as early as the 1940s[11], the field of study of cross-border M&As only took off and began to grow quickly in the 1990s when cross-border M&As become a dominant strategy in growing companies international competitiveness (Bertrand and Betschinger 2012). As a fast growing economic and business phenomenon, cross-border M&As have been attracting a great number of scholars from various disciplines to study the theme. In the literature, research is mainly focused on investigating the patterns, driving forces, deal completion and post-deal performance of cross-border M&As. Scholars aim to open the black box of firms' decision-making and the economic performance of such decisions. This Chapter provides a review of cross-border M&As literature, introduces relevant concepts and research findings to date, and in doing so this chapter sets up the theoretical background of the thesis.

2.1 The Definition and Emergence of Cross-border M&As

2.1.1 A Definition of Cross-border M&As

According to the definition of the Organisation for Economic Co-operation and Development (OECD) (OECD 2008a) of **mergers and acquisitions**, "A *merger* occurs when two (or more) companies agree to merge into a new single company rather than remain separated for creating business synergies. An *acquisition* is the purchase of existing shares issued by another company for increasing ownership or control level by the acquiring company."[12] This definition provides a simple explanation of the means and purpose of an M&A, it is a corporate action either aimed at business synergies or an increase of ownership or control.

When an M&A involves capital flows beyond the boundary of a single country, the M&A is referred to as a **cross-border M&A**.[13] It is an important corporate strategy for a company's restructuring and/or internationalization.[14] Cross-border M&As is a mode of entry into a foreign market, and is a type of foreign direct investment (FDI) as opposed to Greenfield

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[11] Willard L. Thorp and Walter F. Crowder had studied the continuous data on mergers for the 1919-1939 period, which were compiled from the daily reports of the Standard Statistics Co. See Willard L. Thorp and Walter F. Crowder, *The Structure of Industry*, Temporary National Economic Committee, Monograph 27, 1941, pp. 231-234.

[12] See *OECD Benchmark Definition of Foreign Direct Investment* (OECD 2008a)

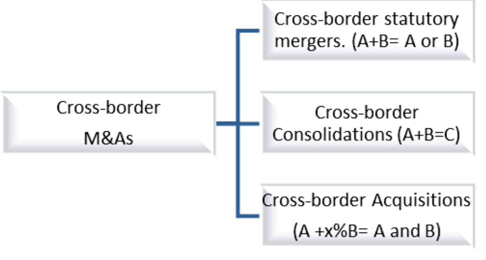
[13] In a global setting a company's nationality is not as clear as before. In this thesis, for the convenience of data analysis in later chapters, the benchmark of Thomson One Banker was chosen, namely the capital source as the country of origin.

[14] In organization literature, there are three modes of entering a foreign market. Cross-border M&A is an equity-based mode to enter a foreign market through merging or acquiring assets and/or shares in a foreign market. See 2.2 for details.

investments.[15] Therefore, cross-border M&As usually have an additional purpose beyond realizing business synergies or increasing the acquirer's ownership or controlling a target, they are a means for companies to increase their international competitiveness.

Based on the firms' status after a transaction, there are three main types of cross-border M&As: statutory mergers, consolidations and acquisitions, as shown in the figure below.

Figure 2-1 Types of Cross-border M&As (Based on Post-deal Firm Status)



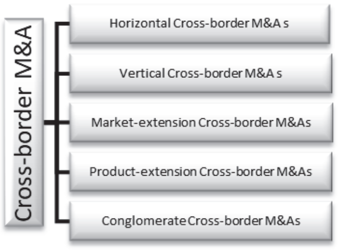
Source: UNCTAD 2000

A statutory merger relates to the business combination where the merged (or target) company will cease to exist, and this often happens in vertical integration. (A merges with B, only A or B exists after the merger); **Consolidation** refers to a business combination whereby two or more companies join to form an entirely new company. All companies involved in the merger cease to exist and their shareholders become shareholders of the new company. (A and B consolidate, becoming C); **Acquisition**, only happens when the acquirer increases their share in the target, therefore, neither of the companies cease to exist (A acquires B, A and B co-exist).

Based on the "relatedness" of the acquirer and the target, cross-border M&As can be referred to as follows: horizontal, vertical, market-extension, product-extension and conglomerate, as shown in the figure below,

[15] There are two types of foreign direct investment, one type is Greenfield investment, the alternative type is cross-border M&As. Greenfield investment is defined by UNCTAD (2009) as "investment projects that entail the establishment of new entities and the setting up of offices, buildings, plants and factories from scratch". In theory a sharp distinction is often drawn between Greenfield investment which provides fresh capital and additional jobs, and cross-border M&As that are perceived to include only a change of ownership in an existing corporate entity. This theoretical distinction however may differ in practice and in a number of instances the acquisitions of existing enterprises can provide important additional economic benefits to the host countries as well.

Figure 2-2 Types of Cross-border M&As (Based on Relatedness)



Source: UNCTAD 2000

A horizontal cross-border M&A occurs between two competitors in the same market; **a vertical cross-border M&A** occurs when two companies which have complementary activities such as a buyer-seller relationship; **a market-extension cross-border M&A** occurs between two companies selling the same products (tangible and intangible) in different markets; **a product-extension cross-border M&A** occurs between two companies selling different but related products in the same market; **a conglomerate cross-border M&A** relates to all the other types of transactions, i.e. when two companies do not have a specific relationship and are usually in different lines of business. The relatedness of two firms usually reveals the firm level motivations of the cross-border M&As.

2.1.2 The Emergence of Cross-border M&As

From more than a century of studies of M&As[16], it is well recognized that M&As come in waves, and the waves are closely related to the major advances on the stock markets (Gugler, Mueller, and Yurtoglu 2006). So far there have been five decades which have experienced such waves, the 1900s wave (peaked around 1898-1902) which created many monopolies; the 1920s wave (peaked around 1925-1929) which happened among related firms, but did not create monopolies; the 1960s (peaked around 1966-1968) wave which happened among unrelated firms and created a number of large conglomerates; the 1980s wave (peaked around 1986-1988) which was characterized as a refocusing wave, the mergers having been designed either to downsize or reorganize operations; and the 1990s wave. Unlike the first four merger waves which mainly happened in the US, the 1990s merger wave happened almost simultaneously in different parts of the world and many of these M&As were beyond a single jurisdiction (DePamphilis 2011). Therefore the cross-border M&As are a distinct phenomenon from the 1990s wave (Very and Schweiger 2001).

Since the 1990s, with the globalization[17] of both acquirers and targets, cross-border M&As began to represent an increased share of the overall M&As (Bertrand and Betschinger 2012).

[16] M&A studies before the 1990s are mainly based on the evidence from the U.S, due to the fact that M&As did not widely occur elsewhere until the 1990s.

[17] Globalization in this thesis means international economic integration. (OECD 2008a). It may be arguable but it is commonly believed that the globalization of the world economy started from the 1980s (O'Rourke and Williamson 2002).

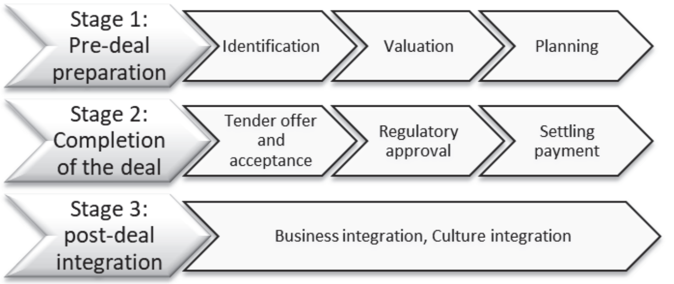
Firstly, since the late 1990s, acquirers were no longer limited to the US and UK, but originated all over the world. For instance, stimulated by the completion of the European Union (EU) internal market, continental European firms began to actively participate in cross-border M&As as bidders, as they were quickly catching up with the level of the US and the UK. **Secondly,** many markets tried to attract potential capital globally. These international capital flows pushed the deals beyond the boundaries of a single country. For instance, the EU attracted firms from the U.S, Japan and European countries themselves to expand there to ensure stronger market positions; from the mid-1990s, many emerging markets such as China and Russia, started the privatization of enterprise and market liberation, which attracted multi-national enterprises (MNEs) to gain access to these previously closed markets of enormous potential via FDI; U.S companies have been continuously attractive targets for acquirers, due to the stable macro and micro environment of the U.S. **Thirdly, a distinct trend** in the 2000s is that latecomers such as companies from emerging markets became stronger and they were eager to grow through OFDI, especially via cross-border M&As (UNCTAD 2013b). During this merger wave, policy makers of some emerging markets, such as the Chinese government, also started to loosen the investment controls to encourage their companies to test the waters of the international market, which by and large triggered the considerable increase in volume of emerging markets' overseas M&As (UNCTAD 2013a). Therefore, in the 2000s, the emerging market acquirers have been increasingly active in the international market. Data shows that the share formed by them as opposed to developed market acquirers has been increasing dramatically. For instance, out of 2,585 majority acquisitions between developed and emerging economies in 2011, 20% of them were initiated by acquirers from emerging economies. [18]

2.2 The Process of a Cross-border M&A

Once the acquirer has decided to pursue a cross-border M&A, the process usually includes the following three main stages: 1) pre-deal preparation; 2) completion of the deal; and 3) post-deal integration. As shown in *Figure 2-3*, the process of cross-border M&A is similar to an M&A in a single jurisdiction. However since a cross-border M&A involves companies from different jurisdictions, it is usually more complex at each stage, especially with regard to the approvals from regulatory agencies of both the home country and host countries (Boone and Mulherin 2007).

[18] This number is based on a 2012 study of A.T. Kearney *"Emerging and Established Markets Converge"*.

Figure 2-3 Three Stages of Cross-border M&As



Source: author made based on a survey of the literature

2.2.1 Stage 1: Locate the Target: Identification, Valuation and Planning

The first move an acquirer usually makes is to identify the potential target. Identification requires a well-defined corporate strategy and focus. The first mistake some acquirers make is mis-identification. There are many (macro, industrial and firm-specific) factors concerning the acquirer when it comes to identifying the target, among which the difference of the target market from the home market should be typically the preliminary concern (Very and Schweiger 2001).

The highly developed and well-defined markets, for example the US, offer the widest choice of publicly traded firms with publicly disclosed financial and operational data (UNCTAD 2011). Acquirers who came from a similar market, such as the UK, usually do not need to invest heavily in studying the market and the financial data. However, since the emerging markets' acquirers are coming from very different home markets, they need professional advice (lawyers, bankers, policy analysts) when identifying the targets because of the lack of understanding of the host market. Under-estimating the challenges and risks in developed markets or careless choices of a target market could be the very first reason that leads to a major failure when inexperienced companies from an emerging market are acquiring targets in a developed market.

On the other hand, to acquirers from advanced markets, the emerging markets are usually less well-defined. For instance, many emerging markets present problematic investment environments, including a higher entry barrier, unreliable financial data, hard-to-understand management, a limited amount of publicly traded companies, etc. Furthermore, the institutional framework can be very different from one jurisdiction to another (UNCTAD 2011). Therefore, entering emerging markets requires additional services from specialists who can provide professional analysis in the identification of targets.

Once a desired target is found, the process of valuing the target begins. The valuation of the target is rather technical in corporate finance. In a global setting, there are a variety of valuation techniques which are widely used, each with their relative merits (Kuipers, Miller, and Patel 2009). Since valuation is not the focus of this thesis, they are not described in depth. In this thesis, only the fundamental methodologies of discounted cash flow (DCF) and multiples (earnings and cash flows) are briefly introduced when used in relative chapters.

However, it is worth mentioning that there is also a variety of industry-specific measures that focus on the most significant elements of the value in different business lines. For instance, chapter 6 explains that in the automotive industry, the methods of evaluating intellectual property and know-how are crucial when the acquirer is making a tender offer.

The relationship between valuation and the institutional environment of the target market should also be considered when evaluating a target. For instance, a target from a jurisdiction with a well-defined institutional environment is often more valuable, but should not be over-valued. For instance, in their empirical study (Kuipers, Miller, and Patel 2009), Kuipers, Miller, & Patel found evidence that foreign acquirers tend to overpay Delaware-incorporated targets due to the maturity level of the legal environment of Delaware.

A sound **implementation plan** should be made after the acquirer decides to pursue a certain target. In this planning, acquirers, together with professional experts, should plan each step of the deal up to the post-transaction integration. The plan should include negotiation, the tender offer, strategies in persuading the target, regulatory approvals and operational strategies after completing the deal. The empirical literature (Colombo et al. 2007; Erel, Liao, and Weisbach 2012) shows that a poorly designed or under-prepared plan is one of the most frequent causes of failure in later stages.

Both the valuation and the implementation plan are crucial for evaluating the synergy gains, the deal cost, and therefore the expected profit from the deal. After the acquirer decides to pursue the target based on the evaluation of the expected profit, the deal should move to the next stage.

2.2.2 Stage 2: Seal the Deal, Acquire the Approvals and Complete the Payment

This stage is the most time-consuming and complex stage in a cross-border M&A. During this stage, firstly, the acquirer should start the process of gaining support and approval from related parties. It includes negotiation with the target's management, (labour)union and shareholders; then, according to different jurisdictions, acquirers also need to acquire approval from relative government agencies (targets' jurisdiction and/or acquirers' jurisdiction). After they gain all the approvals, they can finally settle the method of payment and proceed with the payment to the shareholders.

2.2.2.1 Tender Offer and Acceptance

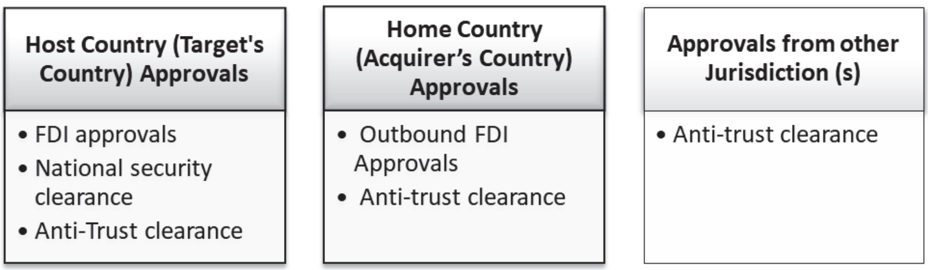
Whether the acquisition is supported or not by the target's management is often studied in M&As literature and it is crucial for a cross-border M&A as well (Chakrabarti et al. 2009; Duncan and Mtar 2006). A tender offer can be friendly or hostile. **A friendly tender offer** means that the acquirer approaches the management of the target and attempts to convince them of the business logic of the deal. If the target's management is supportive they may then recommend to stockholders that they accept the offer of the potential acquirer. Sometimes, if influential shareholders feel that the management is not taking appropriate steps to protect and build their shareholder value, either in principle or based on price, they may object to the offer directly (Rubin, Basnage, and Curtin 2006). **A hostile tender offer** means the acquirer's tender offer is not supported by the target's management but the acquirer chose to pursue the acquisition without the support of the target's management and go directly to the target shareholders (Rubin, Basnage, and Curtin 2006). In this case the tender offer is made publicly, although target management may openly recommend its shareholders to reject the offer. The board of the target can continue to take actions consistent with protecting the rights of shareholders[19]. The board may need to ensure a rather strong overview of management during this process, to ensure that management does not take action which is only consistent with their own perspective and not with protecting and building shareholder value. If enough shareholders take the offer, the acquirer may gain sufficient ownership influence or control to change the management. Namely, the acquirer has then completed a successful hostile takeover. For instance, the successful £132 billion cross-border hostile bid by British mobile phone group Vodafone for German Mannesmann in 2000, was a typical hostile cross-border takeover. However, cross-border bidders often make friendly tender offers with the primary focus on their partners (Betton, Molson, and Thorburn 2008).

2.2.2.2 Regulatory Approval

After a tender offer is accepted, the proposed deal will need to be approved by relative regulatory agencies from the host country (Bénassy-Quéré, Coupet, and Mayer 2007; UNCTAD 2013a), the home country (He and Cui 2012), and other relevant jurisdictions (Fugina 2006). A proposed deal might be withdrawn if it fails any regulatory approvals. UNCTAD's analysis (2013b) found that among 211 of the largest withdrawn cross-border M&As in the period between 2008 and 2012, there were 19% M&As that failed because of regulatory approvals.

The figure below summarises the main approvals which a proposed deal may be requested to acquire during stage 2.

Figure 2-4 Regulatory Approvals Requested during Stage 2



Source: author made based on a survey of the literature

Anti-trust Clearance

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[19] The rationale of defence strategies is to make the takeovers more costly and/or more time consuming, in such a way that the target will be less attractive due to the rise in cost of time and premium. There are several defence strategies the board can take to prevent hostile takeovers, details of these strategies can be found in Pearce, J. and Robinson, R. (2004), 'Hostile takeover defences that maximize shareholder wealth', Business Horizons, Vol. 47, No. 5, pp. 15-24.

Merger review applies to all mergers which may affect the market of a given jurisdiction regardless of the locations where the acquirers and targets have their registered offices, headquarters or production sites. It means that based on the market share of the combined business of a proposed cross-border M&A, besides the home country (the acquirer's country) and host country (the target's country), there might be other jurisdictions that have the authority to review the merger proposal, as shown in *Figure 2-4* .

Since a proposed cross-border M&A may be subject to the screening of multiple anti-trust authorities, the acquirers should take into consideration the extra time, costs and uncertainty involved in a cross-border M&A in multiple anti-trust clearances.

Internationally, the jurisdictional thresholds that determine whether any given M&A deal is subject to merger review vary from jurisdiction to jurisdiction.[20] However, the commonly used notification threshold is the size (turnover) of the combined business in a given jurisdiction. Based on the market share of the combined business, if the proposed M&A meets the threshold and subject to merger review in a given jurisdiction, the anti-trust authority will review whether the combination is likely to materially change incentives on the use of the assets, which in turn could reduce competition in the given jurisdiction. When the proposed deal promotes competition in the given jurisdiction, for instance, the combined businesses will increase efficiency in terms of higher-quality goods or services at the same or lower prices, the anti-trust authority is likely to unconditionally clear the deal in its market. However, when the anti-trust authority deems that the proposed M&A may reduce competition in a market, for instance when the post-deal business creates or strengthens a dominant player, the anti-trust authority will require the parties to provide remedies[21]. Under this scenario, the anti-trust authority may conditionally approve the deal when sufficient remedies are provided; or prohibit the deal if no adequate remedies to the competition concerns have been proposed by the merging parties.

The US and the European Union (EU) are the two main jurisdictions where the acquirers should pay attention to merger-controls (Fugina 2006). Although the US and the EU both have relatively mature anti-trust legislation and practice, the acquirers should consider the differences between the two jurisdictions. For instance, in the EU, compared to the US, a cross-border M&A is not only subject to meeting certain turnover thresholds, but also may be deemed to have a community dimension, making it necessary to make a prior notification to the EU Merger Registry (Duso, Neven, and Röller 2007; Duso, Gugler, and Yurtoglu 2007).

Extra attention should also be paid to the merger control legislation and practice in the emerging markets (Luo, Xue, and Han 2010). Due to the fact that many emerging countries lack adequate legal frameworks, they typically do not have a proper competition culture; furthermore some of them are still in the transitional phase toward market-economies and the industrial policies are still playing dominant roles. Therefore, compared to the US and EU that have mature anti-trust regimes, the emerging markets often do not have efficient anti-trust

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[20] For examples of the different notification threshold and practice of different jurisdictions, see *Report on Country Experiences with the 2005 OECD Recommendation on Merger Review,* OECD (2013). Available at http://www.oecd.org/daf/competition/ReportonExperienceswithMergerReviewRecommendation.pdf

[21] For instance, the anti-trust authorities of both the US and the EU adapt this notification threshold.

regimes and the merger review can be costly and uncertain. Therefore, merging companies face more uncertainties when their deals need to acquire anti-trust clearance from emerging countries.

The table below compared the number of completed M&As and the number of anti-trust reviews in both 2008 and 2010 in BRIC countries, the EU and the US, as well as the clearance situation of the deals. [22]

Table 2-1 The completed M&As and the Anti-trust Reviews in the BRIC, EU and US

	2008 M&As	2008 Reviews	2010 M&As	2010 Reviews	2010 Conditioned	2010 Rejected	2010 Cleared
Brazil	470	638	458	660	4%	1	96%
Russia	1608	NA	2007	4774	2%	86	98%
India	805	NA	969	NA	NA	NA	NA
China	2596	17	3379	117	1%	0	99%
EU	14797	347	14048	274	6%	0	93%
US	11329	1726	14674	1166	2%	11	98%

Source: Boston Consulting Group and INSEAD Knowledge[23]

Between 2008 and 2012, all four of the BRIC countries have revised their merger control policies and practice, the conditions for M&As in these markets have been changing in practice, especially in Russia and Brazil. Both Brazil and Russia have laws requiring companies which merge outside these countries ("foreign acquires foreign" deals) to seek clearance if there might be an indirect effect on competition in these countries or if their worldwide filing thresholds are met. Therefore, as shown in the table, the number of merger reviews are higher than the number of M&A deals both in Russia and Brazil. This indicates that Brazil and Russia have restrictive merger regulations and are largely reviewing the "foreign acquire foreign" deals. In the EU and the US, the ratio of reviewed deal to total deals was only 2% and 15%. China as a newly established anti-trust jurisdiction, in comparison to Russia and Brazil, has less restrictive merger controls. Only around 3% of M&As were reviewed in 2010. Chapter 4 will describe the details of Chinese anti-trust legislation and practice. [24]

As for the results of the required reviews, as shown in the table above, in most jurisdictions, more than 90% of deals are cleared. However, in Russia and Brazil, due to the stringent filing threshold levels, a large number of required reviews lead to the imposition of restrictions.

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[22] As merger regulations have been changing in the BRIC countries since 2008, and data on mandatory filing of the transactions with the authorities is incomplete, the figure for 2008 data are only available for Brazil , China, the EU and the US. The most comparable data for all six countries is for 2010. Data for Russia is available only from 2010. India has not yet started the reporting in 2010.

[23] Available at: https://knowledge.insead.edu/blog/insead-blog/merger-control-in-the-bric-countries-vs-the-eu-and-the-us-the-facts-2742

[24] See section 4.3.4.8 of this thesis.

Especially in Russia, only 2% of the conditioned deals led to 86 deals being rejected in 2010. This number is almost 4 times as many as in the US and 5 times as many as in the EU. Furthermore, the Russian anti-trust authorities also do not systematically publish all their decisions and neither provide elaborate justifications for their decisions. It creates considerable uncertainty on cross-border M&A deals involving the Russian jurisdiction. In the same year, the Brazilian anti-trust authority cleared most of the cases and only rejected one deal, it seems that merger control in Brazil was more an administrative filing process.

Host Country (Target's country) Approvals

The host country's regulatory approval is a powerful factor determining whether a cross-border attempt has occurred or has been withdrawn.

It is a common practice in most countries to have FDI approvals, although they vary in different jurisdictions (UNCTAD 2013a; UNCTAD 2011). The FDI approval regime is to prohibit FDI in protected industries and/or place limits on the extent of foreign ownership of certain sectors. Requirements to obtain prior approval from or notify governments, regulatory authority or other public authorities are common.

Developing countries are usually keen on retaining control of their strategic industries such as financial services, health care, telecommunications and natural resources.

For example, both Chinese and Indian FDI regimes work with a FDI approval system. Both in China and India, FDI is not permitted in sectors like lotteries, gambling, atomic energy; and sensitive industries, such as financial institutes, have caps on foreign ownership. Although the restricted and prohibited activities have been gradually liberalised over years in both countries, majority domestic ownership and prior approvals are still required before parties finalize the deals. For example, in India, *The Insurance Laws (Amendment) Bill, 2015* [25] increased foreign equity ownership limitation to 49% from 26% in Indian insurance firms, while any investment above 26% and up to the cap of 49% will require prior government approval from the Foreign Investment Promotion Board of the Government of India.

Not only developing countries adopted a FDI approval regime. Also many OECD countries use the FDI approval regime to place limits on foreign ownership in certain sectors. For example, in the airline sector, the US places a cap of 25% on foreign ownership of its airlines; for Japanese airlines the cap is 1/3; and the EU limits non-EU ownership of the airlines of its member states to 49%.[26] In the telecommunication sector, foreign ownership is restricted to less than 1/3 in Japan; in Canada, foreign investment restrictions have been lifted for companies that have less than a 10% share of the market by revenue in 2012 (OECD 2013). In natural resource sectors, exclusive domestic ownership is also often applied in many OECD

[25] Available at: http://164.100.47.4/newbios_search/sessionreport3.aspx.

[26] See *Airline ownership and control rules: at once both irrelevant and enduring*. Available at: https://centreforaviation.com/insights/analysis/airline-ownership-and-control-rules-at-once-both-irrelevant-and-enduring-345816

countries. For example, foreign ownership is banned in the fishing and energy sectors in Iceland, and in the oil sector in Mexico.[27]

The FDI approval procedures vary in different countries. In some jurisdictions, government approval must be obtained for all foreign acquisitions of domestic targets, for example in China. In some jurisdictions, foreign investors must obtain an investment licence as a qualification as acquirers. For example, in Saudi Arabia in an asset purchase, prior approval may also be needed for a foreign acquisition of land (for example, in Taiwan), alternatively, a buyer may be required to incorporate a local company to acquire such assets or shares if ownership by a foreign entity is not permitted.

It is also common that acquirer faces screening from the target country's national security agencies.

As sovereign governments, host countries have a right to take measures to safeguard their national security. Therefore, most countries' investment policies address national security concerns. However, in practice few governments clarify or attempt to define what they mean by "national security", but rely on some form of general or security-related investment screening approach and largely on a case-by-case basis.

The below table shows that the national security screening regulations of major economies in Europe, Asia and North America.

Table 2-2 General or Trans-Sectoral Measures with a Bearing on Essential Security in the major economies

Country	**Limited to certain sectors/ activities?**	**Nature of screening**	**Criteria for granting/ denying authorisation**	**Observations**
France	Yes	Security	Public order, public security and the interest of national defence	A notification requirement applies. The extent of this requirement, and the definition of sectors, varies in accordance with the EU or non-EU origin of the investor
Germany	Yes[28]	Security		A notification requirement applies
China	Yes	General	National economic security	Includes screening rights in case of "major industry" or the risk of transfer of "famous trademarks or traditional brands"
Japan	Yes	Security	National security, public order and public safety	An ex ante notification required where issues of security, order or safety are likely to arise.
Korea	No	Security	Essential public	Government may intervene in case of "clear

[27] Although not specifically aimed at excluding foreign shareholders, statutory state monopolies are tantamount to a ban on foreign investment.

[28] The German screening is limited to the production of "war weapons" as defined by separate legislation.

			interests	evidence" of a threat.
United States	No	Security	Credible threat to national security	The President may intervene if other laws do not provide adequate authority.

Source: OECD*, International Investment Perspectives: Freedom of Investment in a Changing World, Paris 2007*, p. 61.

As shown in the table, the major economies have a national security screening mechanism, national security agencies may reject the cross-border M&A deals in the name of the potential threat of national security. In some countries, such as in Korea and the US, government and the president can directly intervene in case the national security agency does not have the adequate authority.

Home Country (Acquirer's Country) Approvals

The home country investment approvals aim at controlling the scope and direction of outbound investment as well as to strengthen macro-economic guidance of the home country. In countries which have an approval mechanism, the regulatory agency usually "selectively" approves the cross-border M&As which are believed to enhance the international competitiveness of certain industries and sectors or to support the country's overall development. Both India and China have a history of controlling outbound FDI (OFDI) [29], especially overseas M&As. Since the 1990s, both countries have gradually liberalized the outflow of FDI. However, both India and China still have regulatory controls over their outbound FDI to some degrees.

China's OFDI approval system is a classic example. Prior to finalizing a cross-border M&A deal, besides the FDI approvals Chinese acquirers have to obtain from host country regulatory agencies, they also have to get approvals from Chinese regulatory agencies when the deal falls into the criteria. Although the Chinese policy makers have liberalized the criteria significantly over the years, up until now, the approvals regime is still in place to screen OFDI projects, including Chinese OMAs. Acquirers, whose home country is like China, which has an OFDI approval mechanism inevitably are influenced by the approval procedure and may face more uncertainties regarding their OMAs.

For instance, in the light of the fast growth of Chinese OFDI, there is a growing interest in studying the influence of the Chinese OFDI policy on Chinese OFDI (Buckley et al. 2007; He and Cui 2012). This thesis is especially interested in analysing how the Chinese OFDI institutions (policy, law and regulations) influenced the Chinese overseas M&As. It seems that on the one hand the Chinese policy makers expect that a pre-selection of the OFDI projects can avoid some failed projects due to the fact that Chinese companies lack OFDI experience (Davies 2013); on the other hand, the policy makers expect to guide the OFDI in favour of domestic economic development. Chapter 4 of this thesis provides a detailed study of the Chinese FDI regulatory regimes and Chapter 5 provides a detailed analysis of the potential influences of the Chinese OFDI regulatory regime on the peculiarities of Chinese OMAs.

[29] For an overview of India's OFDI approval mechanism changes, see *Outward Foreign Direct Investment from India: Recent Trends and Patterns,* Pradhan, Jaya Prakash, 2005.

2.2.2.3 Settling Payment

After the deal has acquired all necessary approvals, the acquirer must proceed with the payment. The shareholders of the target company are usually paid either in cash or in the shares of the acquiring company, or a combination of the two. A variety of factors go into the determination of the method of payment. The availability of cash, the size of the acquisition, the friendliness of the takeover, and the relative valuations of both the acquiring firm and target firm affect the decision (de La Bruslerie 2012). From a taxation perspective, if a share exchange occurs, which may be defined by some ratio of acquiring company shares to target the company, the stockholder is typically not taxed. The shareholder's shares of ownership have simply been replaced by other shares in a non-taxable transaction. If cash is paid to the target company's shareholder, it is the same as if the shareholder has sold the shares on the open market, resulting in a capital gain or loss with tax liabilities. Therefore, shareholders are typically more receptive to share exchanges if they prefer choosing whether and when tax liabilities will arise. And when shareholders lack a cash flow or their sales of shares do not yield capital gain, shareholders then prefer a cash payment.

Furthermore, in cross-border M&As, the choice of payment can be rationalized in a different way due to other factors (Dutta, Saadi, and Zhu 2013). For instance, the uncertainty of the regulatory approval and its impact on the share prices of the two firms can be very destructive. If one of the regulatory approvals mentioned above drags out over time, the possibility of a drop in share price increases and can change the attractiveness of the share swap, while on the other hand it increases the attractiveness of cash payment. This factor is especially important in cross-border M&As compared to domestic M&As when the acquirer and target are not familiar with each other and uncertain of each other's regulatory environment. The method of payment is also time-sensitive in cross-border M&As (Dutta, Saadi, and Zhu 2013). One of the major drivers of cross-border M&As growth in 1999 and 2000 was the high levels of equity values. Many MNEs found the higher equity prices allowed the acquirers to afford more M&As. This allowed them to bid higher for potential targets and then pay with their own shares. It was a quite different time in the 2008 financial crisis, which allowed what the financial press termed "shopping sprees" of cash rich acquirers in the western world. For instance, Chinese acquirers that have available cash become more attractive when the targets are short of cash during the 2008 crisis[30].

2.2.3 Stage 3: Post-deal Integration- Business and Culture

In a cross-border M&A, the acquirer intends to make a profit by managing the acquired business for an extended period, either as a separate subsidiary in a holding company or by merging it into another business[31]. Therefore, although the first two stages are very important for the acquirer, the third stage is probably the most critical stage in determining an acquisition's ultimate success or failure. An acquirer might have made an excellent or poor choice in identifying a target, it may have overpaid or underpaid the target, but if the post-

[30] For a detailed analysis about Chinese OMAs in the western economies, see Chapter 3 of this thesis.

[31] In this thesis, non-financial acquirers are mainly featured. Financial acquirers, who acquire a target for eventual resale, usually do not integrate the acquired business. Rather than manage the business, they are inclined to monitor the effectiveness of current management and intervene only if there is a significant and sustained deviation between actual and projected performance.

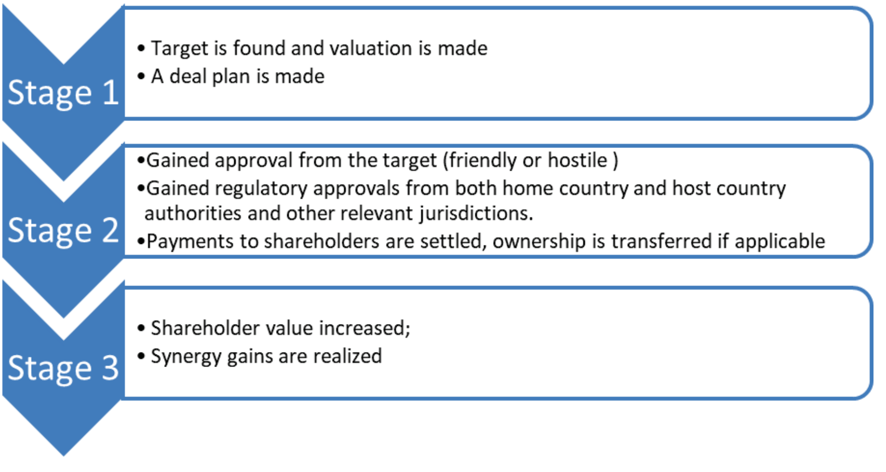
transaction is managed effectively, it can still change the game. Poor post-deal management however may cancel all the previous effort and the deal may turn into value destruction for the acquirer (Sudarsanam and Mahate 2003; Arshad 2012).

Post-deal management is the stage in which the ultimate goal for the transaction should be realized. The expected synergy gain from more effective management, or the injection of capital, etc., should be realized from carefully implementing the deal planning after the transaction. Research found that the biggest challenge faced by a post-deal management is nearly always the merging of corporate cultures (Chakrabarti et al. 2009; Reus 2012). To merge the corporate culture requires careful organizational integration and cross-border cultural integration (Ahern, Daminelli, and Fracassi 2012). In cross-border M&As, the clash of corporate cultures and personalities poses both the biggest risk and the biggest potential gain (UNCTAD 2000b; Hopkins 1999). Some research develops the models to measure the loss and gains caused by cultural or management style clash in cross-border M&As (Schoenberg 2004). However, since it is not as measurable as price/earnings (P/E) ratios or share price premiums, in the end "the value is either gained or lost in the hearts and minds of the stakeholders"[32].

2.2.4 Outcome at Different Stages of a Cross-border M&As

Due to the complexity of a cross-border M&A as reviewed above, the deal can go wrong at any stage. The figure below summarizes the positive outcome of each stage of a cross-border M&A.

Figure 2-5 Success of each stage



As shown in Figure 2-5, in the first stage, if an acquirer fails to identify a desirable target then they may terminate the initiative, or the acquirer may fail to pursue the target due to the valuation outcome. The deal should only be moved to the second stage if the target is

[32]Available at: http://wps.aw.com/wps/media/objects/5315/5443332/Chapter_WEB.pdf

desirable and the deal is profitable based on the valuation. There are deals that failed at the later stages because of misguided identification of the target. Finding the right match is the first and most important success in the long journey of a successful cross-border M&A.

In the second stage, the cross-border M&As attempt can be abolished by either the acquirer or the target. For instance, a friendly tender offer might not be accepted by the shareholders, or a hostile tender offer may be successfully defended by the management of the target. Even a pre-agreement which was agreed by both parties may be breached later on by one of the parties, while the acquirer or target country government agency may disapprove of the deal because of national security concerns or political reasons (UNCTAD 2013a). For instance, a famous failed cross-border M&A attempt, due to a failure to obtain merger approval from a competition authority, was the acquisition of Honeywell international by General Electric (GE) in 2001. GE's acquisition of Honeywell had been approved by management, a shareholder of Honeywell, and U.S. regulatory bodies but failed in the final approval of European Union competition authorities (Nalebuff 2004). In an emerging market such as China, an antitrust authority may also veto a cross-border M&A at the last stage, such as the disapproved acquisition of Huiyuan International by Coca Cola in 2008 (OECD 2011, 335). Additionally, government approval procedures in emerging markets turn out to be more bureaucratic, although emerging markets in general are trying to streamline the approval process, and the complicated and time-consuming administrative procedures are still considered a negative factor influencing the attractiveness of a certain jurisdiction (UNCTAD 2013a).

UNCTAD (2013) found that most governments, as host countries, are willing to attract and facilitate cross-border M&As as a means of sustainable development. However, at the same time, numerous countries reinforce the regulatory environment for FDI, make more use of industrial policies in strategic sectors, tighten screening and monitoring procedures, and closely scrutinize cross-border M&As. UNCTAD (2011) analysed 211 of the largest withdrawn cross-border M&As, with a transaction value of $500 million or more, in the period between 2008 and 2012. Within this group, they found that although most withdrawn cross-border M&As were because of business considerations (81 percent); the bulk of the remaining M&As failed because of regulatory reasons or political opposition.

In the third stage, after a cross-border M&A deal has been completed, it is time to test whether the goal of the cross-border M&A is realized, that is to say whether the deal realized the expected synergy gain and increased shareholders' value. When the acquirer is a private company, whether the synergy gain has been realized depends on whether the investment generates positive returns. Therefore, whether a net present value (NPV) of the investment is greater than zero will be a clear sign of success. The higher the NPV, the more successful the investment is. Accounting data eventually confirms the outcome of the cross-border M&A. The following equation demonstrates how the NPV is calculated.

Equation 2-1 NPV of a Cross-border M&A

NPV= Present value (PV) of the future investment gains - investment costs (IC)

However, it is more complicated when the acquirer is a publicly traded company due to the fact that publicly traded companies succeed or fail by means of their share price. Since the acquirer's share price is a combination of the earnings of the firm and the market's opinion of those earnings, the price-to-earnings multiple, the management must strive to grow both. A well accepted indicator of a successful deal made by a public firm is whether the shareholders' value has increased due to the deal. In a successful cross-border M&A, the share price of the acquirer should have increased, compared to the price if the cross-border M&A had not happened. Event study which is introduced in section 2.5.2 is based on this benchmark. The below equation shows how the share price (Price) is computed.

Equation 2-2 Price

$$Price = EPS * \left[\frac{P}{E}\right]$$

The problem is that the management only have direct influence on earnings per share (EPS), but no direct control of price and earnings ratio [P/E]. Theoretically, the P/E ratio is supposed to be a reflection of the reality in an efficient market, because the analysts, investors, and institutional stakeholders in an efficient market will look at the ability of the management to deliver on the promises made in meetings, advertisements, annual reports, news and at the stockholders' meetings; they will judge the performance of the cross-border M&As by the previous management and the merit of the deal. However, the opinion of the market as reflected in the P/E ratio is rarely precise. Therefore judging the performance of a cross-border M&As only from short term stock market return is not the perfect benchmark, but rather the most easily available one (Duso, Gugler, and Yurtoglu 2010). The literature on methods of evaluating the performance is reviewed in section 2.4. The blend of factors that may contribute to a successful post-transaction success will be reviewed in section 2.4 as well.

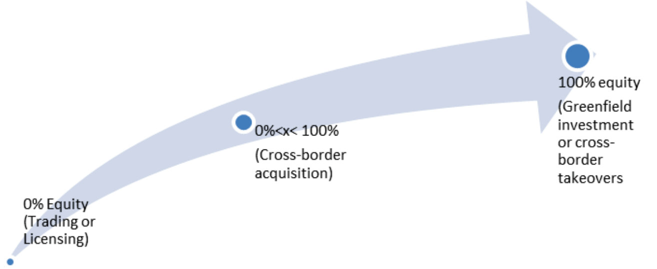
2.3 What Drives Cross-border M&As?

What is the ultimate goal when the acquirer's manager initiates a cross-border M&A? Neo-classical theory sees M&As as an efficiency-improving response to various industry shocks caused by institutional changes, such as antitrust policy or deregulation (Mitchell and Mulherin 1996). An extensive body of literature has suggested that cross-border M&As are also an efficiency-improving strategy to enter into or expand in a foreign market (Barkema and Vermeulen 1998). These studies argue that firms should engage in cross-border M&As primarily to enhance their market power and gain efficiency globally (Barkema and Vermeulen 1998). Therefore, according to neo-classical theory, in the globalized economy, a cross-border M&A is a way to allocate resources efficiently in the international market in order to build a firm's international competitiveness. From the corporate finance perspective, the neo-classical theory is incomplete. These studies argue that cross-border M&As are the same as any other corporate investment strategies: to build shareholder's value. A stock market driven cross-border M&A is usually initiated by rational managers to take advantage of the inefficient stock market (Shleifer and Vishny 2003). This section reviews the literature on the theories and empirical evidence concerning the motivation for cross-border M&As.

2.3.1 Theoretical Arguments – Mode of Entry and Expansion in a Foreign Market

When a firm wishes to enter or expand into a foreign market, it has two general options: non-equity-based mode of entry or equity-based mode of entry, as shown in *Figure 2-6* (Davis, Desai, and Francis 2000; Kang and Johansson 2000). Within non-equity-based modes, the choices are between contractual agreements (i.e. licensing) and trade (Pan and Tse 2000) ; while within equity-based modes, the choices are between wholly owned subsidiaries through Greenfield investments and equity joint ventures through cross-border M&As (Buckley & Casson, 2007). The literature summarises the entry mode as a governance structure that varies in the degree of ownership structure from level zero (trading, licensing) to level 100% (Greenfield investment, cross-border takeovers). The ownership structure of cross-border M&As is in between the non-equity investments and the Greenfield investments.

Figure 2-6 Relationship between Entry Mode and Ownership Structure



Source: author made based on literature

When allocating resources in the international market, a firm's choice of entry mode is crucial, as each entry mode has its advantages and disadvantages. When should the firm choose the equity mode over the non-equity mode? Within the equity modes, when should the firm choose a cross-border M&A over a Greenfield investment? The section introducing the literature explains how firms choose the entry mode on the international market. The theoretical foundation of this strand of literature is based on transaction cost economics (TCE) (Williamson 1994; Williamson 1985) and OLI (ownership, location, internalization) theory (Dunning, 1980, 2000). Both theories are mostly used to explain the driving forces of a firm's choice in changing its governance structure domestically and internationally (Vernon 1979; Buckley et al. 2007; Buckley and Casson 2003).

2.3.1.1 Transaction Cost Economics

TCE suggests that the decision of a firm regarding whether to undertake an activity within a firm's own boundaries rests on the level of transaction cost[33]. When the transaction cost level

[33] Transaction cost is the cost incurred in making any economic exchange. A number of different kinds of transaction cost exist. Transaction cost consists of cost incurred in searching for the best party, the cost of establishing a "perfect" contract, and the cost of monitoring and enforcing the implementation of the contract.

is too high to contract with other firms, the firm is in favour of hierarchies (Williamson 1994). Therefore, according to TCE, in an imperfect international market, whether a firm enters the foreign market through internalization within its own boundaries (equity-based mode such as vertical merger) or through contracting with another party (non-equity-based mode such as trading) depends upon the level of transaction cost involved in each entry mode (Hijzen, Gorg, and Manchin 2005). According to TCE, firms maximize their profits by economizing the transaction cost on an imperfect market. Therefore, risk averse firms may start to enter the foreign markets from the non-equity mode, such as trading, given that the transaction cost (TC) could be high because of the imperfection of the market, such as agency costs and incentive contracts (M. M. C. Jensen and Meckling 1976; Holmstrom and Kaplan 2001). However, when the non-equity mode of entry encounters sudden TC increases, such as a tariff-jump which makes trading too costly, firms are more likely to consider FDI as an alternative mode to enter the foreign markets (Buckley and Casson 2007; Buckley and Casson 2003). The factors which encourage firms to switch from trading to FDI include: trade barriers such as a tariff-jump and transportation cost jump; the problem of inadequate foreign market information; asymmetries in information between trading parties; and other transaction cost-increasing conditions. Thus, firms try to minimize the transaction cost by directly investing within the target markets, taking an opportunity to expand the business by directly operating in the target country. In this case, the equity mode is more "transaction cost economizing"[34]. Using TCE theory to explain the entry mode change has been formalized in theoretical models by Brainard (1997)[35].

2.3.1.2 Ownership, Location, Internalization (OLI)

Another popular theory in explaining entry mode is the OLI paradigm. The OLI paradigm has been popular since the 1980s and it has been used to explain the determinants of FDI and MNEs' other international activities. OLI means ownership, location and internalization. According to OLI, an equity-based mode of entry is favourable in comparison to a non-equity-based mode if a firm enjoys advantages in ownership, location and internalization. **Ownership (O)** advantage means specific capital (knowledge capital) advantages such as human capital, patent, know-how, brand and business reputation. Knowledge capital can be replicated in different countries without losing its value, and easily transferred within the firm without high transaction cost. **Localization (L)** advantage means a firm which enjoys special advantages provided by the location, such as producing close to final consumers or downstream customers, saving transport costs, obtaining cheap labour and materials, jumping trade barriers and providing services. **Internalization (I)** advantage means the equity-based modes internalize some contracting risks such as transferring the specific capital outside the firm and revealing the proprietary information.

The OLI paradigm suggests the greater the O and I advantages possessed by firms and the more L advantages the firms can acquire from other countries, the more likely it is that the

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[34] Williamson, 1985, The Economic Institutions of Capitalism - Transaction Cost Economics , p.41

[35] However, when companies choose the equity mode and produce locally they would lose the benefit of the "products of origin". Therefore, when calculating the cost benefit of producing locally, companies should take into account of whether the cost benefit would be cancelled due to the absence of the benefit gain from "products of origin".

equity-based mode will be chosen. Where firms possess substantial O and I advantages but the L advantages favour the home country, domestic investment will be preferred and foreign markets will be entered by non-equity-mode, such as export.

The OLI paradigm therefore implies that outward FDI tends to take place among a small group of predominantly rich countries where firms possess O and L advantages but are looking for I advantages outside their home countries. This paradigm explains why the OECD countries represented 90% of outward cross-border M&As in the 1990s (Kang and Johansson 2000).

2.3.1.3 International Management Theories

The above mentioned studies which explain the driving forces of FDI (Buckley & Casson, 1998; Dunning, 2000) have limitations in explaining the driving force for cross-border M&As, because they fail to distinguish the difference between Greenfield investments and cross-border M&As. As Neary (2009) concludes, previous studies implicitly assume that Greenfield FDI accounts for the majority of total FDI, therefore these FDI theories are mainly based on the theories of Greenfield FDI. However, cross-border M&As are different from Greenfield investments. Greenfield investments are the highest equity based mode of entry, though the firm will have the highest control but will also have the highest costs in establishment and operation (Dunning & Rugman, 2011) . The “liability of foreignness” (Hymer 1960) is high and uncertain. Therefore firms who choose Greenfield investments should have strong asset specific advantages and aim to expand them to a foreign market (Harzing 2002). An acquirer who conducts a cross-border M&A deal would have less control over the assets, even if it’s a 100% takeover, compared to a Greenfield investment. However, a cross-border M&A allows the acquirer to have access to the target firm’s knowledge-assets such as brand, technology, market and management, which is not a goal of a Greenfield investment. Cross-border M&As in general have more sophisticated motivation.

Aware of the disadvantages of the TCE and OLI theories in explaining motivations of cross-border M&As, researchers in international management developed theories by differentiating the driving forces between Greenfield investment and cross-border M&As. In this strand of literature, researches focus on the motives at firm level rather than just at home country level[36] . Firms enter or accelerate their internationalization process by engaging in cross-border M&As. Some deals primarily aim to strengthen their market position and expand their market; as such they are market-seeking cross-border M&As; some deals primarily seek useful resources such as natural resources and complementary intangible assets, they are resource-seeking cross-border M&As; some deals seek to realize efficiency gains by restructuring their businesses on a global basis, they are efficiency-seeking M&As (UNCTAD 2000a).

In order to better understand the motivation of cross-border M&As, it is necessary to combine the theories of TCE, OLI and international management. The next section reviews the main driving forces of cross-border M&As in marrying these three strands of literature.

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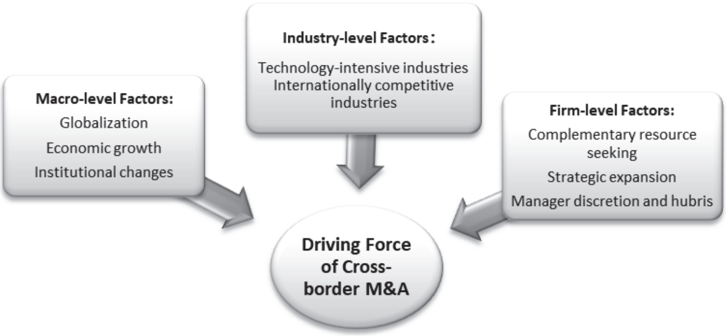
[36] See Mode of International Entry: An Isomorphism Perspective, *Journal of International Business Studies*, vol. 31, no. 2, 239-258),

2.3.2 Driving Forces of Cross-border M&As in the Literature

Based on the literature, the main driving forces of firms involved in the cross-border M&As can be classified as follows: macro-level factors, industry-level factors and firm-level factors (Hijzen, Gorg, and Manchin 2005). This section will explain each of these factors. The figure below shows an overview of the factors driving cross-border M&As.

Figure 2-7 Factors Driving Cross-border M&As



Source: author made based on literature

2.3.2.1 Macro-level Factors

Globalization

Globalization means "fast and continuous inter-border flow of goods, services, capital (or money), technology, ideas, information, cultures and nations" [37]. That is to say that globalization means interconnection among people, corporations, information, economies and nations etc. Globalization is enabled by the development in transport, communications, and information technologies.

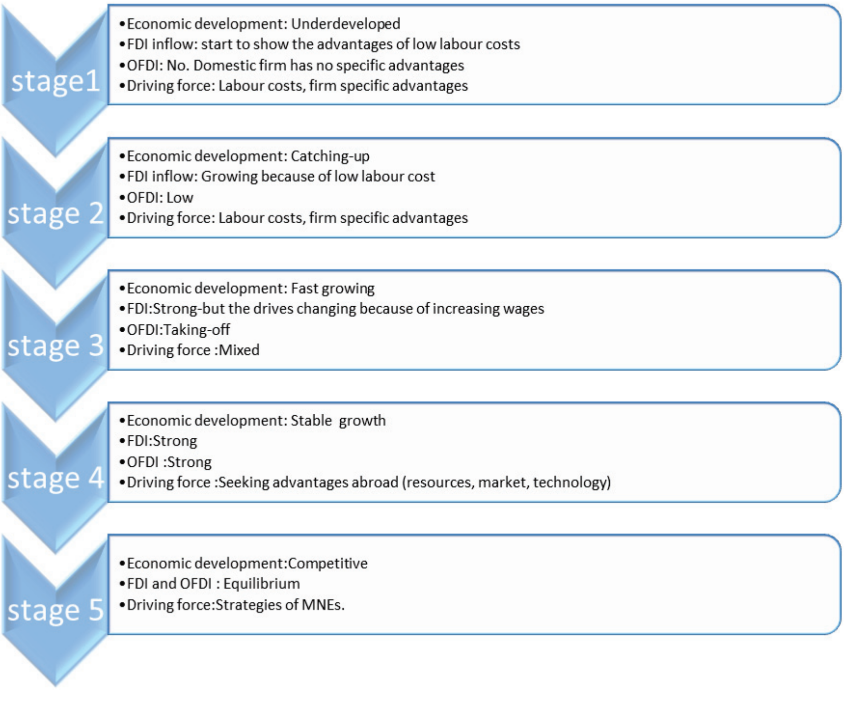
How does globalization drive the cross-border M&As? In an ever-global economy, firms need to compete with international competitors. At the same time, globalization gives firms the opportunity and flexibility to allocate their resources to wherever they can make the most value of them. Therefore, the cross-border M&As is a natural outcome of globalization (Evenett 2003). In the globalized economy, firms from developed countries have been seeking scale, and access to lower production costs through cross-border M&As; the emerging markets start to be more active as well, in seeking resources, market and advanced intangible assets. Cross-border M&As from emerging markets have increasingly become the corporate trend from the 2000s, and the trend was enhanced in the late 2000s because of the 2008 financial crisis (Godement, Parello-plesner, and Richard 2011; Sun et al. 2012).

[37] This definition is from the American Defense Institute.

Economic Growth

Many FDI theories explain the relationship between economic development, competitiveness and FDI (Ozawa 1992; Dunning 2000). These theories could be applied in explaining the relationship between economic growth and cross-border M&As as well. Dunning's five stages of FDI theory argue that the FDI pattern is closely related to the economic growth of the country. Figure 2-8 summarizes the relationship between a country's economic growth stage and firms' choice of FDI strategy and the drivers.

Figure 2-8 Framework of Dunning's Five Stages of FDI Theory



Source: author made based on Dunning (2000)

Based on the five stages theory of FDI, we can explain the influence of economic growth on the cross-border M&As. When a country's economy becomes stronger, for instance from stage 3 onward, both the supply and demand for cross-border M&As are influenced. On the one hand, a steady economic growth in the host countries increases the profitability of the firms after cross-border M&As (such as developed countries at stage 4 and 5). That is the reason that countries such as the US and the UK have been playing the most important role in attracting investors to engage in cross-border M&As. On the other hand, the growing internal market and standard of living in home countries (at stage 3 and 4) increases the overall earnings of domestic firms and equity. As a result, firms increase the available capital for investment abroad, which explains the increasing appetite of emerging economies' acquirers since 2000. Furthermore, firms have been gaining specific advantages and competitiveness over time in terms of economic growth; these advantages enable the firms to engage in cross-border M&As in order to explore their advantages by expanding the market or acquiring complementary resources abroad. Emerging economies' economic growth provides good examples to link the relationship between economic growth and cross-border M&As activities. For instance, China has been rapidly developing to the 3rd and 4th stages since the late 1990s. Due to the growth of the domestic economy, Chinese companies have grown stronger; they are eager to explore the international market. Therefore, Chinese acquirers emerged quickly from the 2000s seeking targets in international markets. [38]

Institutional changes

According to neo-institutional economics (NIE), institutions, formal and informal, can reduce the costs of social interaction (North 1990). Therefore, changes in institutions can be a strong factor motivating economic players to undertake certain business activities. In studying firms' internationalization, more and more studies adapt NIE to explain MNE's internationalization strategy (Kaufman 2003; Mishra and Daly 2007; Georgieva, Jandik, and Lee 2012).

In line with globalization, and the development of regional economies, many countries give up the so-called nationalist and protectionist forces that complicate or even prohibit some types of cross-border transactions. Instead, a trade liberalization and deregulation trend is initiated to benefit the free flow of capital and goods, thanks to the elimination of many barriers to trade. The changes in the institutional environment in both home countries and host countries have manifested the influence on cross-border M&As (Coeurdacier, Santis, and Aviat, 2009; Cosh, Hughes, Lee, and Singh, 1989; Georgieva, Jandik, and Lee, 2012; Kiymaz, 2004).

The deregulation in the EU is a good example of host country institutional change. Traditionally, industries such as energy, banking, and transportation are viewed as critical to a country's infrastructure in continental Europe. However, along with the deregulation movement within the EU, there have been many targets in those industries involved in cross-border M&As, especially pre- and post- financial crisis period, many European infrastructures were opened for foreign acquirers. At the same time, deregulation and relaxation of capital control in the home country are also powerful factors which trigger more free movement of capital. For example, as a home country, China has been removing a series of overseas investment barriers since 2000, and the Chinese government started the go-out policy, encouraging and facilitating Chinese firms to participate in globalization. The boom in overseas investment is the evidence of the effectiveness of institutional changes. [39]

2.3.2.2 Industry-level Factors

Technology-intensive Industries

[38] Chapter 3 explains in depth the emergence of Chinese overseas M&As.

[39] Chapter 4 explains in depth the role of institutional changes in China.

The main motivation of firms to engage in cross-border M&As is to enhance their market power and gain efficiency globally (Barkema and Vermeulen 1998). Therefore, acquirers intend to access the target's assets which are valuable to the acquirer, such as production capabilities or intangible assets (Jovanovic and Rousseau 2002). This is particularly true in the horizontal cross-border M&As[40], when both the acquirer and the target are competitors, and the acquirer's technology is less advanced than that of the target. One of the main motivating factors of firms in a technology intensive industry that engage in cross-border M&As is to gain access to the more advanced technology owned by the target company (Bertrand and Zuniga 2006).

Empirical evidence also shows that in cross-border knowledge building, MNEs is the superior form compared to alliances and the markets (Almeida, Song, and Grant 2002). Therefore, industries which are technology-intensive have more M&As transactions. With regard to cross-border M&As, when the developing countries' acquirers are interested in targets in developed countries, many deals are driven by filling the gap in the technology between the acquirer and the target. Therefore, companies in many developing countries set their eyes on targets in the automobile and IT industries from developed countries. For instance, this is true when the Chinese acquirers are acquiring OECD countries' targets (Deng 2009).

Internationally Competitive industries

Since the 1990s, much of the mega cross-border M&As have taken place within the same industry for the purpose of restructuring. These kinds of unions also tend to be concentrated in a few major industries, such as petroleum, automobiles, finance and telecommunications. One of the explanations is that these industries are the ones that face more pressure from international competition. Since the 1990s, in line with globalization, industries face fierce pressure because of a global basis deregulation (e.g. in finance), technology development (e.g. in IT), market access (e.g. in telecommunications) and falling prices (e.g. in petroleum). These industries therefore have to focus on their core business and they are driven to acquire the same industries through cross-border M&As on a global scale to secure their market position and improve their international competitiveness (Kang and Johansson 2000).

2.3.2.3 Firm-level factors

Complementary Resource Seeking

Resource seeking firms are interested in acquiring the resources which are complementary to their own resources because it is neither possible nor efficient to develop these resources by themselves, such as advanced know-how, more skilled labour, complementary products and famous brand names. On the contrary, in the case of firms which have resources with competitive advantages in the foreign markets, firms would wish to have control of these resources and they tend to choose Greenfield investments over cross-border M&As (Eapen and Hennart 2005). Furthermore, unlike Greenfield investment, which could be driven by tangible resources such as natural resources in the host country, the resource seeking cross-border M&As may be mainly intended to access the intangible resources of the target (Eun, Kolodny, and Scheraga 1996).

[40] See section 2.1.1.1 for the definition of horizontal cross-border M&As.

The production-enhancing resources of the targets, such as manufacturing technologies (for example know-how and patents) or more skilled labour, can involuntarily spill over to acquirers. Meanwhile, based on Fischer & Harrington's (1996) theory retail and service firms can benefit from heightened demand caused by resources combining with no explicit spill-over effects. Therefore, in general, firms with low resources engage in acquiring higher resources (complementary to firms' low resources), hoping that either they can acquire access to the complementary resources, or the high resources in the targets could spill over to their advantage to some degree.

International Expansion Strategies

Nevertheless, entering a foreign market is driven by a firm's international expansion strategies. As explained in section 2.1, after firms have established competitiveness domestically, their managers desire global growth as a strategy to build more value for their stakeholders. In general there are two types of firm international expansion strategies: Global strategy and Multi-domestic strategy (Harzing 2002).

Therefore, firms' international strategies vary according to the different circumstances each firm faces. Global strategies mean that they focus on increasing the firm's competitiveness globally; firms focus on the expansion of business scope in a global market and on benefitting from the economics of scale. A global strategy requires efficiency, and as a result these companies integrate and rationalize their methods to produce standardized products (Harzing 2002). For example, McDonald's and Starbucks' international strategy is opening standard chain shops in every corner of the world. Whereas multi-domestic strategies mean that firms focus mainly on domestic-level competition when they are in the host markets, although firms might experience some level of global competition as well. The company can be characterized as a decentralized network. The production and service could differ from one market to another because in order to win the local competition, subsidiaries are allowed to be very responsive to the local market, for instance the expansion of telecommunication companies. Based on these differences, Harzing's empirical evidence proves that firms pursuing the multi-domestic strategy are more motivated to engage in cross-border M&As.

The Manager's Incentive

As mentioned in section 2.1, sometimes the managers' incentives to initiate and complete the deals are the major drive of cross-border M&As. Empirics (Gugler et al. 2003; Gugler et al. 2010; Roll 1986) show that a considerable number of M&As have been strongly driven by managers. A deal may happen because of the manager's hubris, over-confidence (Billett and Qian 2008; Raghavendra Rau and Vermaelen 1998; Roll 1986) or the intention could be self-interest seeking.

Roll (1986) suggested that acquirers' managers who have repetitive M&A experiences are more likely to be motivated to initiate another deal. Raghavendra Rau and Vermaelen (1998) suggest glamour acquirers' managers have more confidence in the belief that they are more capable of closing a deal and managing the targeted firm more efficiently post-deal. Therefore, this type of managers has strong motivation to convince the shareholders to agree to the cross-border M&As. Empirical evidence also shows that when managers suffer from hubris and over-confidence, the deals, more often than not, are not based on sound economic rationales.

Another problematic incentive of a manager is self-interest. Some of the acquirers' managers are motivated to conduct the deal because of their own interest in terms of tangible or intangible gains. Firstly, empirical evidence shows mergers have a net positive effect on managers' compensation (Bliss and Rosen 2001). Bliss and Rosen found that the bigger the firm becomes the more financial gains for the manager. Besides, managers might be driven to undertake a glamorous deal for intangible gains. Cross-border M&A deals are highly technical and sophisticated business activities, managers might try to make the deals happen in order to enhance their own prestige and self-fulfilment.

Companies which have strong corporate governance are less likely to suffer from their managers' hubris or self-interest seeking. However, in companies with weak corporate governance, the managers have an easy path in overlooking the shareholders' value and in implementing their overconfident cross-border M&As strategies or by conducting the deal to maximize their own interests.

Other Firm-level Factors

There are also some empirical studies which show other firm-level factors that might motivate cross-border M&As. For instance, **risk-spreading** (Vasconcellos and Kish 1998), by following the rule of "never put all your eggs in one basket", firms acquire companies in other economies based on the premise that the "co-variance of industry that returns across economies is likely to be smaller than within one economy"; **time pressure**, namely that if firms see an opportunity in a foreign market and the timing is a crucial factor for success, then firms may be motivated to enter the market through acquiring a firm in the market (Hennart and Park 1994).

2.4 The Completion of Cross-border M&As

2.4.1 The Termination of the Deals

Indeed, many factors, legitimate or not, motivate companies to pursue cross-border M&As. However, since there are various elements which may lead parties to withdraw the deals, a great number of the motivated cross-border M&As are not eventually completed. In many cases, parties terminate their negotiations or even agreements at some point in the deal making, either voluntarily or by force of circumstances.

The percentage of terminated deals is hard to track precisely since the data of attempted deals are not widely available. Therefore, there are only a small number of empirical studies in the literature that investigate the termination of deals at stage 2. Some finance studies attempted to provide an impression in their research. Holl and Kyriazis (1997) suggest that UK firms abandoned up to 25% of their acquisition attempts (both domestic and cross-border) during the 1980s. [41] On a world-wide level, the average rate of failed M&As deals was 31.3% during the period of 1982-2009, this number is much higher in some emerging countries, for instance, China 48.8%, Russia 41% (Zhang and Ebbers 2010).

[41] The UK is known as the most open and non-protectionist market in the world, so are UK bidders.

As briefly discussed in section 2.1.1, an acquirer and the potential target may “break-up” at any point at stage 2 under various circumstances, for instance the following reasons are common in the cross-border M&As field.

1) The deal was withdrawn by one party due to sentimental reasons and cultural differences even though the deal might have been profitable. For example, in the case of the Telia–Telenor merger, the merger agreement was signed and approved by relative government agencies, but the merger was aborted in the end because the Swedish Telia was unable to bear the political control of Norway (Fang, Fridh, and Schultzberg 2004). 2) The acquirer may withdraw their tender offer because of an anticipated negative outcome to the tender offer. The withdrawn bid of Haier on Maytag is an example. Haier Group, China's biggest home appliances producer attempted to buy the US-based Maytag Corp, the then third-largest home appliance producer in the US in 2005. But Haier withdrew the tender offer before Maytag gave feedback. The main reason was believed to be that Haier did not want to join a bidding war (OECD 2008b). 3) In a hostile takeover, the target management successfully resists a hostile takeover or negotiates a friendly solution with the bidder. For instance, in 2006, the German truck-maker MAN AG launched a €10.3bn hostile offer to acquire Scania AB, a Swedish truck maker. Scania's management successfully resisted the bid of MAN. MAN AG later was forced to withdraw its hostile offer. But later on in 2008 MAN adopted a much friendlier approach and increased their voting rights in Scania up to 17%.[42] 4) An adverse ruling by governmental approval agencies is another common reason that leads to a breach of the cross-border agreement (OECD 2011). For instance, before the hostile takeover attempt from MAN, Volvo had tried and had reached agreement with the management to acquire a majority share in Scania in 1999. Volvo was to buy a 49.3% stake in Scania for $7.5 billion, which would have created the world's second-largest truck producer. However the anti-trust authority in the European Union (EU) blocked the deal with the reason that the deal would create a company with almost 100% market share (Case No COMP/M.1672 – Volvo/Scania 2000).

2.4.2 The Consequences of Uncompleted Deals

When deals are called off, both the acquirers and the targets usually try to “pretend” nothing has really changed in terms of shareholders’ welfare, but most “break-ups” generate suspicion on the market to some extent. It is true that some of the abandonments would not incur any monetary compensation, but in fact, most failed transactions have immediate financial consequences.

The acquirers have often already paid a considerable amount of non-returnable costs during the first stage in identifying and valuating the target, as well as in negotiation. Withdrawing

[42] For the details of the bid process, see *Battle For Scania Assumes National Overtones*, Available at :http://www.forbes.com/2006/10/12/man-scania-volkswagen-markets-equity-cx_rs_1012markets04.html

an offer often leads to the loss of such costs. The sunk cost for the target firms is often high as well, especially when the management put up a fight against a hostile takeover. For instance, after successfully defending the hostile bid, they have to live up to their ambitious business announcements which were part of their defence strategy. In a recent abandoned media merger in August 2014, Time Warner's (TW) shares fell by 11% in after-hours trading after 21st Century Fox withdrew its unrequited pursuit of Time Warner. 21st Century Fox planned to repurchase $5 billion worth of TW shares[43]. Furthermore, in some cases, the party breaking the deal would have to bear a heavy penalty. For instance, after the acquirer and the target enter into a binding contract, if one party unilaterally abandons the deal, it would lead to a breach of contract, and therefore would incur penalties which are usually very high. There is usually a clause in such a contract to define the "breach of contract" and the penalty (Dikova, Sahib, and Van Witteloostuijn 2009; Zhang and Ebbers 2010). Some damages may be subject to corporate law, in which case it might be quite risky to the breaker. For instance, according to Delaware corporate law, when one party breaches an acquisition agreement, the law will support an award of damages to the non-breaker. Breach by a target company will not be excused simply because the board obtained a better deal for stockholders. Furthermore, the general rule for damages is "expectancy damages proven to a reasonable certainty" – meaning that in Delaware, if an acquirer loses a deal due to the target's breach, the damages of the acquirer include the value it expected to receive from the acquisition, which could be in excess of the sale price or the valuation given by the target or the market.

Breaching a deal is expensive, not to mention the non-monetary consequences on reputation and credibility when the breach is not justified. However, some of the deals are better called off for the sake of the acquirers or the target in the long run. Furthermore, the deal may be blocked by a reverse ruling of a relative regulatory body from the social welfare perspective. For instance, the courts may block horizontal mergers which violate anti-trust law. From the consumers' welfare perspective, those mergers may have been reducing competition which damage consumers' welfare. For instance, the case of Honeywell vs. GE was derailed solely by the European anti-trust authorities, while being cleared by the US Department of Justice and 11 other jurisdictions. The DG competition of the EU believed that the bundling effect would hurt European customers. (Grant and Neven 2005; Nalebuff 2004)

2.4.3 The "Deal-breakers"

Since the termination of the deals is painfully expensive in many ways, why are many deals aborted? Given the fact that every cross-border M&A is different, and the deal can be terminated at any step during stage 2, a case by case study would therefore be essential in order to look in depth at what constitutes the deal breaker. It might be the combination of different deal breakers which leads to the final termination of the deal. Nevertheless, in the literature of M&As and cross-border M&As, there are three main categories of deal-breakers: macro level factors, industry level factors and firm level factors, contribute to the success or failure at stage 2. See figure below.

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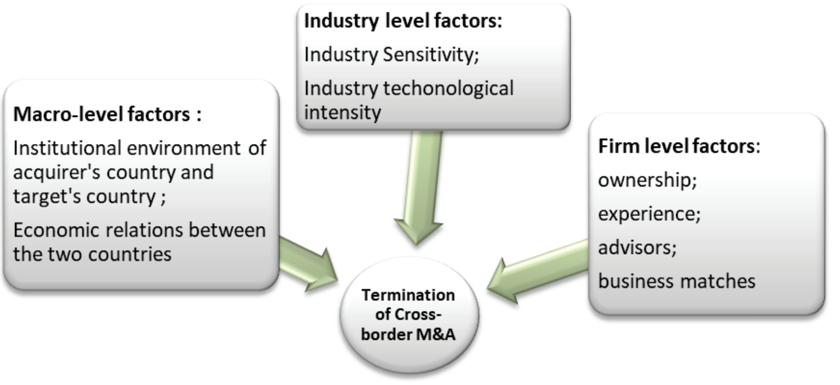
[43] See http://www.bbc.com/news/business-28668539

Figure 2-9: Factors that determine the termination of Cross-border M&As



Source: author made based on literature

2.4.3.1 Macro-level factors

In the literature, there is no systematic study investigating the determinants of completed cross-border M&As. Only some finance literature studies the firm level factors which influence the outcome of a bid. Due to the growth of cross-border M&As, in recent years, studies have begun to test the macro-level factors, rather than firm level factors. Dikova and his colleagues firstly applied North's political economy theory (1990) to examine the probability of a deal completion (Dikova, Sahib, and Van Witteloostuijn 2009). According to North (1990), societal institutions are ''humanly devised constraints that shape human interaction''. Formal constraints such as law, regulation, policies, and informal constraints, such as conventions, codes of conduct, and culture, shape the investment behaviours of firms and managers, at the same time as they reduce the uncertainty of organizations and human behaviour.[44] In the second stage of a cross-border M&A, the acquirer faces a great deal of uncertainty, since the acquirer has to obtain two approvals: the approval from the target and the approval from the governmental agencies of the target's country. Meanwhile, as stated before, in some countries the acquirer needs to obtain investment approval from their own governmental agency before proceeding with the deal. Empirical evidence shows that the more differences between the two countries' institutional environments, the higher the possibility that the deal will be terminated.

In their study, Zhang and Ebbers, (2010) found evidence to show that the better the economic relations, especially the trade relations, between the two countries, the higher the likelihood the deal will be completed. They explained that the better the two countries integrate, and the better the firms from one country understand the business environment in another country, the better the chance that a deal will be completed.

[44] North's theories are described more in details in Chapter 4.

This strand of literature which uses institutional economics to examine the influence of formal and informal institutions on the cross-border M&As is rare. In particular at the stage of deal-making, the role of the home country institutions is often neglected in the current literature.

2.4.3.2 Industry level factors.

Many deals may face political pressure, particularly those whose operations have national security or national interest implications involving sensitive industries such as energy and other scarce natural resources (sensitive resources), military production and crucial infrastructure.

High tech industry also shows a certain pattern, as the technology gap between the target and acquirer may also hamper the completion of a deal. Upon the signing of a preliminary contract, communications between both parties go into greater detail and during this stage, parties may abandon the deal when they realize it is too difficult to integrate due to a major technology gap between them. Therefore, a high level technology deal is less likely to be completed compared to a low technology deal. (Zhang and Ebbers 2010)

2.4.3.3 Firm level factors

In their study, Zhang and Ebbers found evidence from Chinese acquirers to prove that some firm level factors affect the completion of the deals. For instance, they found that 1) a deal with an SOE acquirer is less likely to be completed than other forms of enterprises.2) an experienced acquirer is more likely to complete the deal 3) a deal is more likely to be completed if the acquirer hires an advisor, and/ or the sought percentage of shares is low, and/or the acquirer and target are in the same industry.

Although these factors are briefly introduced here, they are, however, essential, even more so at the post-transaction success stage. Section 2.4 shows that the finance literature found that these firm factors are the determinants of post-transaction success.

2.5 Post- transaction Performance of Cross-border M&As

The successful deal of two firms is a desirable result, given all the efforts and costs which are incurred. However, completing the deal is not the final goal, but whether the deal generates gains for the acquirer is. After an acquirer has gone through all the uncertainty and successfully acquired the target, will the deal generate gains afterwards? What are the key issues that ensure post-transaction success? Another important strand of literature studies the success and failure of cross-border M&As at the post-transaction stage.

These studies are mainly based on the theories and methods gained from the study of general M&As, given the fact that cross-border M&As are nevertheless a type of M&As, which is a corporate strategy adopted by a firm to expand the boundary of the firm to a foreign market as a mechanism to increase shareholder wealth. This strand of literature evaluates the performance of cross-border M&As at post-transaction, and investigates the factors contributing to the success and failure of cross-border M&As. Extensive empirical studies are included in the literature.

2.5.1 Benchmark and Measurements

Studies based on M&As' evidence in the US have a long history in testing the performance of the deals. Although the results are still quite controversial (Wang and Moini 2012), the literature is well established and tested, such as how to measure performance and what factors influence the performance. Since the cross-border M&A is a specific type of M&A, the common methods in financial research of cross-border M&As employed the research methods from general M&As theories and expanded those theories to the cross-border level.

Acquirers' Perspective

The first benchmark to be decided is whose performance to evaluate. There are different perspectives. For instance, some research focuses on the success of the acquirer (Alexandridis et al. 2013; Tsai 2008; Stiebale and Trax 2011), some focuses on the success of the target (Cheng, Dunne, and Nathan 1997; Danbolt 2003), or some focuses on a combination of both (Eun, Kolodny, and Scheraga 1996; Shleifer and Vishny 2003); some even focuses on a wider range, evaluating the wealth effect of outside stockholders who are affected by the deal (Cremers, Nair, and Peyer 2008), such as bondholders, employees and managers. At the macro level, some research also evaluates the social welfare effects (Huck and Konrad 2004). Given the theme of this thesis, the acquirers' performance is more relevant, and therefore this thesis focuses on the studies evaluating the success of the investors (acquirers).

Shareholders' value as the benchmark

Different fields of study have adopted different benchmarks which signal the success of an M&A transaction. According to corporate finance, increasing shareholders' value is the benchmark of a successful investment. This benchmark was popularly adopted in event studies (MacKinlay 1997). Whereas in accounting, profitability in the long run is the benchmark. This benchmark is adopted in outcome studies. Both event studies and outcome studies will be discussed below. However, given the methodology which this thesis accommodates [45], shareholders' value will be the prioritized benchmark of a successful transaction, with the profitability argument on the side to support the whole argument.

Cost-benefit analysis to identify the influential factors

Nevertheless, the nature of a successful investment means that the gains outweigh the costs. Analysing the success of an M&A deal is no less than a cost-benefit analysis of any investment.

Therefore, a net present value (NPV) of the investment that is greater than zero will be an indicator that the deal was profitable. NPV equals to the present value (PV) of the future investment gains minus investment costs (IC), as shown below. The higher the NPV, the more successful the investment is.

[45] This paper adopts both event study (chapter 3) and case study (chapter 6) to analyse the case of China.

Equation 2-3 **NPV= PV-IC**

Choosing NPV as the standard of a successful investment also helps to identify the factors influencing the acquirers' performance. When a cross-border M&A deal enjoys the factors enhancing investment gains and the factors diminishing investment costs, the deal has better potential to succeed.

Scholars studying cross-border M&As rarely invent new methods to evaluate cross-border M&As' performance, instead, they apply those methods measuring the performance of M&As. Scholars from different disciplines have attempted to embrace various criteria to evaluate the performance of M&As. Each measurement has its advantages and disadvantages, and sometimes different measurements lead to contradictory results (Ismail and Annis 2011). Nevertheless, although no single measurement is perfect; the combined results from each measurement yield some general insights into the performance of M&As and the mitigating factors. The next section discusses the main measurements of the M&As' performance: event study, and outcome study, as well as their respective empirical findings; other measurements will be briefly introduced also.

2.5.2 Event study - Stock market based study

The event study has been a dominant approach to evaluate the performance of an M&A deal (Thompson 1995; MacKinlay 1997; Duso, Gugler, and Yurtoglu 2010). Event studies analyse the reactions of the stock market to the events that occur at the time of an M&A or in its aftermath. The basic assumptions of this approach are: 1) the stock market is efficient or semi-efficient; 2) managers aim to maximize shareholders' value in undertaking M&A. Therefore, changes in the share prices of the acquiring and target firms reflect the value of the economic impact of an acquisition, after controlling for the general market movements and systematic risk.

The results from various event studies which cross all five merger waves suggest that the impact of an acquisition on a target firm is positive. At and around the event (the announcement of the M&A), the target's stock price rises sharply so that the stockholders of the target firm earn cumulative average abnormal returns (CAARs) (Andrade, Mitchell, and Stafford, 2001; Eckbo and Thorburn, 2000; Dodd and Ruback, 1977). Contrary to the large gains of targets' shareholders, the results for the share-holders of acquiring firms are not as positive, the results are also not consistent. Some empirical studies show positive returns and some show negative returns. Martynova and Renneboog (2008) investigated 17 empirical studies over five waves, and found the results are almost evenly distributed between positive and negative impact. However, the overall evidence from the 17 studies shows that the acquirers' shareholders earn insignificant CAARs prior to and at the announcement of the deal.

There are also event studies investigating the long-term performance after the deals were made. The basic logic is to extend the event window to a longer period of time after the announcement of a deal. However the magnitude of the M&A effect on the share prices strongly depends on the estimation method used to predict the benchmark return. Ismail and Annis (2011) provided a review of empirical evidence and concluded that, using a long-term event study, the majority of studies suggest either negative or insignificant ARs for the acquirers. Therefore event studies of the long-term effects show that M&As lead to a decline in shareholders' value of the acquirer over several years subsequent to the deal (Tichy 2001; Martynova, Oosting, and Renneboog 2007; Martynova and Renneboog 2008; Gregoriou and Renneboog 2007).

2.5.3 Outcome study

Outcome studies also take a long-term perspective of M&As' performance. However, instead of evaluating the stock market reaction in a longer event window, as the event study does, outcome studies evaluate the long-term outcome after the transaction. This study usually consists of a comparison of accounting measures prior to and subsequent to an M&A deal. The rationale behind these studies is that the strategic aim of a business is to earn a satisfactory return on capital, and any benefit arising from the M&A will finally be reflected in the firm's accounting statements. Therefore, the outcome study interchanges with the accounting-based study.

Accounting-based measures have a broad sense, such as profitability, employing earning-based measures and cash flow performance measures (Healy, Palepu, and Ruback 1992; Switzer 1996), productivity (Yeh and Hoshino 2002), R&D indicators (Bertrand and Zuniga 2006) growth rate of sales, or assets (Gugler, Mueller, and Yurtoglu 2006; Martynova and Renneboog 2008; Stiebale and Trax 2011). Among them, return on assets (ROA)[46] is the most widely used in the M&A literature (Bertrand and Betschinger 2012).

The results of the long-term performance of cross-border M&A acquirers measured by outcome study are ambiguous. In the paper of Martynova et al.,(2007), they extensively review the relative studies, and 9 empirical papers find that the post-deal performance of acquirers had been improved, 6 papers found deterioration in post-deal performance on the acquirers' side, and 6 papers document no significant changes. Another ambiguous result is that even taking a single country as an example, different studies produced different results. For example, the firm-level data of the UK and French (2000-2007) acquirers show that cross-border M&A had a positive outcome in terms of increasing acquirers' sales and assets without decreasing the domestic labour force (Stiebale and Trax 2011). However, an early study of the UK (Dickerson et al., 1997) has reached the conclusion that UK acquirers experience a significant decrease on ROA.

2.5.4 Others studies

Managers' perceived performance

This measurement is based on managers' perception of the performance. Managers engaged in the deal are asked to rate to what extent they have realized their preliminary objectives several years after completing one M&A. A typical survey study with interviews would primarily focus on managers' comments on the deal (Economist Intelligence Unit 2010). The logic is that when aggregated across the results, it could yield generalizations from the samples. Their initial objectives are described using some financial and/or non-financial ratios. Besides, the managers are usually asked to give their "overall" rating about the entire performance of the M&A to establish convergent validity. Zollo and Meier (2008) found that

[46] ROA=Operating income/total assets

the management-assessments have been used in 12 of the 87 papers (14 %) that were reviewed by them.

A majority of empirical evidence based on this study showed that 44%-53% of the managers interviewed appeared to be dissatisfied with their acquisition's performance compared to the goals set before the deal closure (Susan and Schoenberg 2006). Bruner (2002) reviewed 13 studies, which had surveyed executives to assess M&A performance. The result is that 6 out of the 13 studies reported a performance decrease of the acquirer firms after the transactions, and the rest detected no impact or slightly positive change in post transaction performance.

Expert informants' assessment

This approach is similar to managers' assessment, but the opinions are from the experts who have an inside knowledge of the M&A transactions. Some scholars use direct data from security analysts, or directly via the ratings in financial reports and commentary (Susan and Schoenberg 2006). Some scholars used multiple informants to improve the reliability of their findings.

A result (Susan and Schoenberg 2006) based on financial press commentary between two and four years post-acquisition, is that 44% of the acquisitions were described as poor or very poor.

Case studies

Case studies focus on one case or a small sample of cases, then analyse these in great depth. They usually derive insights from documents, data, financial ratios and field interviews with managers and third-party experts. Case studies can acquire information from internal and external documents of transactions, articles in the economic press and from information analyses of commercial databases connected to transactions. By drilling down into the details and factual background of a deal, the researchers often deduce new insights about the success of a single case from a small sample of cases.

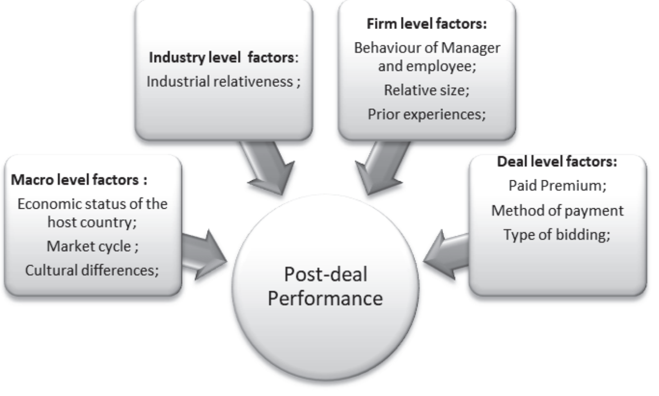
For instance a typical case study conducted by Arshad (2012) found that from the 11 major ratios (liquidity ratios, efficiency/profitability ratios and capital/leverage ratios, etc.,) ex- and post-merger of Standard Chartered bank, it proved that a merger did not improve the performance of Standard Chartered bank after Union bank was acquired by Standard Chartered bank (Pakistan) .

In another case study about the hostile takeover made by AT&T to acquire NCR (Lys and Vincent 1995), the study explored AT&T's motivation, determination and reasons that lead to a wealth destroying transaction (AT&T shareholders' wealth by between \$3.9 billion and \$6.5 billion). Lys and Vincent suggested that AT&T's management who initiated the takeover "in order to save face for perceived past managerial mistakes stemming from the 1984 divestiture of the Bell operating companies." Both AT&T and NCR would have been much better off if the acquisition had never occurred. The deal was indeed proven a failure in the long term, and in 1997 the NCR gained its name back and operated as a separate company after AT&T's restructuring (Shefrin 2000, P. 228).

2.5.5 Factors Influencing the Performance of Cross-border M&As with Empirical Evidence

As discussed above, although there are various studies analysing the performance of general M&A, the results have been ambiguous. Nevertheless, the studies identified the most influential factors that affect the performance of general M&As, even though many of them are controversial. The empirical studies in the field of cross-border M&As employed the factors affecting general M&As, by putting them in the context of cross-border M&As. These factors explain the rise and fall of cross-border M&As. This sector reviews these factors and the respective empirical evidence.

Figure 2-10 Factors that influence the post deal performance



Source: author made based on literature

What kind of cross-border M&As are likely to be successful? Theoretically, we have come to the conclusion that an M&A deal is designed to achieve "efficient resource allocation by allocating ownership and control of assets to those who value them the most and installing the most able managers" (Macey, Högfeldt, and Samuelsson 1995). A successful M&A will have one of the three sources of gains from it: "more efficient asset combination, more efficient management, and better corporate governance structures" while at the same time, the total investment costs of the M&A will be reasonably minimized given the circumstances of the deal.

Based on the above equation of an investment, any factor influencing the cross-border M&A performance could eventually be linked to either affecting the investment gains or influencing the investment costs. There are four types of sources of costs and gains.

2.5.5.1 Macro level factors

Economic development of the host country (country of the target company)

On the macro level, a firm's foreign investment benefits from the overall economic growth of the host country. Therefore firms acquiring a target in a country that has high economic performance in general are more likely to succeed (Evenett 2003; Evenett and Hoekman 2005). Evenett (2004) provided evidence to confirm that the GDP growth in the hosting country suggests a favourable economic environment, which contributes to the profitable operation of firms. Meanwhile favourable tax rates and tariff rates in the host country also favoured the performance of the acquirer. Manzon et.al (1994) investigated 301 acquisitions made by US firms. They found that firms with no excess foreign tax credits that acquire firms in low-tax countries will earn abnormally low returns compared to firms with no excess foreign tax credits that acquire firms in high-tax countries.

Market Cycle [47]

There are studies that show the relationship between market cycle and performance of M&As. Namely during high-equity market cycles (optimistic market), optimistic managers with shareholders' support will pursue aggressive strategies such as M&As and cross-border M&As (Gugler et al. 2010). However, during low market cycles the market provides better M&As opportunities; and the M&As conducted during low market cycles tend to perform better (Pangarkar and Lie 2004). Pangarkar and Lie found that Singapore acquirers perform better when the deals are made during a low market cycle. One reason is that cautious shareholders might induce managers to scale back their merger plans; and for managers that can overcome shareholders' risk aversion, they are less likely to be affected by hubris and more likely to avoid overpaying for the target. The other reason is that restructuring strategies may be easier to implement during low market cycles compared to high market cycles.

Cultural differences

Cultural differences have been shown to affect FDI (Doukas and Lang 2003), and this seems to particularly affect cross-border M&A since interaction is necessary between two firms (Morosini and Singh 1994; Reus 2012; Dikova and Rao Sahib 2013). Investing firms need to understand the local needs of the target firm and the cultural differences between home- and host-country, in terms of social norms, market peculiarities, and consumer preferences. Thus, firms looking for expansion in a foreign market can face significant disadvantages when competing with local competitors in an unfamiliar host-country environment. This disadvantage, in FDI literature called the "liability of foreignness", refers to the unavoidable costs which foreign companies incur that companies operating in their home environment do not (Hymer 1960).

The cultural difference and liability of foreignness mean that the greater the cultural distance, the less likelihood there is of possible gains from the M&As. Studies show that when firms engage in cross-border M&As, rational managers choose less distant targets. In the early stage of cross-border M&As, British, Swedish and Danish companies definitely looked for partnerships with North-European and USA companies, and tried to avoid strategic alliances with Japanese and South-European companies (Cartwright, Cartwright, and Cooper 1996). Datta and Pulia (1995) investigated 112 large cross-border M&As by US firms between 1979 and 1990 and found that cross-border M&As characterized by a high level of cultural distance were associated with lower wealth creation for acquirers' shareholders. Empirical evidence

[47] Market cycle means that in one cycle a market usually experiences four stages: up, peak, down, bottom. Stock market experiences high and low cycles as well.

also shows that three key dimensions of cultural difference (trust, hierarchy, and individualism) affect both the volume and the gains. (Ahern, Daminelli, and Fracassi 2012)

However, cultural difference can be a positive factor in cross-border M&As under certain criteria. Page (2007) shows that in the new technology era, greater cultural distance could increase the likelihood of a successful merger if cultural diversity facilitates innovation and promotes new approaches to problem solving.

2.5.5.2 Industry level factors

Industrial "relatedness" between the acquirer and the target

The research question scholars have been trying to solve is whether different types of M&A are associated with different degrees of gain. The answers so far are quite controversial. Some argue that the connections between the acquirer and the target have significant effects on the gains. At the domestic M&A level, Healy (1992) found that transactions involving firms with highly overlapping businesses significantly out-perform those with few overlapping businesses. Datta, & Raman (2003) also found evidence to support the explanation that operational synergies are created when the assets acquired are related to the acquirer's core business. Mueller (1980) on the other hand found that conglomerate mergers produce better wealth effects for shareholders of both the acquirer and target than non-conglomerate mergers do. Furthermore, there is also other evidence that reveals no significant performance differentiation across the different types of M&A (Switzer 1996).

On the cross-border level, there are also empirical studies (Conn and Michie 2001; D. K. Datta and Puia 1995) tested whether the cross-border M&A has similar effects to domestic M&A. Datta and Puia examined 112 large cross-border M&A by US acquirers between 1978-1990 and found the aspects in common have no clear influence on the value creation of the acquirers. Conn and Michie took the examples of UK acquirers. It showed that the aspects in common have a significant effect on cross-border M&As compared to domestic M&As. Conn and Michie investigated the effect of long-term performance in the case of horizontal and non-horizontal deals both for domestic and cross-border M&A transactions. They only found a difference in the level of performance between the long-term performances of horizontal and non- horizontal deals in cross-border M&As.

2.5.5.3 Firm level factors

Relative size

Relative size is a well-recognized factor influencing M&As' performance (S. B. Moeller, Schlingemann, and Stulz 2004), and it has been proven relevant to cross-border M&As too. The basic argument is that the stock market reaction to acquiring firms varies depending on the relative size of the acquirer to the target.

Equation 2-4 Relative Size

Relative size =Target's value/ Acquirer's value

Empirical evidence proves that the larger the target relative to the acquirer, the worse the gains from the deal (Asquith, Bruner, and Mullins 1983). Asquith investigated 214 merger bids, dividing the sample into two groups, bids in which the target firm's equity value is greater than 10% and less than 10% of the acquirer's. They found cumulative abnormal returns are significantly greater when the target's value is larger than 10%.

Behaviours of Managers and Employees

Considering managers' behaviour could affect the deal in so many ways, such as affecting the paid premium and bidding strategy, as above discussed; there is much research focused on the impact of managers' behaviour in failed transactions. For instance, a stream of research done by experts of M&As identified sixteen factors associated with unsuccessful M&As. Of these sixteen factors at least half were directly related to people and people management issues (Cartwright, Cooper 1996): under-estimating the difficulties of the cultural difference (a factor that leads to high costs for post-deal management); under-estimating the problems of knowledge transfer; demotivated employees in the acquired company; departure of key managers in the acquired company; focus on "making the deal", but not post-acquisition planning and integration; poor decision-making after the transaction because of the post-acquisition conflict; poor work-performance caused by distraction due to the M&A; insufficient research about the acquired company.

There are many research streams in cross-border M&As that support the argument that the manager's behaviour may seriously affect the performance of transactions (Datta, Iskandar-Datta, and Raman 2003). Goergen and Renneboog (2004) also found that, in the case that the predominant reason for takeovers is agency problems or managerial hubris, then the performance turns out to be poor. Furthermore, Klaus Gugler and his co-authors (2010) developed the managerial theory of mergers; they believed that the psychology of the manager's behaviour often has a significant impact on mergers. They confirmed some larger negative returns for acquirers for deals made in optimistic environments by optimistic managers.

Prior experiences

The "Learning by doing" logic is applied in understanding cross-border M&As performance (Collins et al. 2009). Firms improve themselves based on previous experience, so therefore firms which make multiple cross-border acquisitions can learn from their previous experiences. However, it is well recognized that every deal is unique and every situation is different from the last; and few aspects can potentially be transferred from one deal to another, but assuming that every deal which is closed will create better results in the next is not reasonable. Therefore, some also find that too much experience is not necessarily better than no experience at all, as those experiences may lead to hubris or over-confidence of managers. Haleblian and Finkelstein (1999) found a U-shaped learning curve, from studying 449 acquisitions, indicating the relationship between acquisition experience and acquisition performance; i.e., low levels of acquisition experience negatively influenced performance until a firm accumulated a certain level of acquisition experience. In addition, they found the more similar a firm's acquisition targets are to its prior targets, the better they perform. They offered behavioural learning theory as an explanation. The relatively inexperienced acquirers, after making their first of several acquisitions, inappropriately generalize acquisition experience to subsequent dissimilar acquisitions; while more experienced acquirers appropriately discriminate between their acquisitions.

Some empirical research has supported learning by doing theory in cross-border M&As. Collins et al. (2009) found that firms learning from their prior acquisition experience are more likely to make successful acquisitions, and among successful deals, multiple acquirers yield significantly higher returns than single acquirers. Furthermore, Hayward (2002) found that firms learn best from prior acquisitions which are not very similar to previous experiences.

2.5.5.4 Deal level factors

Paid Premium

The premium paid by the acquirer is the visible and significant part of the total costs incurred in the transaction. Everything else being equal, the higher the premium paid the less profit the investment earns (Hayward and Hambrick 1997; King 2002; Sirower 1999). Many reasons contribute to managers' over-paying or under-paying for the M&As. For over-paying M&As, an explanation offered by scholars is that the market for M&As of public companies is excessively competitive (Alexandridis, 2010; Alexandridis, Fuller, Terhaar, and Travlos, 2013). Therefore, as a result, acquirers tend to enter non-profitable deals because they bid more aggressively and offer hefty premiums to target firms and the target captures most of the synergies gained. Another explanation is that fierce competition for listed targets is likely to enhance managerial hubris-related effects that, due to the winner's curse, can lead to reduced gains for acquirers (Billett and Qian 2008).

Alexandridis (2010) found that the mean premium paid in the US, UK and Canada [48] is typically around 40% higher than in the rest of the world. Meanwhile, mean acquirer abnormal returns (ARS) are mostly non-negative throughout the rest of the world. The return difference between acquirers from the rest of the world and their counterparts in the three most competitive markets is statistically significant. Furthermore, evidence was found that it is the interactions between an over-confident acquirer's managers and over-confident target managers, that leads to the greatest over-payment and share-holder value destruction (John, Liu, and Taffler 2010).

Bris, Brisley, and Cabolis (2008) however associate higher price with the more concentrated ownership structures that public target firms have in countries with a weaker legal environment. The concentrated ownership leads targets to demand higher prices for their shares. They found that, for worldwide M&As among listed firms in the period 1989–2002, acquiring firms pay a higher premium for target firms from countries with a weaker legal and institutional environment than for domestic M&As.

Type of bidding

This factor is closely linked to the final paid premium as it is known that many M&A deals interest multiple bidders. For example, when the target firm suffers from inefficient management/bankruptcy, a bidding contest is likely to happen after the initial bid is offered

[48] According to the analysis of World Bank, in the years that Alexandridis' research focused on, the US,UK and Canada were the most competitive markets for publicly listed targets, followed by Sweden, Norway, and France.

(Betton, Molson, and Thorburn 2008). Therefore the first bidder has concerns that its bidding offer may trigger a bidding war. Fishman (1988) analysed the first bidder's bidding strategy which could be affected by this issue. The gains of the winning bidder, at some level, depend on how successful the bidding strategy was. Some empirical studies have shown that shareholders of targets can earn more in the case of revised bids because of the bidding contest. That means the revised bidding leads to lower gains for the acquirers. Swenson (1993) found that for cross-border acquisitions in the 1980s in the US, the shareholders of the target companies realized significantly greater (10%) returns than shareholders of target companies involved only in domestic deals, due to the high resistance of a foreign bid. That also leads to lower gains for cross-border acquirers.

Goergen and Renneboog (2004) found that in takeovers, the "type of takeover bid has a major impact on the short-term wealth effects with hostile takeovers triggering substantially larger price reactions than friendly operations". Another study found that when immediate white knight strategy is used against a hostile bid, it tends to lead to a strong and negative market reaction (Banerjee and Owers 1996). However, in the bidding war, if the white knight bids follow two consecutive hostile bids and the war ends, there are minimal losses to the white knight bidders. In this hypothesis there is a lack of empirical research done from the bidder of cross-border M&A in recent years, but there are individual cases available for case studies.

Payment Method

Previously, in explaining the process of a cross-border M&A, the rationales behind different methods of payment were introduced. From the behaviour point of view, the literature shows that different methods of payment have different effects on M&As.

Jensen and Meckling (1976) firstly investigate the effect of different payment methods. There is strong empirical evidence to show that payment method has a major impact on the share prices of both the bidder and the target. The simple way to understand the logic is that top managers employ cash as their M&A payment only when they foresee bright prospects for post-merger performance. Therefore, the method of payment turns out to be a signal to outside investors as to whether a given M&A will be profitable.

However, the hypothesis above is not robust in cross-border M&As. Early study showed the insensitivity of payment method in the performance of cross-border M&As when the acquirers are UK companies (Eun, Kolodny, and Scheraga 1996). In their research, they did not consider payment method as a variable due to the fact that, unlike the case of domestic M&A, stock is rarely used as a payment method in cross-border M&As, most of them were carried out using cash in the earlier stage when cross-border M&A had just taken off.

Nevertheless, in the later stage, using a global dataset, research revealed that stock was gradually used as a payment method and stock financed deals are not necessarily value-destroying outside the competitive markets, such as the US, and UK (Alexandridis, Petmezas, and Travlos 2010).

A recent study carried out by Dutta, Saadi, and Zhu (2013) even found evidence (Of 1,300 completed deals by Canadian acquirers between 1993 and 2002 ,545 deals are cross-border and 755 deals domestic) showing that the stock financed M&As have significant and positive effects because the market tends to over-estimate the synergy gains in stock financed deals.

However, the market corrects this over-enthusiasm in subsequent periods. Furthermore, to answer the question regarding why acquirers are choosing stock as a payment method, Dutta, Saadi and Zhu found that stock payment is used as a possible remedy for reducing information asymmetry and lowering corporate governance related risk in cross-border acquisitions.

2.6 Discussion

2.6.1 The Role of Home Country Institutions

This chapter has presented the extensive theoretical and empirical literature in cross-border M&As. It serves as the background of this thesis, and helps to understand the general driving forces of cross-border M&As, the likelihood for completing the deals, and the post-transaction performance. The current literature shows that in the globalized economy, a growing number of firms are motivated to use cross-border M&As as a means to enter or expand on the international market. Theories suggest that a rational cross-border M&A as a corporate strategy will offer efficiency-improving opportunities for the acquirer to gain competitiveness from acquiring market, assets or efficiency on the international market. The empirical literature, however, shows this goal was realized quite rarely, rather than often.

Because firstly, a given deal might be withdrawn (unilaterally or bilaterally) at some point before the deal was completed, and all the previous effort of the acquirer turns out to be a non-retrievable cost. Although the empirical literature did not offer conclusive determinants of the acquirers' success at the deal-making stage, the empirical evidence shows that, in the sophisticated process of a cross-border M&A, the risk for deal withdrawal in general is quite high. Furthermore, the acquirers from advanced markets have a better chance to close the deals compared to the acquirers from emerging markets. The second reason the acquirers often do not realize their goals is that even though many deals can be eventually completed, the empirical evidence shows a "winner's curse", which means a considerable amount of the completed cross-border M&As do not create shareholders' value for the acquirers (Kang and Johansson 2000).

However, the current cross-border M&As literature (Shimizu, Hitt, Vaidyanath, and Pisano 2004) , has identified a number of explanatory factors (macro-level and micro-level factors) having effects on determining the motivations of the acquirers, the likelihood of deal completion and the post-deal profitability. Notably, the roles of home country institutions have been addressed in different stages of a cross-border M&A, and these studies indicate that home country institutions matter to cross-border M&As in the following aspects.

Firstly, industry "shock" triggered by institutional changes (i.e., deregulation) in the home country is a powerful driving force for acquirers to pursue cross-border M&As in the industry. For instance, the liberalization of the investment policy and industrial policy of emerging markets encourages the acquirers from emerging economies (Gu and Reed 2013) to acquire targets from advanced economies to advance themselves in both domestic markets and international markets.

Secondly, since some cross-border M&A deals are subject to home country regulatory approval before the ownership is finally transferred, the home country regulation can determine directly whether a deal will go through or not (Sauvant and Chen 2014; UNCTAD

2013a). Furthermore, formal and informal institutional differences between home and host country can predict the likelihood as to whether a deal will be completed or not (Dikova, Sahib, and Van Witteloostuijn 2009; Fang, Fridh, and Schultzberg 2004).

Thirdly, empirical evidence also found that informal institutions, such as cultural differences between the home country and host country contributed to the profitability after the transaction (Georgieva, Jandik, and Lee 2012; Aureli and Demartini 2010).

The above institutional analyses of home-country institutions provide some insight, but are not complete. They do not offer a full picture on the role of home-country institutions in cross-border M&As, or, in another words, we do not know the comprehensive influence of a firm's institutional background on its cross-border M&A decision and outcome. For instance, does the institutional background of an acquirer affect its motivation? Does the institutional background drive a merger wave? Does the institutional background predict the likelihood of acquirers completing the deal? Does the institutional background affect the post-transaction performance? And how?

The current literature does not answer the above questions. Inspired by the institutional studies in the current literature as well as the questions the current literature has not answered, this thesis aims to offer a more comprehensive view of the role of the institutional background of acquirers in cross-border M&As by studying the case of Chinese overseas mergers and acquisitions (OMAs).

2.6.2 The Chinese Overseas Mergers and Acquisitions

While the literature contains extensive studies on cross-border M&As, there remain some literature gaps. First of all, the international M&As market was mainly occupied by first-mover acquirers from developed countries, such as the US and UK, up to the late 1990s. Therefore, the theories and empirical evidence in literature are mainly based on the study of first movers. However, since the late 1990s, cross-border M&As have a strong late-comer colour, a large number of acquirers are from emerging economies such as India, Russia and China. The late-comers have different advantages and disadvantages compared to the first-movers, and therefore, the theories and empirical evidence from the current literature may not directly apply to the later comers.

Secondly, the literature has thoroughly investigated the micro-level factors affecting cross-border M&As in order to improve the management of cross-border M&As. These studies, however, usually took the institutional background of firms as given. Therefore macro level facts such as the effect of home country institutions are not well studied but rather fragmented and incomplete. A cross-border M&A is a progressive corporate strategy, so therefore the effect of the institutions should be studied systematically at each stage of the deal. There is no systematic theory or empirical evidence to explain whether the home country institutions matter, when they matter, and how.

This dissertation aims to fill the above literature gaps. Firstly, by examining the Chinese acquirers' motivation, deal-making capability and deal-profiting performance, it can enrich the empirical evidence of the overall cross-border M&As. Secondly, using the new institutional economics approach, by analysing the institutions of China and their effects in the process of Chinese OMAs, this thesis offers a systematic understanding of the effect of the institutional background of acquirers in cross-border M&As.

Chapter 3. Chinese Overseas Mergers and Acquisitions

3.1 Introduction

Chapter 2 shows that, theoretically speaking, cross-border M&As, as a mode of entry into foreign markets, are usually driven by economic rationales. Companies with specific ownership advantages and an internalization advantage have stronger motivation to enter a foreign market (Dunning 2000) through cross-border M&As if the host country offers location advantages. The synergy gains can be realized by acquiring assets (tangible and intangible), markets or economies of scale (Davis, Desai, and Francis 2000). However, the empirical literature shows that the outcome of cross-border M&As does not often meet expectations. The acquirers not only bear the risk of losing the deal during the deal making due to various reasons, such as the regulatory agency rejection, or the successful resistance of the target management etc., (Dikova, Sahib, and Van Witteloostuijn 2009), but also, even when the acquirers successfully close the deal, there is very high risk that the deal does not create value for the acquirer's shareholders (Williams 2009; Goergen and Renneboog 2004; Neergaard 2009; Asquith, Bruner, and Mullins 1983; Datta and Puia 1995). The literature also suggests that the high risk of a disappointing performance has never stopped managers from pursuing cross-border M&As. Managers from all over the world are constantly looking for cross-border M&As opportunities.

3.1.1 Emerging Literature on the Emerging Acquirers

From the late 1990s, emerging economies such as Russia, India and China have also joined the international acquirers team, and the deal numbers and volume from emerging economies has grown rapidly ever since. In the current international M&As market, the acquirers from emerging economies play a very important role. For example, in the Dealogic M&As report 2010, 21% of the cross-border M&As volume was contributed by emerging markets.[49] Therefore, the mainstream literature may be incomplete in the global context since it was based on the study of developed countries' acquirers (Bruner 2002; Martynova, Oosting, and Renneboog 2007; Martynova and Renneboog 2008; Andrade, Mitchell, and Stafford 2001).[50]

However, not surprisingly, due to the growing importance of the emerging economy's acquirers in the international M&As market, some research has begun to pay attention to the cross-border M&As initiated by the late-comers. For instance, one recent body of research carried out by Bertrand and Betschinger (2012) investigated the performance of Russian M&As. They examined 600 Russian bidders that initiated deals announced between 2000 and

[49] Dealogic classifies Western Europe, Japan, Australia, New Zealand and North America as developed markets, with everything else falling into emerging markets.

[50] For instance, Martynova & Renneboog (2008) investigated 17 empirical studies across five merger waves based on a wide range of empirical evidence across multiple countries. Although these empirical studies did not conclude unanimous results on whether or not a Cross-border M&A increases the wealth of the acquirers, those acquirers in the studies were all from advanced economies.

2008, and found that both domestic and outbound mergers tended to reduce the performance of the Russian acquirers, which was quite consistent with the mainstream literature.

3.1.2 Chinese OMAs Literature

A section of research has also begun to pay attention to Chinese OMAs. Many findings are consistent with the mainstream literature; however interestingly enough, some findings have shown the peculiarities of Chinese OMAs. There are two main results which are different from the mainstream literature.

First of all, some research (Zhang, Zhou, and Ebbers 2011) pointed out that Chinese OMAs have a higher rate of abandoned/ withdrawn OMAs attempts. Their study shows that nearly half of OMAs planning announced by Chinese acquirers is not completed. They explained that Chinese OMAs announcements had been imposed as a result of a high risk of abandonment or withdrawal due to the political attention they receive in the foreign market, especially in the strategic industries such as oil and gas.

The second interesting finding is that although Chinese acquirers in general suffer from a lack of world-class M&As capacity (inexperienced managers in the overseas market, cultural barriers and negative political influence), some studies found that the financial market nevertheless has a positive response to Chinese OMAs (Gu and Reed 2013; Black et al. 2013). For instance, Gu and Reed found that Chinese OMAs tend to be driven by investment policy (go-out strategy), but they are rewarded by the stock market, Chinese acquirers increase their shareholders' value after the implementation of the "go-out" policy. E. L. Black et al. (2013) compared the acquirers from China and the US, and found that the Chinese acquirers outperform the American ones in both domestic M&As and OMAs.

There are also other deal-level peculiarities that were found in recent literature in studying Chinese OMAs. For instance, Chinese acquirers tend to pursue strategic assets (Edamura et al. 2014; Wang, Boateng, and Yan 2007) and furthermore they tend to pay cash (Ren, Liang, and Zheng 2010).

Although Chinese OMAs have received considerable attention in recent years the study of Chinese OMAs suffers from two drawbacks. Firstly, the studies are fragmented, and there is no systemic study that has investigated the Chinese OMAs' process which is a process in three stages, from the motivation to the deal making (withdrawn or completed), then to the post-deal integration. Secondly, these studies often apply the literature based upon Anglo-Saxon OMAs experience which does not necessarily fit well in terms of Chinese OMAs reality. For instance, the mainstream literature often takes acquirers' home countries (Anglo-Saxon countries') institutional settings as given. The market economies as well as the rules for economic activities in these markets have been well established. Therefore, there seems little point in studying the different role of the institutional background of British acquirers and American acquirers. Secondly, the institutional settings of these countries are fairly stable and predictable over a given period of time and for institutional changes which may have effects on firms M&As, scholars studied their role individually (Mitchell and Mulherin 1996). However, in contrast to Anglo-Saxon firms who operate in the environment equipped by clearly defined and relatively stable institutional settings, Chinese companies are embedded in a very different macro environment. The institutional settings for economic activities are still less defined and undergoing continuous changes. Therefore, the behaviour and performance of Chinese companies at each stage of OMAs (motivation, completion and post-deal) may differ from the advanced economies acquirers. Therefore, the characteristics of Chinese OMAs should be investigated, and the similarities and particularities compared to the main-stream literature should be identified.

The goal of the following chapters is to fill the above two gaps. This chapter focuses on providing a systematic analysis of the characteristics of Chinese OMAs from a process point of view. It analyses the motivation of Chinese acquirers, the deal completion situation and the performance of completed deals. Section 3.2 investigates the OMAs during the period from 1990 to 2013; it focuses on the deal level and firm level characteristics of Chinese OMAs. Section 3.3 and 3.4 analyse the deal motivation and the deal completion based on the empirical evidence from section 3.2. Section 3.5 tests the short-term stock performance of the Chinese acquirers, by investigating sample deals with high values which were conducted by listed Chinese acquirers during the period from 2004 to 2012. Section 3.6 concludes the chapter.

3.2 Characteristics of Chinese OMAs (1990-2013)

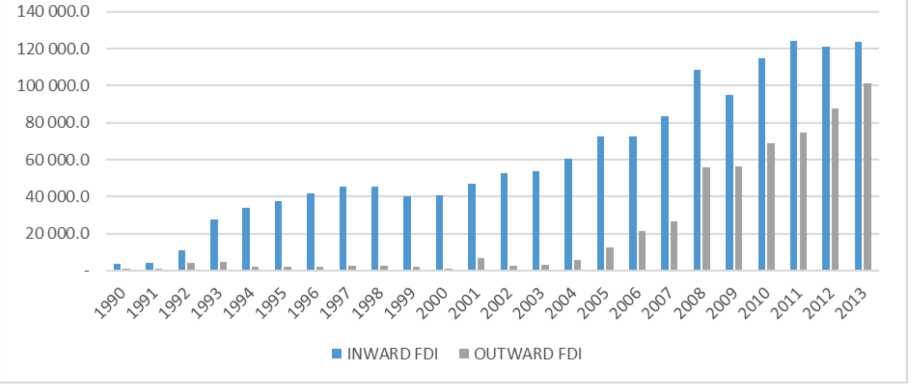
3.2.1 Overview Statistics of Chinese OFDI and Chinese OMAs

The emergence and growth of Chinese OFDI (outbound foreign direct investment)

China began its economic reform in 1978 and the Chinese economy has been developing at a rapid and steady pace ever since, with on average, the gross domestic product (GDP) growing 10% per year for the last 35 years. However, Chinese companies did not fully start the internationalization until the beginning of the 2000s. Before 2000, Chinese companies entered the foreign market mainly by trade, the Chinese OFDI was hardly noticeable till the year 2000, as was the yearly growth in volume ($830 million in 1990 and $915 million in 2000), as shown in the figure below. The Chinese OFDI in the 1990s was hardly noticeable compared to Chinese inward FDI (IFDI) and the size of the Chinese economy. To put the OFDI in context in 2000, the value of OFDI was only 0.08% of the GDP ($1205 billion) and 2.2% of the IFDI ($40.7billion). However, the OFDI went on a growth track after 2000. The OFDI of 2004 ($5.498billion) was 6 times 2000's, and 2008's volume ($55,91billion) was 10 times the 2004's, the 2008 number almost doubled in 2013 ($101billion). The gap between the OFDI and IFDI had also been significantly shortened in the 2000s. In 2008, the OFDI was already half the size of the IFDI and 0.7% of the GDP, and in 2013, the OFDI was 81% of the size of the IFDI and 1% of the GDP. MOFCOM predicted that the OFDI would exceed the IFDI and China would become a net investor in 2015.[51] And China had realized that goal in 2014, with OFDI outnumbering capital inflows.

[51] See MOFCOM official statement. Available at: http://english.mofcom.gov.cn/article/newsrelease/press/201501/20150100878729.shtml

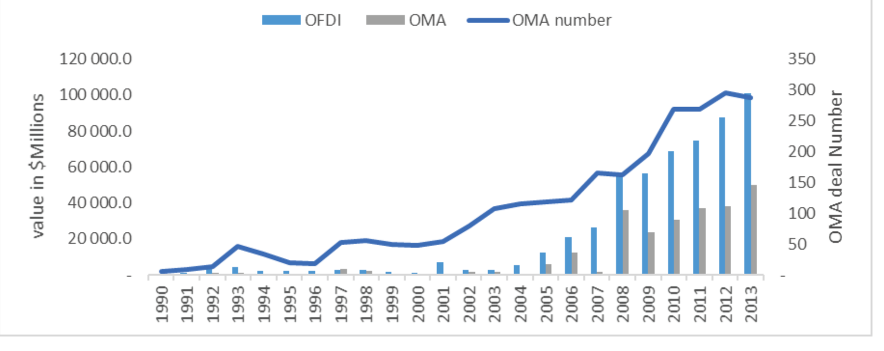
Figure 3-1 The volume of IFDI and OFDI 1990-2013 (US$ millions)



Source: UNCTAD 2014

OFDI and OMAs. As an important type of OFDI, the OMA has a similar growth pattern to the Chinese OFDI. The figure below shows the trend of Chinese OMAs and its relation to OFDI.

Figure 3-2 Chinese OFDI and OMAs (1990-2013)

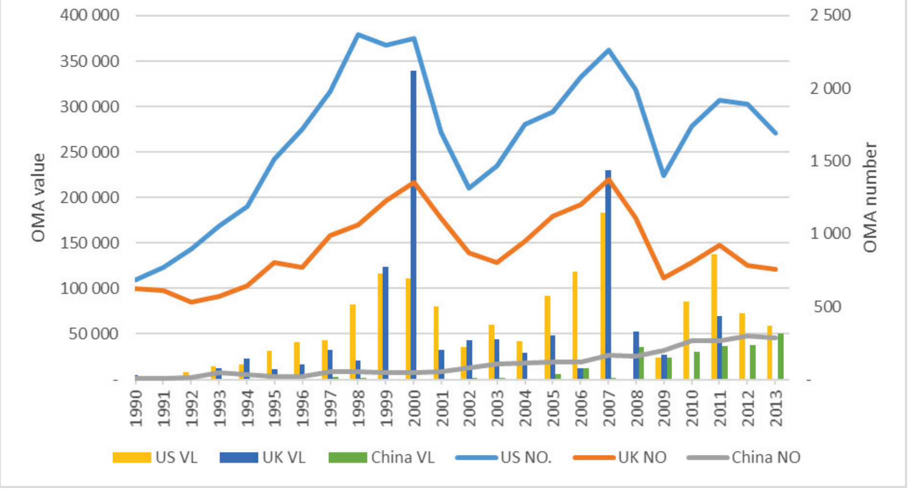


Source: UNCTAD 2014

As shown in Figure 3-2, Chinese acquirers emerged on the international M&As market from the 1990s, with a handful of deals which had moderate values. Both the number and value of Chinese OMAs started to increase noticeably from 2001, and it has grown steadily since then. Furthermore, during the crisis and post-crisis period (2008-2013), the Chinese OMAs experienced a spike. The average yearly number of OMA deals was around 30 in the 1990s, 117 in the 2000s, and 247 during 2008-2013. The average yearly OMAs value was $920 million in the 1990s and $ 8.247billion in the 2000s (9 times that of the 1990s), then during the crisis and post crisis period, the average yearly deal value increased to $35.84 billion (more than 4 times that of the 2000s). Furthermore, the Chinese OMAs had been a significant proportion of Chinese OFDI. The total OMAs (1990-2013) value made up 45% of the total OFDI value, in the 2000s, the OMAs value took up 34% of the total OFDI, and since the crisis, 48% of OFDI value is contributed by OMAs.

OMA waves in the 1990s and 2000s. Compared to the first movers, such as the US and the UK, Chinese acquirers were late-comers in the international M&As market. Chinese OMAs were, and still are not at the same level as the US and UK in terms of the number of deals and their deal value. The Figure 3-3 below demonstrates the comparison of the Chinese OMAs, the UK OMAs and the US OMAs.

Figure 3-3 OMAs yearly number and value US vs.UK vs. China 1990-2013



Source: UNCTAD 2014

As shown in the figure, since the 1990s, in both the UK and the US, two OMAs waves have occurred, one rose from 1990, peaked at 1997-2000, another rose from 2002 and peaked at 2007. Chinese OMAs certainly missed the OMAs wave in the 1990s when it was almost negligible. The average yearly Chinese OMAs deal number (30 deals) was 4% (784 deals) of the UK's and 2% (1447 deals) of that of the US. After all, the US was making 25% of the world's cross-border deals across the 1990s (world average yearly cross-border deal number was 5730). During the 2000s, the Chinese acquirers took a part in the international OMAs wave, and the Chinese OMAs increased together with the OMAs of the UK and those of the US until the latter two hit the financial crisis. OMAs of the UK and US dropped sharply between 2008 and 2010 (crisis period), then they slowly bounced back in the early 2010s (post-crisis period). The Chinese OMAs, on the other hand, didn't suffer any drawback during the crisis and continued to increase through the crisis and post-crisis period. Therefore, the

Chinese OMAs caught up with the first movers slightly in the 2000s (117 yearly OMAs on average) but the gaps with the UK (1059) and US (1816) were still significant. During the crisis and post-crisis period, China on average made 247 OMAs yearly, although still significantly below the level of the UK (847 deals) and the US (1773 deals), the gaps (29% of UK's OMAs and 14% of US's OMAs) were considerably shortened compared to the pre-crisis period.

It is important to point out that the above trend is concluded from the data in an UNCTAD report. FDI data in general is hard to capture precisely due to the different reporting systems and level of reporting in different nations. The Chinese FDI data from UNCTAD is especially troublesome because firstly, the FDI data in UNCTAD report was from the Chinese government agency, the Ministry of Finance of China (MOFCOM). The data from MOFCOM is problematic in many ways. Firstly, MOFCOM only started official data collection from 2003; prior to 2003, the data was estimated by accumulating outflows since 1982. Secondly, the complexity of the Chinese companies' governance structure may cause some under-estimation or exaggeration of the deals.[52]

The cross-border M&As statistics of the UNCTAD report came from *Thomson One Banker* which is a widely used financial database but there are concerns with regard to the precision of M&As data in the report from the deal level. Firstly, it does not tackle the round-tripping problem with Chinese OMAs.[53] The UNCTAD database on cross-border M&As contains information on the ultimate and immediate target and acquiring countries, the nationality of the capital is geography based, not source based. Secondly, the value and the number of deals only capture the disclosed and completed deals of which the acquirers acquired 10% of target shares. Therefore, some undisclosed deals which might acquire 10% and above are estimated or not recorded in the data. Thirdly, the value of cross-border M&As in UNCTAD is the net value. It equals the M&As' purchase value minus the M&As sales value when the companies happened to conduct both purchase and sales. Therefore, UNCTAD data is the best available one in order to analyse the FDI trend at country level but it is not the most reliable data to conduct the qualitative analysis at deal level.

3.2.2 Data and Methodology

Methodology. The aim of this section is to provide deal level statistics in order to shed light on the characteristics of Chinese OMAs. The main focus areas are the characteristics relative to the driving forces of Chinese OMAs or relative to the deal completion, namely the deal-making capability. Determining the specific motivation of a deal is challenging, as OMAs are usually driven by a combination of various motives. The deal specific motives are not always clear cut and they are usually not publicly reported, especially the non-listed acquirers or

[52] The Chinese regulatory environment towards FDI in the 1990s incentivized many Chinese companies to have a holding structure, typically with the holding companies in Hong Kong or other tax havens. Since the Chinese government agency define "Chinese company" based on the registration of the company instead of ultimate capital source, the Hong Kong (or others similar ones) registered companies with capital from China were treated as foreign firms from 1990s till late 2000s when the government improved its statistical method. Therefore, there were heavy round-tripping problems in the MOFCOM data until the late 2000s. The OFDI were most likely under-estimated and IFDI were over-estimated.

[53] See above footnote on the definition of round-tipping.

small scale OMAs. Similarly, to conclude, the determinants of deal completion are challenging due to the incomplete data issues as well. However, by analysing deal level variables derived from the literature with a large number of Chinese OMAs samples, this section aims to conclude with some deal level characteristics of the Chinese OMAs.

Data. The sample analysed in this section consists of all M&As deals with acquirers whose ultimate parents are Chinese companies with the targets whose ultimate parents are not Chinese companies over the 24 years period from 1990 to 2013. In this section, deal level data is collected directly from the SDC database via Thomson One Banker (T1) to avoid country level data issues as mentioned in UNCTAD data. It also better serves the purpose which is to investigate the characteristics of Chinese OMAs. Information related to the characteristics of the deals (acquirer/target nation, industry, name, announcement date, date of effectiveness, deal status: completion/withdrawal, target industry/nation, deal attitude, deal value and acquisition percentage, whether the acquirer/target hired financial and legal advisors) are taken from T1. Some qualitative characteristics of the deals which cannot be collected from the T1 (acquirer's ownership, deal motivation, acquirers' managers' involvement, etc.,), which will be used for the purpose of this study, are investigated separately through various archives such as news, financial analysis and company report, etc.

3.2.3 The Main Statistics of Chinese OMAs 1990-2013

3.2.3.1 Deal characteristic and the completion rate (1990-2013) Summary

The table below summarizes the main statistics of Chinese OMAs from 1990 to 2013.

Table 3-1 Summaries of basic statistics (1990-2013)

Total announced / completed deal- in number (NO.)	4826/2724
Total announced / completed deal-in value (VL)	\$5.26bil/\$3.53bil
% Completion in NO./ in VL	56.5% / 67.1%
% Friendly deal /Hostile deal (in NO.)	87.8%/0.0%
% Friendly deal completion (in NO.)	57.6%
% Private /public/others in (in NO).	61.3% / 28.3%/ 10.4%
% target Asia Pacific/ Americas and Europe/others (in NO.)	72.1% / 25.1%/ 2.8%
% target Asia Pacific/ Americas and Europe/others (in VL.)	40.3%/ 50.8%/ 8.9%

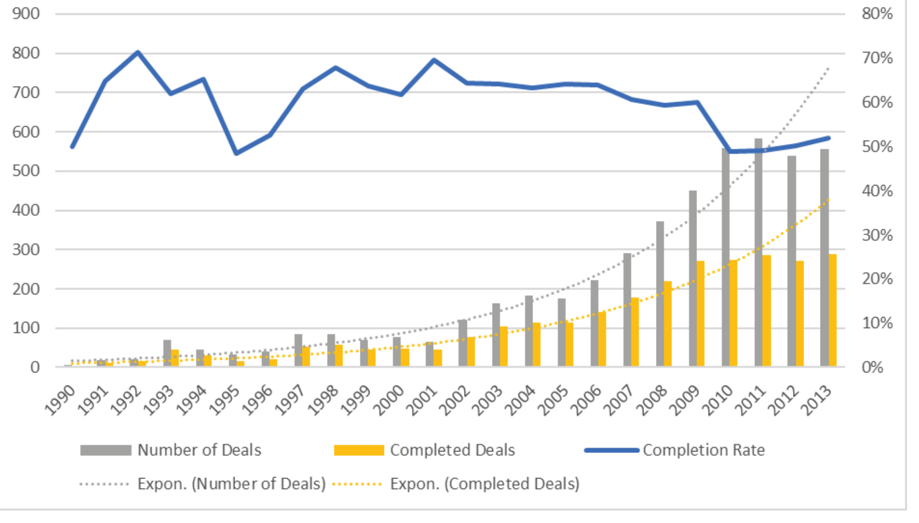
As shown in the table, during the 24 years between 1990 and 2013, there were 4826 Chinese OMAs announcements (value \$5.26 billion), among which 2724 deals were completed (\$3.53 billion), and 2102 deals were not. The completed deals accounted for 56.5% of the total announced deals, but the value of completed deals accounted for 67.1% of the total deal value announced. It implies that the deals which are higher in value have a higher chance of being completed which is consistent with the literature.

Furthermore, the Chinese acquirers have the following characteristics: **firstly, they tend to be friendly acquirers,** the friendly OMAs accounted for 87.8% of the total deals and there was only one hostile takeover out of 4826 OMAs. Given the fact that Chinese companies are inexperienced in OMAs, therefore, hostile overseas takeovers are too risky for Chinese acquirers; furthermore, hostile takeover and bidding wars are undesirable in the Chinese business culture. **Secondly, the majority of acquirers are private companies**, only 28.3% of the acquirers were publicly listed companies. **Thirdly, they prefer targets which were geographically closer to them,** 72.1% of the targets were in the Asia Pacific region, although in terms of deal value, these 72% deals in the neighbouring region only accounted for 40.3% of total deal value. The majority of the capital (50.8%) went to the Americas and Europe.

Yearly Chinese OMAs in deal number

The figure below shows the annual OMAs deals and its trend, it also shows deal completion rate over time.

Figure 3-4 Yearly Deal Number and Completion Rate

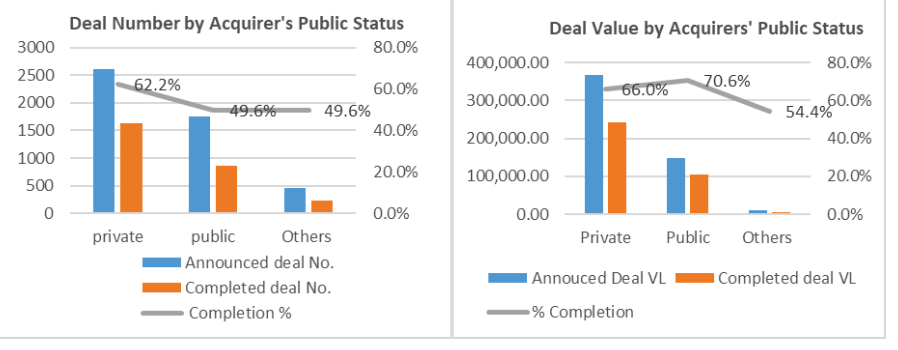


As shown in the chart, the Chinese OMAs growth trend is consistent with the conclusion based on the UNCTAD report of 2014. Chinese OMAs (both the total announcements and completed deals) started from a very low base line, and they grew away from the low baseline from the early 2000s. They have been growing considerably faster since 2007 and 2008, both in terms of announced deals and completed deals. The above figure also shows the completion rate over time, where it appears that the completion rate is not notably time sensitive. There was a tendency though when the deal numbers grew, especially around 2010-2013, for the completion rate to experience a slight drop; however, the completion rate of 2010-2013 could be a little higher in reality since there might be some current pending deals completed in the following years.[54]

Public status of Acquirers

The figure below shows the breakdown of acquirers' public status in all the announced deals, and their relationship with the deal completion rate. In this figure, the acquirer is defined as having a public status when either the ultimate parent company (where the capital is sourced) is public or the acquirer itself is public. Because in both situations the market will have a reaction to the OMAs deal of the acquirer no matter whether the acquirer or the parent company is publicly listed.

Figure 3-5 Public status of acquirers and the deal completion.



It shows that the private companies who are the majority of the acquirers (54.2% of the total number) also have 12 % higher chance of completing the deals compared to other acquirers (62.2% / 49.6% of total number). For the private acquirers, the completed deal number is nearly proportional to the completed deal value, 62% completed deals accounted for 66% total announced deal value. However, the completed deals initiated by public acquirers have a higher value than the uncompleted ones, 49.6% completed deals accounted for 70.6% of the total value. It implies that for public acquirers, deals involving higher transaction value have a higher chance of being completed.

Ownership Status of the acquirers

The table below provides an overview of the acquirers' ownership status.

[54] The last update of the deal level data, including the deal status, in this thesis was on 22 April, 2015.

Table 3-2 Acquirer's Ownership Status

Acquirers' Ownership	Announced Deal no.	Completed Deal no.	% completion	Completed Deal No. Mkt Share	Completed Deal VL ($Mil)	Completed Deal VL share
All	4826	2724	56%	n/a	352794.72	n/a
SOE	1488	854	57%	31%	241063.03	68%
Non-SOE	3338	1870	56%	69%	111731.69	32%

It shows that deals initiated by SOEs accounted for 31% of the total number of deals announced, the majority of the OMAs were initiated by non-SOE. Furthermore, both SOE and non-SOE acquirers had similar deal completion rates. From the deal value perspective, although SOE initiated deals were small in number (31%), the value of these deals accounted for 69% of the total completed deal value. This implies that SOE initiated deals have a higher average value, compared to the non-SOE initiated deals.

Target Regions in value and deal number

The figure and table below show the target regions of Chinese acquirers in terms of deal value and deal numbers.

Figure 3-6 Deal Value and Number by Target Region (Announced vs Completed)

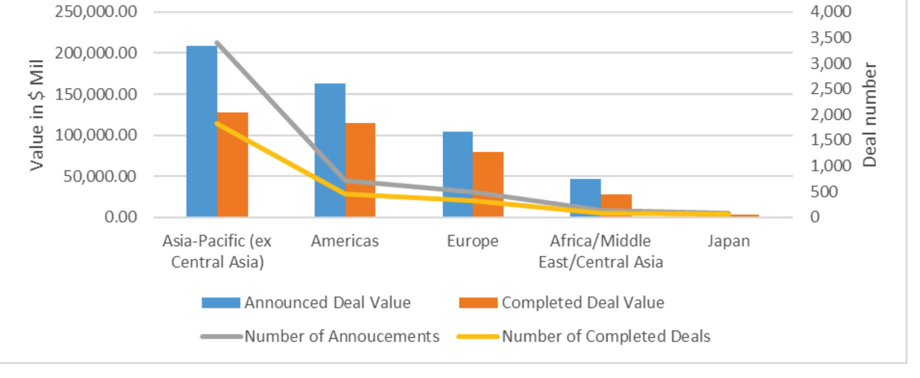


Table 3-3 Shares in terms of Deal Value and Deal Number by Target Region

Target Nation Region[55]	Announced VL mkt share	Completed VL mkt	Announced No. mkt	Completed No. mrt	%Completion in No.

[55] According to the code in the Thomason One Banker,

		Share	share	share	
Asia-Pacific (ex Central Asia)	40.3.8%	37%	72.1%	69.1%	54%
Americas	30.9%	32.6%	14.8%	16.5%	63%
Europe	19.9%	22.5%	10.3%	11.6%	64%
Others	8.9%	8.0%	2.7%	2.8%	58%

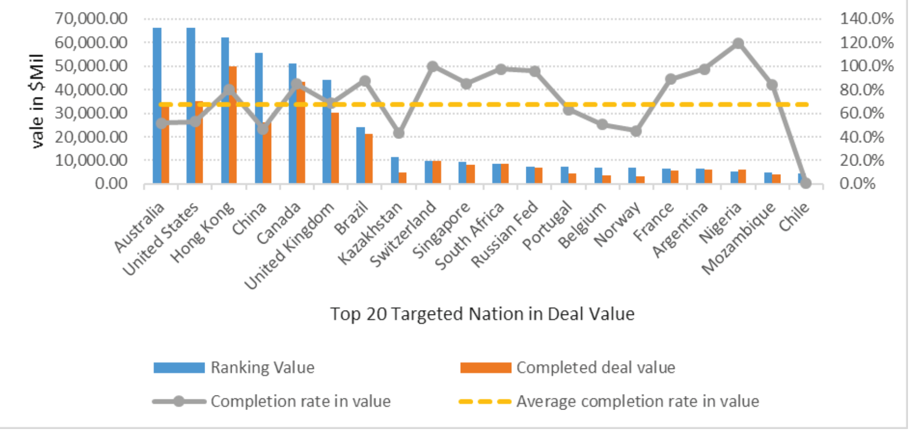
Chinese acquirers primarily focus on targets which are more approachable, namely subsidiaries of foreign MNEs whose premises are inside China [56] and targets from neighbouring regions; there are 72.1% (70.5% without Japan) of the total number of deals targeted at the Asia-Pacific region. However, in terms of investment value, these deals only take a 40.3% share of the total value of the announced deals. After Asia-Pacific, Chinese acquirers mostly prefer targets from the Americas and Europe, and in total they initiate 55.1% of OMAs there, (32.6% in the Americas and 22.5% in Europe) although number wise, these deals are only 25.1% of the total number of OMAs. It means the OMAs projects in these markets have a much higher value compared to the OMAs in the Asia-Pacific Region. Other regions in total take up around 5% of Chinese OMAs both in terms of announced deals and completed deals. Furthermore, Chinese acquirers have the lowest completion rate (53%) in the Asia-Pacific region, 10% lower than in the Americas (63%) and Europe (64%). The choice of target region confirms the theory that companies prefer targets geographically and culturally closer to them. (Georgieva, Jandik, and Lee 2012; Siegel, Licht, and Schwartz 2011). However, these deals do not have a higher chance, but rather a lower chance (54%) of being completed, which is 10 percent less compared to the OMAs targeting the Americas and Europe.

Target nations in value and deal number

The figure below shows the top 20 nations in terms of announced Chinese OMAs value, it also compares the deal completion rate in each target nation to the average completion rate.

[56] Targets inside China means the companies' whose ultimate parents are not Chinese companies but reside in China, for instance, foreign companies' subsidiaries in China. Therefore, these deals are included as OMAs too.

Figure 3-7 Deal Value by Target Nation (Announced vs Completed)

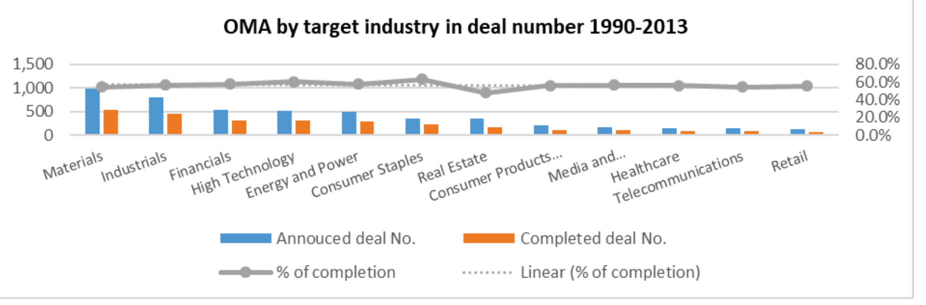


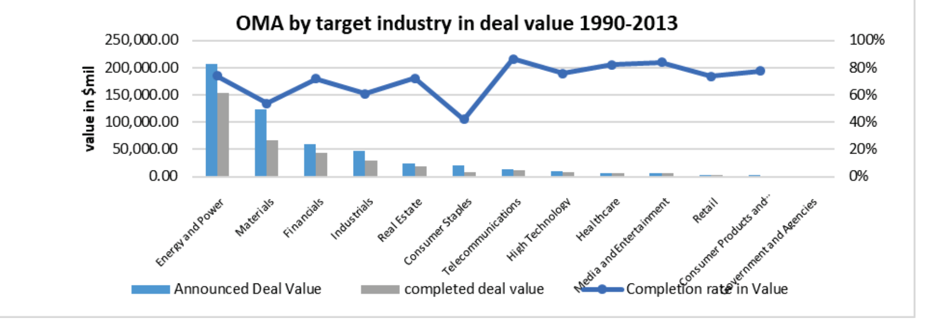
The Chinese OMAs capital primarily targets companies from developed nations, the top host countries being Australia, the US, Hong Kong, Canada and the UK. If including the OMAs inside China (since the ultimate capital of those targets are also dominated by these developed countries), the top 6 host countries account for 65.7% of the total value of the announced deals, and 62% of the total value of completed deals. Deals in Australia, the US, mainland China, Kazakhstan, Portugal, and Belgium have a lower than average deal completion rate. The extreme case is Chile, where10 Chinese OMAs were announced and in the end only 3 of them were completed, and the value accounted only for 0.4% of the total announced deal value.

Chinese acquirers' choice of a target nation reveals their motivation; they are primarily targeting resource rich countries, or countries offering market and/or intangible assets. Deals in Australia (No.1), Canada (no.4), and Brazil (No.7) are mainly resource and market seeking, and deals in advanced industries countries such as the US (no.2) and UK (no.5) are mainly intangible asset seeking.

Target Industry and completion Rate. The figure below shows the Chinese OMAs in both deal number and value by target industry, and their relationship with the completion rate.

Figure 3-8 Deal Value by Target Industry (Announced vs. completed)





As shown in the above figures, the Chinese OMAs capital has been mainly targeting Energy and other materials; they accounted for 62.8% of the total announced deal value and 62.2% of total completed deal value; Financials, Industries, Real estates and consumer goods are also popular targeted industries for the Chinese acquirers. Deals in the energy and power sector have a slightly lower probability (57.6%) of completion, but the completed deals account for a significant share in total announced deal value (74.1%).

Advisors and Deal completion

In the literature, another important variable affecting the deal completion rate is whether or not the acquirers hire professional advisors (Dikova, Sahib, and Van Witteloostuijn 2009; Zhang and Ebbers 2010). The table below compares the professional services the Chinese acquirers employed in the US situation. This table also compares the relationship between professional service and deal completion.

Table 3-4 Advisors Hired by Chinese OMAs, US OMAs

Status	Chinese Announced OMAs		American Announced OMAs		Chinese Completed OMAs	
	Deal No.	%	Deal No.	%	Deal No.	% of Announced OMAS

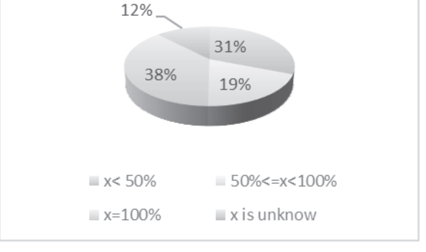
with Financial Advisor	1,119	23.2%	12,551	25.2%	808	72.2%
without Financial Advisor	3,706	76.8%	37,239	74.8%	1,916	51.7%
With Legal Advisor	1,071	22.2%	14,610	29.3%	819	76.5%
Without Legal l Advisor	3,754	77.8%	35,180	70.7%	1,905	50.7%

As shown in the table, only 23.2% of Chinese acquirers hired a financial advisor, 72.2 % of these Chinese OMAs were completed, 20% higher than the deal completion rate of the deals without financial advisors. The situation is similar to that of the legal advisor; as when hiring lawyers, the probability to close the deal (76.5%) is 26% higher than when acquirers do not hire lawyers. However, only 22.2% of Chinese acquirers hire lawyers. Compared to the number of American OMAs, 25% of American acquirers hire financial advisors (2% higher than Chinese OMAs) and 29.3% of them hire lawyers (7% higher than Chinese OMAs).

Equity control in completed Chinese OMAs[57]

The figure below shows the equity control level in the Chinese OMAs.

Figure 3-9 Completed Chinese OMAs by acquired shares (x)



As shown in the figure on the left, in all the completed deals, Chinese acquirers became the absolute majority shareholder in at least 57% of deals. If, considering the fact that within the 12% of classified deals in which the amount of acquired shares was unknown to the public, there could be more than 57% of deals in which Chinese acquirers' gained control of the target. And within these deals, there are 38% that are acquisitions (100% takeovers). The data shows that Chinese acquirers tend to have a high-level control of the target after the OMAs.

3.2.3.2 Financial crisis (2009-2013)

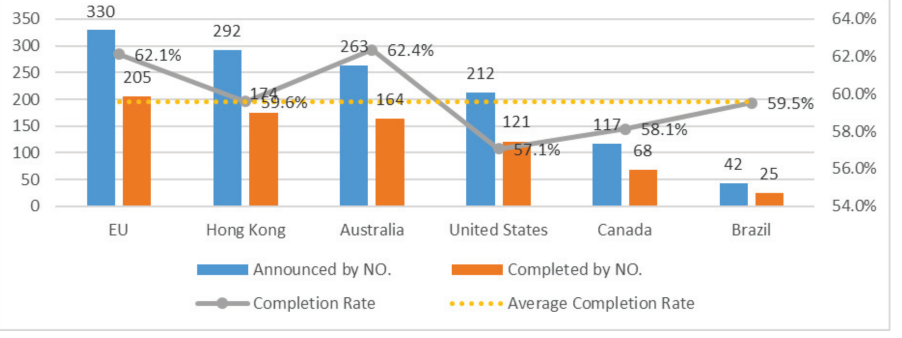
When the financial crisis hit the advanced markets (ie. US and UK), acquirers from these markets slowed down their OMAs (see Figure 3-3), their OMAs falling drastically from the peak of the 2000s OMAs wave. Chinese OMAs, however, continued to grow and maintained a high level of OMAs from 2009 to 2013 (see Figure 3-4).

Deal number by target nation (Excluding deals made in China)

During this period, Chinese OMAs showed a clear trend of primarily targeting the advanced countries where the targets became available due to the stress of the financial crisis, for instance the targets from the EU ranked at the top both in announced deals and completed deals as shown in the figure below. OMAs in the EU also have a good chance (62.1%) of being completed, next to Australia (62.4%).

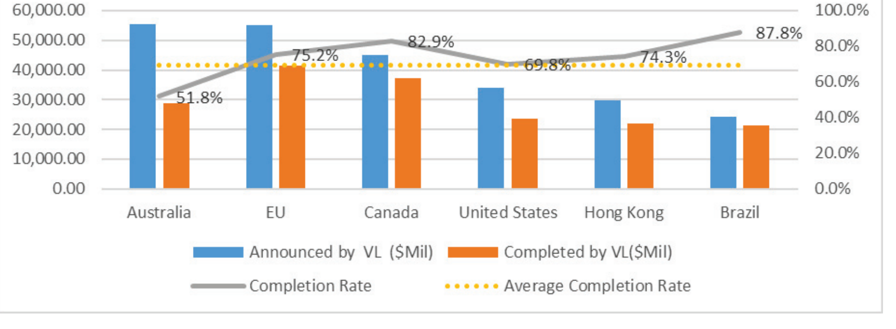
[57] The Thomson one banker database only shows the acquired share when the deal was completed. Therefore, there is no access to data with the connection to acquired shares and completion rate.

Figure 3-10 OMAs number by target nation (2009-2013)



Furthermore, in terms of deal value, although OMAs in Australia ranked at the top and have the top completion rate, the completed deals value in Australia, however, is less than in the EU. The EU ranked second in terms of announced deal value but the completed deals in the EU had the highest value. Canada ranked fifth in terms of announced deals and completed deals; its deal completion rate was also lower than average, but the completed deals had a higher value, 58% of completed OMAs in Canada which accounted for 83% of the total value. Hong Kong had a similar position as before, and it attracted a high number of deals (ranked no. 2 in deal number) but the values are comparatively smaller (ranked no.5 in deal value). Brazil was not ranked in the top 5 but remains the only target nation from the emerging economy group where Chinese OMAs had a considerable footprint during the crisis (See Figure 3-11).

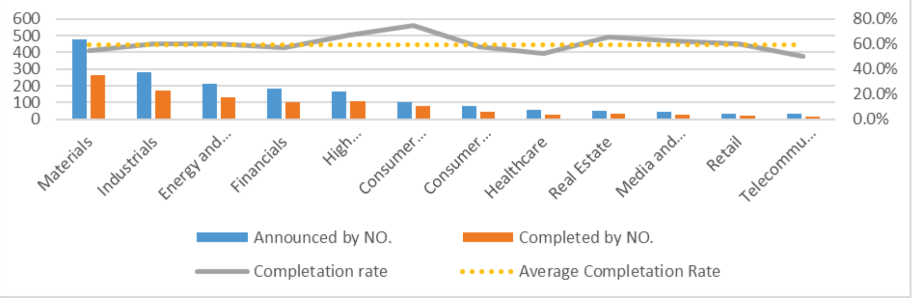
Figure 3-11 OMAs value by target nation (2009-2013)



Deals by target industry

With regard to sector distribution, during this period, while Chinese OMAs showed a clear growing appetite in resource seeking (i.e. materials and energy/power), they still accounted for the most OMAs as shown in the figure below. However, the targeted industry is more diverse. For instance, in sectors such as industrial, high technology and consumer staples, there were a considerable number of deals, as shown below. Those deals were primarily market-seeking and strategic-asset seeking deals.

Figure 3-12 OMAs Numbers by Target Industry (2009-2013)



3.3 Driving Forces of Chinese OMAs

3.3.1 Institutional Drivers of the Chinese OMAs wave

The literature found that institutional changes, including anti-trust and deregulation, drive OMAs (Shimizu et al. 2004). Observing the empirical evidence of Chinese OMAs, two institutional factors were identified as contributing to the growing volume of Chinese OMAs: domestic deregulation in the early 2000s and supportive financial policies during the financial crisis. In line with the literature, the institutional changes which resulted from the Chinese economic growth and globalization have driven two Chinese OMAs waves.

3.3.1.1 The effect of the behind-the-times deregulation in China

The empirical evidence above shows that Chinese OMAs missed the cross-border M&As wave which happened simultaneously in the developed world in the 1990s (see *Figure 3-3 OMAs yearly number US vs.UK vs. China 1990-2013)*. The 1990s cross-border M&As wave was fuelled by deregulation on a global scale (Hijzen, Gorg, and Manchin 2005; Evenett 2003). But in the 1990s, although the Chinese domestic market was deregulated and liberalized towards the market economy, outbound investment was still heavily regulated. Companies were subjected to a number of complicated administrative screenings and foreign exchange controls when engaging in overseas investment. The regulatory controls significantly increased the transaction cost (time, uncertainty, monetary cost) and sometimes it was just not feasible to conduct any overseas investment. It was more profitable and less risky to invest domestically rather than overseas, while with regard to the overseas market, they chose trade over OMAs. Taking a closer look at the limited number of deals, they were dominated by two types of OMAs. One type was not really "outbound" but with a foreign capital source, namely those targets were physically located in China but controlled by their foreign parent companies; these deals are subject to domestic investment regulations which are much less complicated. The other type was overseas asset acquisition which aims to upgrade the domestic production of Chinese companies (mainly SOEs) with the green-light from the government agencies[58]. Therefore, in the 1990s, for the majority of Chinese companies, OMAs were not attractive because investment in the domestic market was much less costly and risky. High performing companies were entering the foreign market by trade.

The much-delayed deregulation of overseas investment in the early 2000s changed the Chinese OMAs landscape. The deregulation was triggered by the growth of the Chinese economy, globalization and preparation for joining the World Trade Organization (WTO). The policy maker on the one hand "believed" that Chinese companies were ready for international competition, while on the other hand, the obligations of WTO pushed the policy makers to adapt their trade and investment policy. The Chinese policy maker initiated the "go-out" policy in 2000 and China joined the WTO in late 2001, and as shown in previous *Figure 3-4 Yearly Deal Number and Completion Rate*, there was a clear deregulation effect around 2000 and 2001, (Gu and Reed 2013). The Chinese OMAs finally began to take off then. The institutional environment on OMAs has constantly been liberalized since then, and a number of supportive policies were followed by the policy maker, which further encouraged Chinese companies to engage in OMAs[59]. The delayed deregulation of overseas investment significantly lowered the barrier for Chinese OMAs, decreased the transaction cost, and was the most important driving force which triggered the Chinese OMAs wave in the 2000s. Besides the deregulation of OMAs, there were also other systematic institutional changes in China in the 2000s which pushed Chinese companies to go abroad to increase their international competitiveness. While in the literature there is a lack of detailed analysis of the effect of institutional changes in China, Chapter 4 of this thesis offers such an analysis from a new institutional economic approach.

3.3.1.2 The effect of the global financial crisis

The financial crisis hit the western markets badly, but however it was a good market time for Chinese acquirers to conduct OMAs. To the Chinese acquirers, the financial crisis significantly decreased the transaction cost for OMAs. The financial crisis on the one hand created a better macro investment environment for Chinese acquirers in the financially stressed markets, while on the other hand, from the firm level perspective, the crisis generated more targets and these targets were less costly (price, negotiation with the Union, etc) than before. Many OMAs opportunities were presented to Chinese companies because the targets needed the capital which they could not obtain elsewhere to revive. The Chinese acquirers either processed capital by themselves or with the financial support of the government's foreign reserves. For instance, as shown in *Figure 3-11 OMAs value by target nation (2009-2013),* Chinese acquirers have invested the most in the EU as European companies needed quick liquidity during this period. During this period, the investment climate in the EU for Chinese investors was also extremely favourable. On the one hand, many member states viewed Chinese investment as a potential saviour of their economy and competed to attract Chinese investment. On the other hand, the Chinese government also encouraged and facilitated Chinese companies' OMAs ambitions in Europe. In Chapter 5, the case of Geely's acquisition of Volvo will be presented. The deal had received financial support from policy

[58] This point is explained in length with the case of Chinese automotive industry in Chapter 6.

[59] The institutional changes of China are explained in detail in chapter 4.

banks and commercial banks. Geely paid Ford $1.8 billion in cash, and raised $900 million to keep Volvo running; Geely had multiple loans from the Bank of China, the China Construction Bank, and the Export-Import Bank of China.

3.3.2 The Main Firm Level Motivations

Based on the literature and the empirical evidence of companies' behaviour from this section, the following three types of Chinese OMAs are proposed; they are categorised by the firm's primary motivation: resource-seeking, market-seeking and strategic-asset-seeking. The acquirers could be pursuing multiple objectives in one OMA, so here the OMAs are classified according to their primary motivation. The table below summarises the main characteristics of the different types in terms of applied theory, each OLI advantage and target industry and nation.

Table 3-5 Main type of Chinese OMAs based on the motivation (based on completed deals)

Motivation	Applied theory	Mkt share (in VL)[60]	ownership advantage	Location advantage	Target Industry	Target Nation
Resource	Public Choice	62.2%	Capital-State supported	No	Energy, power and other material	Resource rich
Market	OLI paradigm	37.8%	Knowledge capital	closer to the host market	Industry, consumer goods, telecommunications	Consumer rich
Strategic asset	Reversed OLI		Capital, market	Reversed-bring target closer to China market	High tech, Technology intensive industrial and consumer goods require brands	intangible asset rich

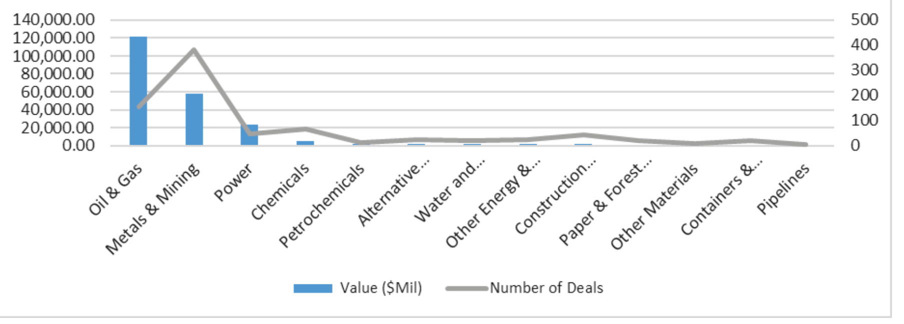
Source: Author made based on literature

3.3.2.1 Resource seeking OMAs

Resource seeking OMAs target the energy, power and other material sectors. More than half of the Chinese OMAs are involved in these sectors (see Figure 3-8). These deals were not only encouraged by synergy gains but also by industrial policies which support OMAs in the resource sector. In particular, the oil and gas as well as the metal and mining sectors were encouraged to meet the growing needs at home (Shankleman 2010). Singapore, South Korea and Malaysia (Heenan and Keegan 1979; Yeung 1998; Dicken 2003) had a similar industrial policy that also worked in China. These OMAs were motivated by national interests more than the profitability of the deals. As shown in the figure below, of all resource seeking OMAs, oil and gas, mining sector deals accounted for 82% of the value. These deals aim at providing a steady supply to national economic development.

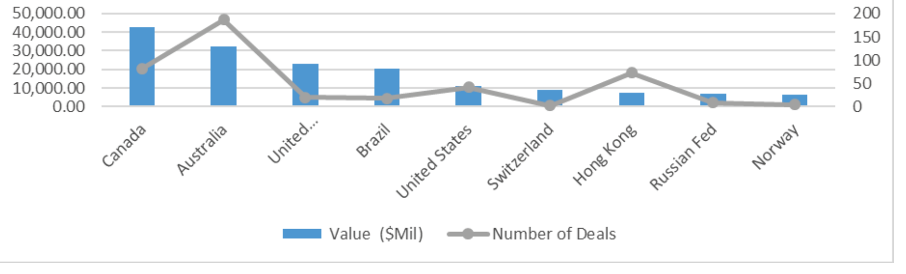
[60] See Figure 3-8 Deal Value by Target Industry (Announced vs. completed)

Figure 3-13 Completed Resource deals by target mid-industry



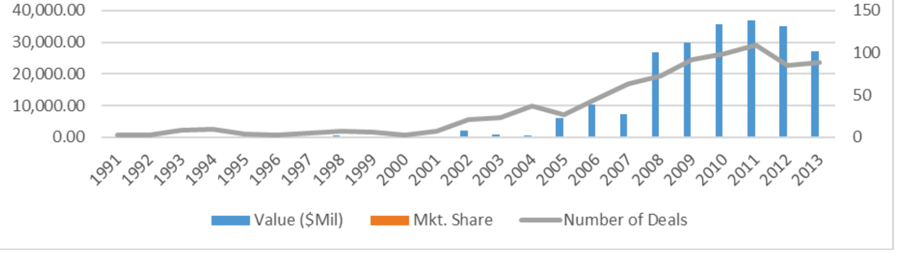
The resources-seeking FDI was concentrated in terms of value in the developed countries which are resource rich. (Buckley et al., 2006). As shown in Figure 3-14, developed countries such as Canada, Australia, the UK and the US were primary target nations. Emerging economies that are resource rich, such as Brazil and Russia, were also among the top target nations.

Figure 3-14 Completed Resource OMAs by Top Nine Target Nation



Furthermore, the majority of resource deals were made during the crisis period. As shown in the blow figure, there was a cluster of resource seeking OMAs from 2008 to 2013.

Figure 3-15 Completed Resource OMAs Annual Volume



The deals' value in the resource sector during the 6 years around the crisis accounted for 87% of the total value of 24 years OMAs in the resource sector. This outcome resulted from a number of macro factors during this period. In the crisis period, the dollar denominated foreign exchange reserves lost value with Quantitative Easing (QE) in the US. And China, having huge dollar reserves, endeavoured to diversify away from less profitable reserves into more profitable asset classes, energy and power which fits this agenda of SOEs. Furthermore, the economic re-balancing process entails a correction of China's under-valued exchange rate. For non-SOE acquirers, the stronger renminbi makes overseas acquisitions much cheaper, so it is another incentive to make the step to move abroad. Thirdly, from a host countries perspective, the investment climate for Chinese investors has changed. Prior to the crisis, these countries had formal (such as US) or informal (such as Russia) restrictions on Chinese investment in resources; however, because of the crisis, many of these countries needed capital to revive their economies, and Chinese acquirers seized the opportunities with facilitation from the government. Chapter 4 provides a more detailed analysis of the international investment climate change towards Chinese investment.

3.3.2.2 Non-Resource seeking OMAs

Besides the 62.2% of total OMAs investment which was spent on resource seeking deals, the rest of the 37.8% investment went to OMAs motivated by more economically oriented rationales, namely to increase their competitiveness domestically and/ or internationally. There are two main types of these OMAs: Market seeking and strategic asset seeking, the latter deals often having a long-term market seeking agenda.

Market-seeking OMAs- the OLI paradigm

In Dunning's OLI paradigm, companies choose the equity mode to enter an overseas market when they process ownership and internalization advantages and they can explore the location advantages of the target (market, cheap labour, etc.,) by conducting an M&A in the target's market (Dunning, 2000;Kang & Johansson, 2000).

Due to the late development of modern Chinese companies, it was not until the late 1990s and early 2000s that Chinese national champions emerged (except for energy companies). During the fast growth of the Chinese domestic market, some Chinese champions accumulated both monetary capital and knowledge capital, the latter being the main source of ownership advantage, which allows them to have comparative advantages in a foreign market. Where the OMAs would go depends on which foreign market their ownership advantages lie in.

Typically, when acquirers' ownership advantage exists only in the market which is similarly developed or less developed than the Chinese economy, Chinese acquirers would engage OMAs which the target's market is what they seek, namely to expand in these markets themselves. Whilst these deals are mainly "merging-equals or merging-down for target's market", there are also a few Chinese OMAs that are "merging-down for efficiency" (economy of scale). But the "merging-down for efficiency" deals are limited in number because so far the Chinese companies still have a location advantage in terms of production cost, the location advantage of other economies has not yet outweighed the "liabilities of foreignness" (LOF) which the Chinese acquirer may suffer in these economies.[61] With the

[61] In the literature, the extra cost a foreign company suffers compared to that of a local firm when doing business in a foreign market is called "liability of foreignness" (LOF) (Hymer, 1960).

growth of labour costs in China, the "merging-down for efficiency" OMAs will be the trend for manufacturing companies when the increased production cost outweighs the LOF. However, so far the main market-seeking OMAs are merging for the target's market. For instance, the Chinese OMAs in South East Asia in the industrial sector mainly fall into that category.

When the acquirers' ownership advantages are international, then they tend to engage in international-market seeking OMAs. Typically, these acquirers would target companies in the developed market where the target's location advantage can help the acquirers to expand in the target market as well as globally. These OMAs are "merging up for the international market". For instance, Lenovo's acquisition of IBM's personal computer (PC) division was a typical deal motivated by international market expansion. The acquisition allowed Lenovo to explore its advantage in competitive know-how in PC production on the international market which IBM had already accessed over the years. The acquisition was a rapid way for Lenovo to expand its market internationally.

Table 3-6 Market-seeking OMAs in China

OMA Motivation	Regional Market seeking		International Market Seeking
Target market	Less well-developed	Similarly developed	Advanced
Target advantage	Domestic Market or lower production cost	Market	Domestic market and international sales channels
	Merging equals or merging down for target market		Merging up for international market

Source: author made based on analysis

Strategic asset seeking OMAs- the reversed OLI paradigm.

Market seeking OMAs were the most frequently-studied kind in the cross-border M&A, these deals fit the OLI paradigm which the advanced market MNEs have applied for decades, and emerging MNEs are following the same routes. However, as late comers, not many MNEs of Chinese origin have accumulated enough ownership advantages to expand in the advanced market. Most Chinese companies, especially manufacturers, have accumulated considerable monetary capital but they are often disproportionately handicapped by the level of brand, technology development, or other sorts of intangible assets, which are jointly referred to as strategic assets. Since it takes time and is often hard to develop these assets by themselves or to acquire these assets from the domestic market, the more desirable alternative is to acquire the targets from the advanced market, which will enable rapid access to the target's strategic assets. (Deng 2009; Wang, Boateng, and Yan 2007). These are the deals that are "merging-up for strategic assets". Dunning's OLI paradigm in this case cannot explain the motivation of this kind of strategic asset seeking deals since the OLI paradigm was based on the OMAs experience of developed economies' MNEs, whose domestic market often offers rich strategic assets already. Therefore, advanced economies' companies that were looking for a quick upgrade of strategic assets would have firstly gone for domestic M&A. That is also the reason Dunning's OLI paradigm best explains the market seeking OMAs. However, it seems that a reversed OLI paradigm can offer a reasonable explanation of Chinese "merging-up for strategic asset" OMAs. The table below provides an explanation of the "reversed" OLI paradigm for their merging-up OMAs.

Table 3-7 A reversed OLI Paradigm for Chinese OMAs

	Acquirer	Target
Ownership advantage	Cash rich / lack of knowledge capital	cash stressed/ intangible capital rich
Location advantage	powerful in Chinese market/ limited share on the international market	not powerful in Chinese market/ may have good market channels internationally
Internalization	Increase ownership to gain access to strategic asset	decrease ownership to gain access to capital

Source: author made based on analysis

As shown in the table, in a typical strategic asset seeking OMAs, it was not the acquirer who possessed the ownership advantage in knowledge capital, but the target. However, the acquirer possessed monetary capital which the target may seek; the internalization through OMAs is not for the acquirer to gain control but to gain access to the strategic assets (brand, know-how, patent, etc.), and the target usually aims to gain capital from the acquirer. The OMAs were not typical for the acquirer to enjoy the location advantage in the target market, but primarily to enhance its location advantage in China and to provide the target location advantage in China after OMAs. Although the immediate motivation of the Chinese acquirers is to access the targets' strategic assets, these OMAs often have long term motivation such as market-seeking. For instance, the acquisition of Geely vs. Volvo was a typical strategic asset seeking OMA. [62]

3.4 Deal Completion

3.4.1 The Overall Low Completion Rate

The empirical evidence in this chapter [63] shows that Chinese OMAs had a much smaller volume compared to the advanced economies OMAs during 1990-2013. The table below also showed that Chinese OMAs had a significantly lower completion rate compared to the Anglo-Saxon OMAs. Moreover, Chinese acquirers also had less chance to complete OMAs compared to other emerging economies' acquirers. The table below provides a comparison of the deal completion rate with both advanced market acquirers and emerging market acquirers during 1990-2013.

Table 3-8 Deal Completion compared to other countries

Acquirer Nation	Announced Deal	Completed Deal	% Completion
US	49822	40340	81.0%

[62] See chapter 6 for detailed analysis.

[63] See Figure 3-3 OMAs yearly number US vs.UK vs. China 1990-2013

UK	25876	21657	83.7%
Russia	2235	1575	70.5%
India	2938	1992	67.8%
China	4826	2724	56.4%

From the firm level perspective, conducting OMAs is a learning process (Dikova, Sahib, and Van Witteloostuijn 2009; Collins et al. 2009), during which managers develop their deal-making skills with experience. Chinese acquirers and their managers in general would suffer LOF because of their lack of experience in dealing with foreign targets and host countries regulatory agencies, given the short history of Chinese OMAs. Therefore, the empirical evidence shows that there is a big gap in completion rate between the advanced economies OMAs and the emerging economies OMAs.

From the macro level, the liability of origin (LOO) plays a role in national companies' internalization (Moeller et al. 2013). For instance, the image of a Chinese corporation is influenced by the country level institutions of China (e.g. different political regime, rule of law, human rights). Another LOO is the poor intellectual property protection, the poor corporate governance (especially for Chinese acquirers that have an SOE background) and poor corporate social liability (e.g. environmental protection) in China greatly decreased the attractiveness of Chinese acquirers in competition with acquirers that have another country of origin. That partially explains why Chinese OMAs have lower completion rates compared to other emerging economies OMAs. This argument is elaborated on in chapter 4.

3.4.2 Factors that Influence the Completion Rate

Although the overall deal completion rate was low for Chinese OMAs, and the empirical evidence showed there were some deals that have a higher chance of success than others, the following factors influence the probability that the deal is completed.

Market Timing. Although the completion rate was not extremely time sensitive, during the Crisis period, 2009-2013, with the dramatically increased appetite of Chinese OMAs, the completion rates were a bit lower than average. This implies that, when deals are clustering, the completion rates are a little lower.

Acquirer's public status. Private companies have a 12 % higher chance of completing the deals compared to public acquirers, which implies that private companies suffer less LOO on the international market. And for the public acquirers, deals with a higher value have a better chance of completion. This implies that gigantic deals may enjoy some advantage since the Chinese acquirers conducting these deals may already be known due to their scale or record of international activities etc. which means that a sizable deal may suffer less LOO.

Target Region. Although the Asia Pacific region attracted the most Chinese OMAs because of its geographic and cultural closeness, these OMAs do not have a higher, but rather a lower chance of being completed; they are 10 percent less likely to be completed compared to the OMAs targeting the Americas and Europe. This implies that distance may not be a determinant for deal completion.

Target Nation. Chinese OMAs were completed very differently in different host countries. It implies that different host countries have a different regulatory environment compared to

Chinese OMAs. For instance, European markets have consistently opened the door to Chinese investors and Chinese investors face few barriers in the EU market. While in the US, the climate towards Chinese OMAs is less welcoming, the Committee on Foreign Investment in the United States (CFIUS), an interagency committee charged with reviewing transactions by foreign investors that may raise U.S. national security considerations, has rejected some Chinese OMAs. According to the unclassified annual report to Congress issued by CFIUS in February, 2015, China had the most notice filings in both 2012 and 2013.

Target Industry. The completion rate is not target industry sensitive. Only the deals in Real Estate had a noticeably lower chance (47.8%) of completion. Deals in the energy, power and material sector also have a marginally lower probability of completion compared to other industries, but the completed deals account for a significant share in total announced deal value; this is in line with the previous finding that the higher value deals are more likely to be completed.

Professional advisors. The empirical evidence confirmed the previous findings in the literature. Chinese acquirers who hired financial advisors and legal advisors had significantly higher probability of completing the OMAs, 20% and 26% higher respectively. However, there are only 23.2% and 22.2% of Chinese acquirers that hire financial advisors and lawyers respectively. Compared to the American acquirers, Chinese acquirers hire lawyers and financial advisors less often.

3.5 The Performance of Chinese OMAs

Section 3.2 provided an overview of Chinese OMAs with 4826 sample deals over the years between 1990 and 2013. Section 3.3 analysed the main motivation of the Chinese OMAs, and section 3.4 have identified the factors that contributed to the incomplete OMAs. This section will explore the performance of the completed deals. This section aims to investigate whether the completed OMAs are profitable for the shareholder. The literature has shown that the Anglo-Saxon M&As rarely increase acquirers' shareholders' value (Baker, Pan, and Wurgler 2009; B. E. Eckbo 2010; Goergen and Renneboog 2004; Tichy 2002), interesting enough, some studies found Chinese OMAs generally increase the acquirers' shareholders' value (Gu and Reed 2013; Black et al. 2012) therefore it is interesting to extend the literature and find out whether the Chinese acquirers perform better compared to the acquirers from advanced markets.

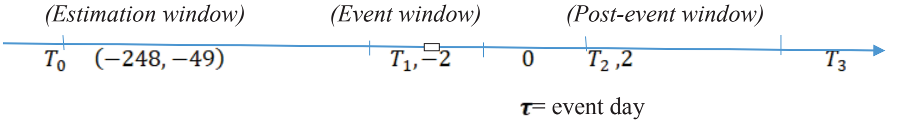
3.5.1 Methodology and Data

Event Study. As pointed out in the literature review, the performance of acquirers can be measured in many ways. However, constrained by the data of OMAs initiated by private acquirers, the choice was made to analyse those OMAs initiated by the public acquirers. The event study is used to measure the short-term stock market performance of acquirers. Namely, an event study reveals the market reaction of an Overseas M&A announcement by examining the abnormal returns which are the unexpected return which the event generates for the acquirers' shareholders around the announcement of the OMAs.

It is generally accepted that the effectiveness of event study methodology depends on many assumptions.[64] In order to have appropriate results, the event study should avoid violating any of the assumptions[65]. Therefore, in a stock market like China, which is relatively new and less perfect,[66] the event study method is far from perfect in examining the performance of an M&A event. However, by 1) ensuring reasonable data collection, 2) implementing the event study correctly, and 3) reporting the results modestly, the results can demonstrate the high points of the Chinese OMAs performance.

The major advantage of using the event study is that the effect of an M&A will be reflected immediately in the equity price (MacKinlay 1997), assuming that the market is semi-efficient. [67] The event study of this chapter was conducted with a window of five days (-2, +2) around the M&A announcement.[68] The figure below shows the exact timeline of the event study. [69]

Figure 3-16 Timeline for the event study



The steps to conduct the event study are as follows:

Step 1: Define the Event, which is the Chinese OMAs announcement. The announcement date was given by Thomson One Banker.

Step 2: Calculate the Normal Return (Expected Return): estimating the expected return during the 5 days of the event window in the absence of the OMAs announcement. This

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[64] Event study is based on the following two theories: 1) the market expectation of the event is rational; 2) market price reflects the discounted value of the future profit gain from the event.

[65] Using event study to examine the performance of an M&A deal is on the assumption that Market reaction has a strong implication regarding the profitability of the deal in the future.

[66] The development of the China stock market will be further explained in depth in chapter 4.

[67] Given the trading volume of the China stock market and the depth of the capital market, the Chinese stock markets are assumed to be semi-efficient. The stock price genuinely reflects the confidence of the market. However, once the market index is chosen, the question is whether the relationship between the index and companies stock is best correlated. Therefore the sample only includes acquirers listed in the Great China area.

[68] Meanwhile the study with windows of 3 days was conducted to see whether the effect of the Outbound M&A announcement holds on to a shorter window.

[69] The estimation window is the timeframe during which the stock prices are collected in order to calculate the firm specific parameters. Defining the estimation window is crucial in order to calculate reliable firm specific parameters.

thesis chooses the Market model, as mentioned below, to estimate expected returns, which is a well-accepted tool by scholars in financial economics.

$$E(R_{it}) = \alpha_i + \beta_i R_{mt} + e_{it}$$

Where α_i and β_i are firm-specific parameters, α_i is the average return of the firm, compared to the market average return. and β_i is the sensitivity of this firm's return to the market return; R_{mt} is the market return of the period t; e_{it} is the usual statistical error term.

Step 3: Compute the abnormal returns, which equals the actual return minus the expected return.

$$AR_{i\tau} = R_{i\tau} - E(R_{i\tau})$$

The equation of each abnormal return:

$$AR_{i\tau} = R_{i\tau} - \alpha_i - \beta_i R_{mt} - e_{it}$$

Step 4. Calculate the cumulative abnormal returns (CAR).

$$CAR_i = \sum_{i=0}^{n} AR_i$$

Step 5: Estimation procedure: the estimation window is 200 days, 45 days are chosen as "noisy" days to eliminate the event leakage effect.[70]

– Estimation window: 200 days (-248,-49)

– Data frequency: daily stock adjusted price

– Event period and -47 days are not included in the estimation

Data source: Similar to the data used in section 3.2, the data chosen in this section are sourced from Thomson One Banker, and stock information data are taken from DataStream.

Sample (Event) is the announcement of Chinese OMAs with public Chinese acquirers, during the period from 01/01/2004 to 12/31/2012[71] ; the acquisition shares of the target after the event is equal to or above 20%. Detailed criteria as follows:

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[70] Given the fact that the Chinese market is not as efficient or as well-regulated as western markets, news such as a high value outbound M&A is likely to leak some days beforehand. Therefore, there are 45 silent days which are not included in the estimation window, in order to decrease the effect of the leakage.

Table 3-9 Sample Selected Criteria and results

Data Item	Include	All Mergers & Acquisitions	n/a
Acquirer Ultimate Parent Nation (Code)	Include	China	34896
Target Nation (Code)	Exclude	China	4425
Target Ultimate Parent Nation (Code)	Exclude	China	3760
Date Announced	Between	01/01/2004 to 12/31/2012	2145
Percent of Shares Acquired in Transaction	Between	20 to 100	925
Deal Status (Code)	Include	Completed Unconditional	925
Deal Value ($ Mil)	Between	10 to HI	406
Acquirer Public Status (Code)	Include	Public	112
Independent events	Exclude	Repeated events	105
Location of listed market	Include	Shanghai, Shenzhen, HK, and Taiwan	76

Source: Thomason One Banker

Note:

- As China is the acquirer's ultimate parent nation, it is intended to identify the acquirers' nationality by its ultimate capital, this will avoid acquirers which are inside China but in fact are foreign owned entities (WOFE) [72].
- By restricting the target ultimate parent nation to non-Chinese companies, it is intended to avoid round tripping the Chinese invested companies in tax havens, which as explained before is problematic in the data of the Chinese government agency. By choosing the target immediate nation as non-Chinese, this excluded the deals that took place inside China as they are not representative for OMAs.
- The reason for choosing the period from 2004 to 2012 is that 2004 is the time the Chinese domestic regulatory environment was normalized after the 2000 go out strategy and China's access to WTO in 2001. The OMAs started to grow away from the low baseline from 2004. The reason the data stopped at 2012 is because deals announced from 2013 may not be effective till the time of the selected sample. That will distort the completion rate of the deals.
- By choosing 20% of acquired shares with a transaction value at $10millon or above, one can be fairly certain that the effect of the announcement can be captured by the market. However, by choosing a 20% threshold, this screens out events in which 1) the deals were not completed in the end; 2) the deals were completed but the transaction values were confidential.

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[71] The Chinese outbound M&A experienced a wave from 2005, when the central government polished its 11th five-year plan; in this plan, the policy maker further encouraged the Chinese companies to invest overseas. Events from 2004 are included in order to have more samples to adjust the result. The reason not to include events that happened after 2010 is because events that were announced after 2010 may not have their post-event period long enough for the post-event windows which are needed to examine the long-term performance.

[72] WFOE is the form of foreign subsidiary of a foreign company in China. The shareholders are 100% foreign investors.

- When the acquirers announce two OMAs towards the same target, the effect of the event should be captured once; only the earlier event in the sample is chosen. Companies which had repeated events, often acquired the share of the same target on the same day. Therefore, it is more accurate to include one event in the sample.

3.5.2 Distribution of the Events

Based on the Thomson One Banker data, the basic distribution of the events was analysed in order to identify the characters of the events which are the completed OMAs in which the acquirers acquired equal to or greater than 20% of the targets' shares and the transaction value of each deal was equal to or greater than $10 million.

Distribution by acquirer's ownership status

The table below shows, however, that while only one third of the acquirers in the sample has an SOE background, the value of these deals accounted for 53% of the total value. SOE acquirers conducted deals on average valued at more than twice the Non-SOE initiated deals.

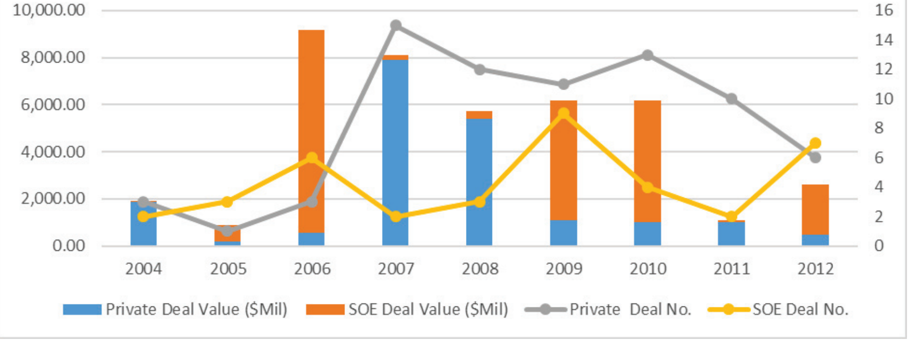
Table 3-10 Distribution by acquirer's ownership status

Acquirer Ownership	Deal Value ($Mil)	Deal VL Market Share	Deal No.	Deal No. Market Share	Average Deal VL
Non-SOE	19,501.65	47%	74	66%	263.54
SOE	22,367.51	53%	38	34%	588.62

Time distribution of the events.

The figure below shows the yearly distribution of the sample.

Figure 3-17 Time distribution of the events

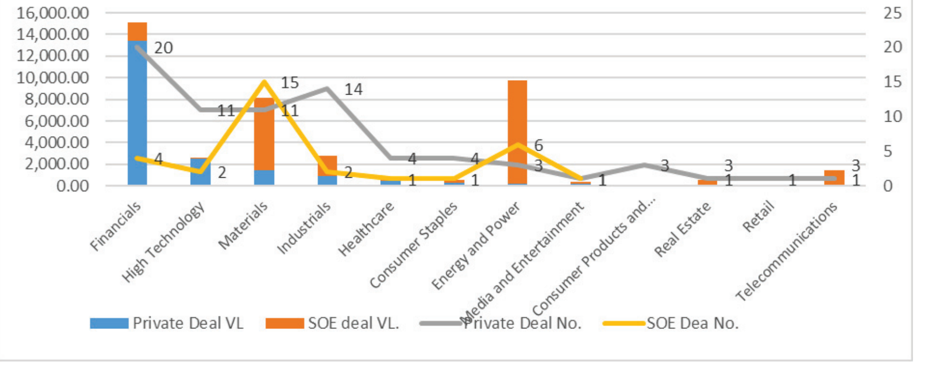


When looking at the total deals over time, there was a clear growth trend in both deal number and deal value (see *Figure 3-2 Chinese OFDI and OMAs (1990-2013))*. However, as shown in the above figure, the sample OMAs do not have such a growth trend, neither in terms of deal number nor in terms of deal value. This applies to both non-SOE acquirers and SOE acquirers. The total volume of the sample, however, was clustered between 2006-2010, two years prior to and two years after the crisis. The SOE deals were mainly clustered in 2006, 2009 and 2010; non-SOE deals were mainly clustered in 2007 and 2008. This confirms the general market timing theory explained in section 3.3.

Target industry distribution

The figure below shows the sample distribution by the target industry.

Figure 3-18 Target Industry Distribution of the sample

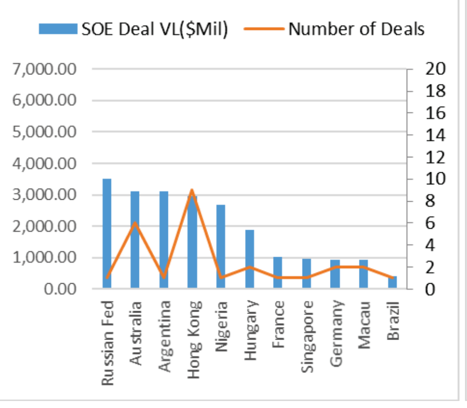


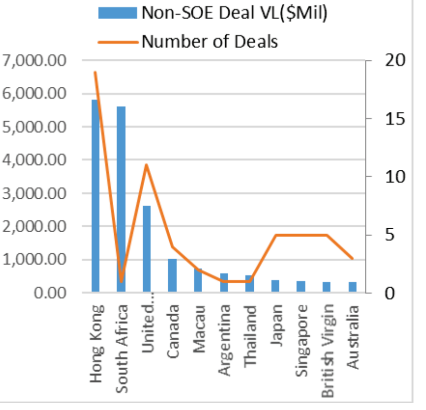
SOE acquirers mainly targeted resources, with a little investment in telecommunications, financials and industrials. As explained in section 3.3, the resource seeking OMAs were mainly motivated by national interest which reflected national investment policy. The state as the owner of SOEs obviously encourages SOEs to invest heavily in resource investment when opportunities present themselves due to the financial crisis. Non-SOE acquirers on the other hand had much more wide-spread investment; they had been involved in all industries, with primary targets in financials and high tech, which conforms to their main motivation - competitiveness building by seeking market or strategic assets. They are rarely involved in the energy sector (3 deals) and the deals were usually acquisitions of equipment and services in the energy industry, so therefore the value of these deals ($66mil/deal) was also marginal compared to the SOE deals ($ 1589mil/ deal). The resource seeking deals in total accounted for 42% of the total deal value.

Target nation distribution

As shown in the figure below, since the SOE were mainly targeting energy and other resource sectors, it is logical that their primary targeted nations were resource rich countries such as Russia, Australia and Argentina. Targets in Hong Kong are usually holding companies whose parent companies are resource rich countries. As non-SOE acquirers were mainly market seeking and strategic assets seeking, they went to host countries that offer consumers technology, brands or management skills, such as Hong Kong and the US. The outstanding rank of South Africa as the second invested host country by non-SOE investors was thanks to one gigantic acquisition ($5.6 billion), ICBC, made to acquire a local bank in order to expand their market to South Africa.

Figure 3-19 Target Nation Distribution of the Sample





Source: *Thomason One Banker*

3.5.3 The Event Study Result

The main investigation in the event study is the market reaction to the Chinese OMAs announcement, which means the short-term performance of Chinese acquirers in high value OMAs (deal value ≥ $10 million).

Table 3-11 reports the results of the performance of the sample which was listed in the Greater China area, with both a 3 days window (-1,1) and a 5 days window (-2,2). [73]

Table 3-11 CARs of sample deals (with MSCI China Index) [74]

[-1,1] CARs		[-2,2] CARs	
Hypothesized mean	0	Hypothesized mean	0
Standard deviation (sigma)	0.049917	Standard deviation (sigma)	0.065847
Sample size	76	Sample size	76
Alpha	0.05	Alpha	0.05
Sample Mean (Xbar)	0.009107	Sample Mean (Xbar)	0.017993
Standard error	0.006444	Standard error	0.008501
Test statistic=t	1.413254	Test statistic=t	2.116603
p-value One Tail To Right	0.081418	p-value One Tail To Right	0.019261
Critical Value One Tail To Right	1.671093	Critical Value One Tail To Right	1.671093

[73] The reason for testing the 3-day event window effect is to show whether or not the market reactions captured in the 5-day window and the 3-day window are different.

[74] The market index of great China used here is MSCI China index.

Note:

P-value <= alpha, Reject H0 and accept Ha, otherwise Fail to Reject H0

Test Statistic >= Critical Value, Reject H0 and accept Ha, otherwise Fail to Reject H0

Tool: Event study tool

The table displays the short-term performance of Chinese acquirers which are listed in the great China area (China, Hong Kong and Taiwan) upon both a 3-day event window and a 5-day window. The total number of events is 74, and excluded are the events which the acquirers listed elsewhere. As shown in the table one finds on average a positive reaction of the Chinese market to the announcement of Chinese OMAs. Chinese acquirers' shareholders on average gain 1.00% and 1.80% (0.000) cumulative abnormal returns with 3-day and 5-day event windows respectively.

In the table below, by expanding the sample to 105 deals listed across the world, the aim is to check the robustness of the above result within the global market index. Using a global market index, the result can show that whether the market reacts similarly on a broader scale.

Table 3-12 CAR of OMAs (with global index)

[-1,1] CARs		[-2,2] CARs	
Hypothesized mean	0	Hypothesized mean	0
Standard deviation (sigma)	0.05258236	Standard deviation (sigma)	0.072183556
Sample size	105	Sample size	10
Alpha	0.05	Alpha	0.05
Sample Mean (Xbar)	0.01182947	Sample Mean (Xbar)	0.014688947
Standard error	0.00603161	Standard error	0.008280022
Test statistic=t	1.96124628	Test statistic=t	1.774022813
p-value One Tail To Right	0.02678129	p-value One Tail To Right	0.040059063
Critical Value One Tail To Right	1.66542537	Critical Value One Tail To Right	1.665425373

Note:

p-value <= alpha, Reject H0 and accept Ha , otherwise Fail to Reject H0

Test Statistic >= Critical Value, Reject H0 and accept Ha , otherwise Fail to Reject H0

Tool: Event study tool

According to the results, the market generally rewarded Chinese OMAs. With a 3 days window, the global market reacts similarly (1.1% CAR), then with a 5 days window, the market reward is slightly smaller compared to the gains from the Chinese market. Nevertheless, Chinese acquirers gain 1.5% CAR at the significance level of 95% regardless of where the acquirer was listed. This may prove that the market in general recognizes the economic rationale of Chinese OMAs and therefore perceive Chinese OMAs as good news.

3.6 Discussion

3.6.1 Peculiarities of Chinese OMA

This chapter has provided a full picture of the motivation, completion and short term performance of Chinese OMAs with empirical evidence and a qualitative analysis.

In line with the literature (Gugler, Mueller, and Yurtoglu 2006), the empirical evidence of Chinese OMAs showed that deregulation was also a determinant of the merger wave. The significant investment policy change starting around 2000 unlocked the potential of Chinese companies; as a result, it stimulated a Chinese OMAs wave. Prior to deregulation, the transaction cost caused by regulatory approvals was simply too high for companies to engage in OMAs. The deregulation greatly loosened the regulatory control, facilitated Chinese companies' internationalization ambitions, and therefore the international M&As market witnessed the increasing participation of Chinese acquirers.

The 2008 financial crisis provided another and rather major push to Chinese companies. The financial crisis on the one hand led to a "low market" in the financially stressed markets, such as the US and the EU, which was to the advantage of Chinese acquirers because it created a better host-country environment for the Chinese acquirers; while on the other hand, at the firm level, the crisis generated more OMAs supply in the international M&As market, and many targets became available to Chinese acquirers because of the crisis. Therefore, the empirical evidence showed a Chinese OMAs boom around the crisis period.

Chinese acquirers, as inexperienced late-comers in the international M&As market, have been "learning by doing". They started with caution in choosing the region and market position of the target. Region-wise, Chinese acquirers in the beginning preferred engaging in OMAs in the markets they are relatively close to and familiar with (i.e., Asian counties) although these markets did not offer a higher certainty in completing the deals. Then with experience, as well as contingent events such as the financial crisis, Chinese acquirers speeded up their OMAs in the developed markets; the EU, for example, became a primary target region during the crisis time (see *Figure 3-11 OMAs value by target nation (2009-2013)*). Target-wise, with little experience, Chinese acquirers mainly targeted the poorly performing companies or companies that needed quick liquidity. And in general, they approached their targets in an amicable manner. Later on, with experience, Chinese acquirers, especially the non-SOE companies, started to approach all kinds of companies based on their specific motivation and market situation. This is in line with the literature which found that cross-border M&As process is a learning process. (Very and Schweiger 2001; Xu and Hitt 2012; Collins et al. 2009)

At the same time, empirical evidence also showed a number of peculiarities of Chinese OMAs which are not well explored in the literature.

Firstly, the "merge-up" pattern. The mainstream literature is mainly focused on the cross-border M&As from developed economies, especially Anglo-Saxon countries' OMAs. Those deals are either made between equals (both the acquirers and the targets are from developed markets) or acquirers "merge down" (the targets are from less-developed markets). However, this chapter suggests that there is a large number of Chinese acquirers who merge up. The merging-up deals offer a "new" style of cross-border M&As, namely Chinese acquirers acquiring targets from markets more developed than China. The motivation is to access the strategic assets (i.e. IP, know-how, and brand) of the target or the international market the target has. That also explains the empirical evidence that Chinese acquirers often aim to be the majority shareholder and they are often "extremely" friendly.

Secondly, the high risk of failing OMAs attempts. In the cross-border M&As literature, there is little study of the determinants of successful completion of the deals. The Chinese evidence showed that Chinese acquirers have a higher than average failure rate in completing the deals. Many would hypothesize that SOEs drag down the completion rate (Zhang, Zhou, and Ebbers 2011), and interestingly enough the empirical evidence showed that with SOEs or not, the deal completion rates were not much different, namely both have as low as a 56% completion rate. Although from the micro level perspective, the empirical evidence can offer some variables related to deal completion which was discussed in section 3.4., the empirical evidence cannot explain why Chinese OMAs suffer from liability of origin (LOO).

Thirdly, the shareholder value increasing effect. Whilst the mainstream literature found mixed results regarding stock market reactions on cross-border M&As, the Chinese evidence showed a clear positive market reaction on Chinese OMAs; in section 3.5, one finds the market tends to view Chinese high value OMAs as a positive event, the acquirers' shareholders often gain positive returns around the announcement of an OMA deal. Both event study methodology and this analysis of sample deals have limitations, given the immaturity of the China stock market and small samples, the results from event study should not be generalized and should be interpreted with reservation. However, other finance studies of Chinese OMAs (Gu and Reed 2013; Black et al. 2013) with different samples also confirm the wealth increasing effect of Chinese OMAs.

3.6.2 Does the acquirer's institutional background play a role?

The current literature in cross-border M&As has not offered a sound investigation to explain the above-mentioned peculiarities of Chinese OMAs. The theoretical arguments "borrowed" from the current literature have limited power in explaining the following peculiarities of Chinese OMAs: 1) why are many Chinese companies motivated to merge up? 2) Why do the Chinese OMAs in general have a lower chance to complete the deals? And 3) why are the Chinese OMAs performing better than the others? These peculiarities of Chinese OMAs seem to suggest that the "Chinese identity" of the acquirers plays a role; however, in the cross-border M&As literature there is lack of theoretical framework which can be directly applied here in order to either confirm or reject this hypothesis.

Some literature on Chinese OFDI and Chinese MNEs (Buckley et al. 2007; Rodríguez and Bustillo 2011; Child and Rodrigues 2005) touched upon the impact of firms "Chinese identity", this literature found that the macro environment of China plays a role in shaping the Chinese outward FDI and the behaviour of Chinese MNEs. However, very few studies have been designated to investigate the impact of the "Chinese identity" in companies' OMAs behaviours and outcomes (Rui and Yip 2008).

Therefore, it is important to investigate the role of the "Chinese identity" in Chinese OMAs, which will bridge the cross-border M&As literature and the Chinese FDI literature. This thesis proposed to apply the NIE approach to study the role of "Chinese identity". The "Chinese identity" means that the Chinese acquirers are incorporated and primarily operate in China. That is to say those Chinese acquirers exist and operate under the constraints and benefits of Chinese institutional settings (formal and informal) and these companies have a Chinese institutional background.

One of the basic theories of NIE is that institutional settings in a society affect society members' behaviour and performance (Coase 1998). The different quality of different institutional settings results in different behaviour and outcomes of economic actors (North 1990). The basic proposition of this thesis therefore, based on NIE, is that because Chinese acquirers and managers are embedded in the institutional settings (formal and informal) of China, this institutional background of Chinese acquirers affects their behaviour and outcome in OMAs. Since a different institutional background poses a different set of liabilities to the companies and/or facilitates different kinds of ambitions of companies, one can observe the peculiar behaviour and outcome of Chinese OMAs. To put it another way, this thesis attempts to confirm that the "Chinese identity" of acquirers is an explanatory factor of Chinese OMAs' peculiar motivation and performance (in both deal making and profitability).

The next chapter introduces the NIE theories that are adopted for this thesis, and then describes in depth the relevant institutions and institutional changes in China and how this institutional background affects Chinese acquirers in OMAs.

Chapter 4. The New Institutional Economics Approach of Chinese Overseas Mergers and Acquisitions

4.1 Introduction

The basic proposition of this thesis is that the behaviour of Chinese acquirers and their managers is influenced by their institutional background ("Chinese identity") which also ultimately contributes to the peculiarities of Chinese OMAs. Although this thesis does not prove the weight of the effects of the acquirers' institutional background due to the difficulties of quantifying it, it nevertheless suggests that the institutional background of acquirers is a contributing factor of Chinese OMAs at every stage of the process.

In order to test the proposition of the thesis, it is important to have a good understanding of the peculiarities of Chinese OMAs, and a good understanding of the Chinese institutional settings which may influence the Chinese OMAs. As discussed in Chapter 1, the current literature has failed to provide a comprehensive picture on both, and therefore these are the two basic literature gaps that this thesis should fill.

Chapter 3 fills the first literature gap. Due to the fragmented approach of the current literature (Zhou et al. 2012; Wang and Boateng 2007; Wu and Xie 2010), it fails to give a full picture of the characteristics of Chinese OMAs. Chapter 3 takes the process approach and examines the Chinese OMAs as a process containing three stages: motivation, deal-making and post-deal performance. By investigating Chinese OMAs from the process perspective, Chapter 3 underpins the peculiarities of Chinese OMAs.

The task of this chapter is to fill the second literature gap by providing a good understanding of relevant institutional settings in China based on the new institutional economics (NIE) insights. In the literature, there are studies that have tackled the role of the institutional background of acquirers. For instance, some research found cultural differences between the home country and host country (Ahern, Daminelli, and Fracassi 2012; Dikova and Rao Sahib 2013); home country trade liberalization (Hijzen, Gorg, and Manchin 2005) plays a role in cross-border M&As. There are also studies which explain certain Chinese OMAs' characteristics from a "Chinese identity" perspective. For instance, there are studies linking the "go-out" policies to Chinese OMAs performance (Gu and Reed 2013); there are studies linking Chinese industry policy and Chinese acquirers' resource seeking motives (Jiang and Sinton 2011; Davidson 2003; Criscuolo et al. 2014) and strategic asset seeking motives (Deng 2009; Luo and Tung 2007). These studies all suggest a link between Chinese OMAs and the acquirers' Chinese institutional background, but the literature has neither offered a full picture of this link nor the full picture of Chinese acquirers' institutional background.

This chapter attempts to fill this literature gap. The rest of this chapter is organized as follows; section 4.2 presents the relevant insights from new institutional economics theories and develops a framework to apply to the study of Chinese institutional settings. It is not intended to be a complete survey of the NIE, but an extract that concentrates on the specific arguments made here that fulfil the aims of this chapter. Section 4.3 will introduce the three main institutional frameworks in China's history and institutional changes in China, which offer a full picture of Chinese companies' institutional background. Section 4.4 concludes the chapter.

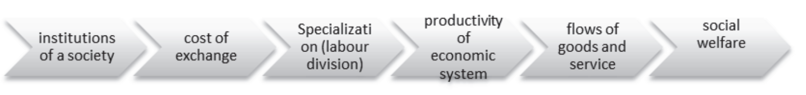
4.2 New Institutional Economics Approach

4.2.1 The Basic NIE Theories

4.2.1.1 Institutions and Social welfare

In NIE, "**institutions** are the humanly devised constraints imposed on human interaction" (North 1993). North further specified that institutions "consist of formal rules, informal constraints (norms of behaviour, conventions, and self-imposed codes of conduct) and the enforcement characteristics of both". New institutional economics argues that institutions matter in the economy of the society, because "…the institutions (that) govern the performance of an economy…" (Coase 1998). Coase further explained the chain effect between institutions and the social welfare. The figure below summarises this chain effect.

Figure 4-1 Relationship between Institutions and Social welfare



Source: Coase 1998

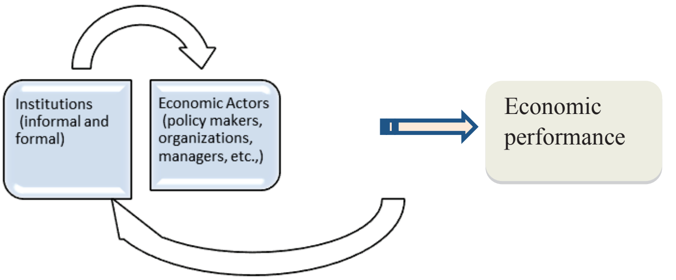
Coase pointed out that the quality or efficiency of a society's institutions controls the social welfare of that society. This rational is concluded by a chain of causalities. Firstly, the social welfare of a society depends on the flows of goods and services (Neoclassic Economics); then the goods and services depend on the productivity of the economic system which then depends on specialization (Adam Smith). Then the specialization (division of labour) depends on the cost of exchange (i.e. the theory of firm). The lower the transaction cost, the more sophisticated the division of labour is in a society. Finally, the transaction cost is determined by the quality of the institutions of a society. To sum it up, this chain of effects proves that social welfare is ultimately determined by the institutions of the society, or to put it another way, the institutions control social welfare (Coase 1998).

4.2.1.2 Institutions, Economic Actors, and Economic Performance

In economic life, institutions are the "rule of game", and economic actors are the players of the game. The players are constrained by the "rule of game", but meanwhile the interaction between the rules and the players also pushes the evolution of the rules. NIE studies the relationship between institutions, economic actors and economic performance in a dynamic manner. Economic activities are not conducted in a static social vacuum, institutions and institutional changes are influential to economic life. Therefore, it becomes important to understand how the changes in the institutional environment and institutional arrangement affect the economic performance of the firm (North 1994).

Firstly, institutions incentivize the behaviour of firms and managers. Therefore, different institutional frameworks incentivize different types of behaviour, resulting in different performances. Secondly, the other way around, economic performance then incentivises economic actors (managers, interest groups and policy makers) to improve the efficiency of institutions; "it is the interaction between institutions and organizations that shapes the institutional evolution of an economy"(North 1994). The figure below summarises the above explained relationship between and among institutions, economic actors and economic performance. This relationship explains the behaviour of firms and policy makers. It is important to clarify that by no means does NIE claim that the institutions are the sole determinant of the behaviour of economic actors, but they are an important determinant. [75]

Figure 4-2 Institutions, Economic Actors, Economic Performance

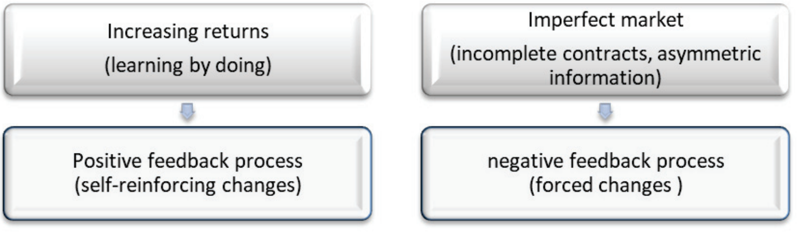


Source:(North 1994)

4.2.1.3 Drives for Institutional changes

According to North (1990), there are two forces determining the path of institutional changes, namely increasing returns and an imperfect market.

Figure 4-3 Two types of institutional changes



[75] " Human behaviour is always shaped and influenced by the environments of individual actors as well as by their physical makeup" (Shaffer 1995)

Source: North (1990)

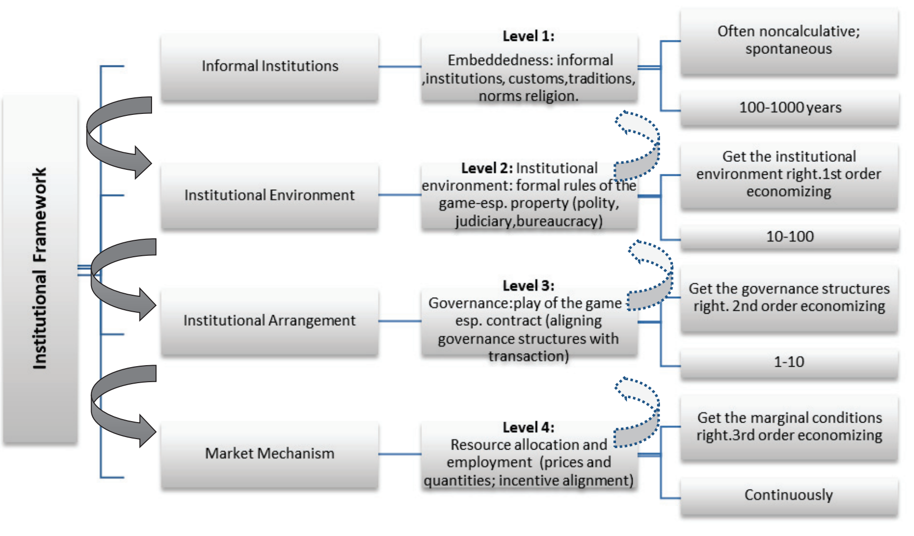
The figure above summarises the two forces driving institutional changes. One force is **the increasing returns**, where organisations receive feedback about the continuous changes between them and institutions. These organisations learn by doing, and increase the profitability of their businesses. This kind of institutional change can also be described as self-reinforcing or the positive feedback process. The other is **the imperfect market** characterized by incomplete contracts, and asymmetric information, where transaction cost is important and the behaviour of agents is affected by ideology and limited information. In this case, the institutional changes are forced to minimize the transaction cost. Compared to the first kind of institutional change, this kind of change is a more negative feedback process.

4.2.2 Economics of Institutions of a Society

4.2.2.1 The Four-layer Institutions

Williamson (2000) made a four-layer scheme to further define institutions. He classified institutions into four layers, and explained how these four layers are related. The figure below summarises the main characteristics of the four layers of institutions in a society, followed by a detailed explanation.

Figure 4-4 Economics of Institutions



Source: Williamson (2000)

Informal Institutions. As shown in the figure above, **the first level** institution refers to the informal institutions. They are socially embedded by way of values, norms, customs, taboos, attitudes and the like. North (1990) referred to informal institutions as “ideologies” or “belief structures” and the complementarities.

Based on the contents, the informal institutions can be categorized into three kinds of ideologies: social ideology, political ideology and economic ideology (Wartick and Wood 1998). Social ideology concerns whether in a society the culture is more individualism or collectivism; political ideology refers to which kind of political system the society desires or recognizes as a whole; people are either more liberal or more conservative; and economic ideology refers to how the society perceives an efficient economic system.

Informal institutions have an influence in a very broad way. Firstly as level 1 institutions, they vertically affect the structure of the other three levels of institutions (Williamson 2000) (See Figure 4-4). Secondly, as ideologies, they also directly influence the behaviour of all economic actors. Without understanding the “social embeddedness”, it is hard to understand the behaviour of economic actors comprehensively (Knack and Keefer 1995; North 1990). Therefore, in order to understand the performance of an economy or an economic activity at a certain period, it is essential to acquire a good knowledge of the informal institutions of such an economy at that time.

The informal institutions are usually present in a society consistently since they are not subject to public or private interventions. It takes centuries or millennia to change these informal institutions, and they are believed to be spontaneous in origin (Williamson 2000). There is little room for “deliberate choice”, rather, it is non-calculative. For instance, one economy may have had its commercial culture and values consistently for centuries, regardless of any changes in its political systems. However, it is suggested that government (and powerful interest groups) can influence the legitimacy of the existing ideology and accompanying norms and values. This influence can be effective the more the government is considered the legitimate institution by which to inform the people about the “right” ideology and the appropriate values and norms. In his book Malešević compared the dominant ideologies and modes of legitimization in communist Yugoslavia and post-Communist Serbia and Croatia which suggest that the political changes induced ideology changes (Malešević 2002).

Institutional Environment. Williamson defined **the second level institution** as an “institutional environment” which refers to the formal institutions: political, bureaucratic and judicial institutions made by policy-makers[76], especially with regard to property rights. Level two institutions can be legislative, bureaucratic and judicial. These formal “rules of the game” forbid, allow or stimulate the behaviour of economic actors. For instance, constitutional law, property law and criminal law are examples of these formal “rules of the game” which regulate the behaviour of players. Compared to level one, these institutions are essentially man-made rules, and therefore, they are one of the main concerns of new institutional economics. NIE investigates 1) how the “rules of the game” are formed; 2) who gets to play the game; 3) what are the “rules of the game”; 4) and most importantly whether the “rules of the game” are efficient.

[76] In this thesis, policy-makers are referred to as formal institution makers which includes the makers of policy, law, and other regulatory institutions.

The institutional environment has its continuity since it changes rather cumulatively and progressively. Unless there are massive intrusions[77], it takes decades or centuries to change a country's institutional environment. For instance, except for some amendments, the fundamental rules of constitutional law in the US have not been changed since 1789. However, when the "massive-intrusion" happens to a country, there is usually an opportunity for reform of the institutional environment (Williamson 2000). For instance, most East European countries transited from a social institutional environment to a capitalist institutional environment after the breakup of the Soviet Union.

Institutional Arrangements. The third level institution concerns the "institutional arrangements" which refer to the institutions of organization (firms, government agency) and contracts (trade and licences) that co-ordinate the co-operative and competitive behaviour of economic actors. Level 3 institutions deal with how the specific game is played or 'the governance of contractual relations', such as contract relations and enforcement; corporate governance. The idea is that for each specific transaction there exists an efficient governance structure, i.e. TC-minimizing governance structure. Williamson referred to this as second-order economizing. The goal of the policy maker is to establish the "TC-minimizing" institutional arrangement. And with interactions between these arrangements and organizations, policy makers may voluntarily, or as required, adjust the arrangements in order to constantly minimize the transaction cost; i.e., in the interaction between institutional arrangements and the players (e.g., government agency, companies and managers), there is a possibility that the current institutions can be changed or that new institutions can be created according to the bargaining power (Samuels 1966). Mantzavinos, North and Sharip (2004) argue that learning (i.e., trial and error) is crucial in the formation and evolution of institutions, both formal and informal. This process is also considered "cognitive institutionalism" or learning process (Mantzavinos, North, and Shariq 2004). Policy makers learn from observing the efficiency of the institutions, interactions, etc., and adjust the institutional environment dynamically.

Therefore, institutional arrangements change much faster than the institutional environment in a society. "The possible reorganization of transactions among governance structures is re-examined periodically, in periods from a year to a decade, often at contract renewal or equipment renewal intervals" (Williamson 2000). Firstly, unlike the institutional environment (for instance political regime), changes at the second level institutions (for instance contract law) are much less dramatic. This does not require "massive intrusion" or dramatic reform. Secondly, the ever-changing business world requires fast establishment and adaptation to the new rules of the game. An inefficient rule of the game may lead to a less competitive position of the firm on the international market. Both companies and policy makers should be fast learners.

Resource allocation and Employment. Finally, at the **fourth level,** Williamson locates the market as the institution that co-ordinates demand and supply and optimises the price. Firms are considered as function of production. Agents are supposed to be rational and self-interest maximizing. This level of institutions is to get the "price" right. It is in line with neoclassical

[77] Williamson (2000) gave some examples of when a country's institutional environment changes drastically, such as the breakup of the Soviet Union and Eastern Europe.

economics. An efficient market is the necessary condition to locate the resources efficiently with rational economic agents. "Adjustments to prices and output occur more or less continuously"(Williamson 2000), so therefore the market is constantly changing.

4.2.2.2 Relations between the layers

As Williamson (2000) pointed out, **each level of institutions has a controlling influence on the level below it** and there are also feedback effects from lower levels to higher levels (as the arrows show in *Figure 4-4 Economics of Institutions,* the darker arrows indicate controlling influence, the lighter arrows indicate feedback influence). This means that the informal institutions of a country put constraints on the emergence and evolution of the institutional environment. The institutional environment then determines the shape of institutional arrangements. All these informal and formal institutions then control whether the market is efficient. Furthermore, although the informal institutions and institutional environment (except for property rights) are exogenous variables, property rights (Level 2) and the institutional arrangements (Level 3) are endogenous variables. Davis and North (1971 p5-6) distinguish between the two as follows: "The institutional environment is a set of fundamental political, social and legal ground rules that establish the basis for production, exchange and distribution. An institutional arrangement is an arrangement between economic units that governs the ways in which these units can cooperate and/or compete. It provides a structure within which its members can cooperate … or provides a mechanism that can effect a change in laws or property rights".

Therefore, according to Williamson (2000) in order to have an efficient institutional framework for economic development, the following orders should be respected: Firstly and fundamentally, under society's unique informal institutional settings, policy makers should make efficient formal institutions (Constitutions, property rights, political system, judicial system). In a well-defined institutional environment, the uncertainty of economic players is minimized. Economic players are therefore incentivized to cooperate with (via contracting) or compete with (via competition) each other. Secondly, the country's "play of game" the level 3 institutions: governance structure of transactions should be right. A well-defined institutional arrangement (contract enforcement, corporate governance) should be designed to minimize the transaction cost in contractual relations among firms or inside a firm. Poorly designed institutional arrangements on the other hand would create enormous transaction cost among economic actors. Lastly, after economizing the first order and second order institutions, a competitive market should be established. It should have a sufficient mechanism to ensure efficient allocation of the resources and the means to enforce efficient employment relations.

4.2.2.3 Theories Applied

NIE relies strongly on theories from multi-disciplines and benefiting from political sciences, sociology, management sciences, and law in particular. Williamson (2000) indicates the specific theories that provide special insight to the study of the economics of institutions: "social theories" will be applied for the analysis of the evolution and function of informal institutions. Property Rights and positive political theory (PPT) are useful for studying level two institutions. The main argument of property rights is that an institutional environment with well-defined property rights and enforcement can allocate the resources efficiently. It brings certainty, therefore ensuring growth in terms of the flow of transactions. PPT is explored in order to examine how the choice of policy makers is shaped, and what the outcome is of their choices. The Policy maker is a function of his own utility. How to incentivize policy makers to make efficient institutions is therefore essential. Furthermore, interest group politics might be influenced by the existing distribution of wealth and power. They influence policy makers' choice of institutions. *"The dynamics of interest group politics depend on the existing pattern of corporate ownership. This introduces another source for the path dependence of legal rules. ...Each interest group plays a role in the economic system and seeks to push for rules that favour it. Interest groups differ in their ability to exert pressure on legal rules that favour them or against rules that disfavour them. The more resources and power a group has, the more influence the group will tend to have in the political process. In particular, the existing corporate ownership structures will affect the resources (and hence political influence) that various players will have and thus the rules that will be chosen"* (Bebchuk and Roe 1999) .

Transaction Cost Economics (TCE) is applied for Level three institutions. The discrete choice between arrangements is the focus (Williamson 2000), whichever arrangement minimizes the transaction cost will prevail. Institutional arrangements aim to internalize the transaction cost of market players. The policy maker therefore should choose the kind of arrangement which promotes "more efficient asset combination, more efficient management, and better corporate governance structure" (Macey, Högfeldt, and Samuelsson 1995). Williamson emphasized the importance of contract enforcements at this level. Firms' choice between contracts or buying is a typical application due to the institutional arrangements in which firms operate. TCE in general is widely applied everywhere in the NIE.

Lastly, Neoclassical Theory and Agency Theory are applied at Level four in which a marginal analysis is central. The level 4 institutions (market) should be adjusted continuously, so that markets can correctly reflect supply and demand and therefore optimally allocate the resources. In the employment issue, agent theory is applied to find institutions that best align the interests of employer and employee.

4.2.3 Acquirers and Their Home Country Institutional Framework

This thesis aims to apply the above NIE insights to test the proposition of this thesis: how the institutional background of acquirers contributes to the peculiarities of Chinese OMAs.

NIE insights suggest that in a specific economic "game", on the one hand, economic agents (i.e., policy makers, industries, firms and other interest groups) bargain and influence the emergence and evolution of the "rules" of that "game"; on the other hand, economic agents "decide" their best strategy to play the game based on the "rules" in hand in order to best allocate their resources. Furthermore, in the process of rule-making and game-playing regarding one game, except for the specific "rules of the game", economic agents are also constrained or facilitated by another level of institutions at the same time, namely informal institutions, the institutional environment and the market.

Regarding Chinese OMAs, the institutional background of Chinese acquirers is not only limited to the "rules of the game" for OMAs, but also includes the other layers of institutions.

Focusing on the relevant decisions and bargaining on the "rules of Chinese OMAs", the following decisions and bargains happen in a given period of time[78]:

1) **Chinese Policy makers** formulate or change the relevant institutional arrangements (e.g. investment policy, regulations, tax and enforcement). These institutional arrangements are the "rules of the game" for OMAs, the emergence and evolution of these "rules of the game" are influenced by the bargaining with interest groups (e.g., industries, companies, host-country interest groups) and other layers of institutions;
2) **Potential Chinese acquirers** lobby for the "rules of the game" which would serve them the best; they then decide on their growth strategy (e.g., make or buy, domestic or international) in the institutional background at the time; constraints and/or facilities provided by the "rules of the game" and others.
3) **Targets** decide whether to accept the acquirers based on the attractiveness of the offerss; and the acquirers' institutional background is one of the indicators of the acquirers' attractiveness.
4) **Other stakeholders** decide whether to accept a certain Chinese OMA (e.g., national security scan, anti-trust clearance);
5) Finally, in the case where the acquirer is a listed company, the **stock market** decides whether a certain OMA is constructive or destructive to its value. The efficiency of the stock market then is also a factor affecting the reaction of the market.

The above decision-making process does not exhaust all the decisions that can be made in the "game" of Chinese OMAs; however, they represent the most important decisions in the game. The decision-making process highlights a different level of interactions among agents seeking to influence the way the "rules of the game" are built and evolve, meanwhile taking the best of these "rules of the game". The bargains are played both on a domestic level (e.g. the bilateral interactions between Chinese policy makers and relevant industries), and on a global level (e.g. interactions between policy makers of China and host countries). The next section reviews the formation and evolution of the Chinese institutional framework, and specially pays attention to the rules related to Chinese OMAs.

4.3 Institutional Changes in China and Chinese OMAs

Opening the box of the decision-making in OMAs helps to break down the rationale of the emergence and evolution of home-country institutions , as well as the rationales of the economic agents' behaviour in the process of Chinese OMAs. That is also the strength of the NIE approach. This section therefore gives an overview of the institutions built and institutional changes in China, with the focus on the OMAs related institutions. This review does not aim to analyse all the major institutional evolutions in China, but rather the most relevant ones which affect Chinese companies' institutional background and their performance in the international market. Based on the literature review in Chapter two and the proposition of this thesis, the most relevant institutions which will be reviewed in this section

[78] It is worth noting that in OMAs, decision-making is time sensitive, policy makers or firms would have different rationales and decisions at a different time. Therefore, the timeframe is stated whenever there is discussion of the "games" or the "rules of the games".

are informal institutions; property law, corporate law, intellectual property law; and the overseas investment policies and regulations.

4.3.1 Overview of the Three Institutional Frameworks of the PRC

From 1949, when the PRC was established, until the present, China's institutional setting (i.e., institutional framework) has changed dramatically. The institutional framework (IF) which was originally formed under the central planning economy was gradually replaced by a more market compatible one. Haven said that it is important to be aware that the development of the Chinese IF is not a smoothly upward road although along the way the evolution of the IF has equipped a "economic miracle" with China's impressive economic growth (Shih 2010). Rather, the road is filled with push-and-pull from different directions by different economic agents and there have certainly been both forward-moving changes and backwards-moving changes before the IF of China evolved to the current version.

The process towards building a more efficient institutional framework in China therefore is a unique case to study. Based on the theme of this thesis [79], the development of the Chinese institutional framework has been divided into three stages by means of two major institutional changes. Although the main focus is the current IF, it is important to understand the evolution with a detailed understanding of the previous ones.

The first Chinese IF (the 1st IF) lasted from 1949 to1978 during which the theme of the institutional framework was "closed-door" and a rigid socialist economy. The society's ideology was synchronized with the institutional environment–collectivism and state (people's) ownership. There was neither private ownership nor market mechanisms. The so called "companies" were not corporations but state-run production and state-run service providers. China, at this period, had poor quality level 2 institutions. As Williamson (2000) put it, the first order of economizing had failed, and therefore level 3 and 4 institutions were almost absent. The "rules of the game" of OMAs were absent because there was no ground for any contracts or competition to be formed domestically or internationally. It is not surprising that under the poor institutional environment, the economic performance of Chinese "firms" was extremely poor. This was not arguably a very negative feedback to the economic actors (state, policy makers, organizations and individuals). Policy makers, at the end of this period, had to react to the feedback that the closed-door policy was not leading China to any economic success. The 1st IF, especially property rights needed some modification to unfold the potential of market, firms and people.

Therefore, in 1978, policy makers modified the rigid socialist regime and started to correct some major mistakes in the 1st IF. It began to feed people a revised ideology, the so-called "Socialism with Chinese characteristics". Disappointed by the socialist ideology and confused by the direction of economic development, people were very receptive to this "half socialism, half reformism" ideology (level 1). Under this mixed ideology, the state promoted individualism and encouraged people to pursue personal success. Policy makers promoted the "open-door" policy and more market compatible institutions, although these institutions were mixed with the socialist institutions, policy makers conducted consistent changes.

[79] This division is only to serve the research purposes, with the reasoning primarily based on their function in the progress of Chinese OMAs. For other ways of division see Tao (2012) and Redding (2002)

Fundamental laws (e.g., property rights of farms, corporate law) were made more flexible and laws to facilitate the economic activities (contract law) were also created to implement the property laws and to enforce contracts and promote competition. These changes lead to the emergence and flourishing of firms and market, and contributed to the economy's continuous growth. Firstly, thanks to the privatization of SOEs and consolidation of the market, a number of modernized companies emerged. Secondly, the more market-oriented institutional framework attracted a considerable volume of FDI. The FDI not only brought in investment but also gave Chinese companies the chance to directly interact with international players. These experiences helped to train Chinese companies to become acquainted with international business practice. Furthermore, through FDI in China, MNEs also became acquainted with the Chinese institutional framework. China gradually built its credibility on the international market[80], Towards the end of stage two, China started to be perceived as a country that has emerging corporate governance (Tenev, Zhang, and Brefort 2002) and a stable institutional framework.

At this stage, the main mission of the institutional framework was to facilitate the domestic market and nurture national champions. Therefore, there were a number of regulatory controls of investment. Domestically there were sector restrictions on private investment and FDI, such as financial sectors and the automotive industry were not open to private companies or foreign companies. For outbound investment, policy makers imposed heavy controls on Chinese companies' overseas investment. Acquiring an overseas target during that period was both costly and time-consuming and there was a high risk that the idea would be rejected by approval authorities. However, at the end of the 1990s, policy makers, industries and firms agreed that the investment controls were hurting the competitiveness of Chinese companies. The Chinese companies would only increase their competitiveness organically from a free market and start competing in the international market. Under the institutional framework at that time (2nd framework), the protected domestic companies were on the one hand lacking ambition in terms of innovation or international expansion. On the other hand, many high-performing companies were ready to expand internationally and the institutional framework was not only unable to facilitate their ambitions but also holding them back.

Reacting to the positive and negative feedback from stage 2, policy makers initiated another institutional change around the end of the 1990s and beginning of the 2000s. The regulatory control for both domestic and overseas investment was liberalized on a grand scale. The main feature of this change was to build an institutional framework (the 3rd framework) not just to facilitate companies' domestic development but also to encourage, guide and facilitate their international expansion. That is when the Chinese OMAs emerged.

From the methodology point of view, although the major institutional changes happened under the 1st and 2nd IF, a qualitative analysis approach was adopted, rather than a quantitative analysis, due to the missing data on the early years. Therefore, the quality of the institutions of China cannot be compared with other counties. However, for the 3rd IF of China, both qualitative and quantitative analysis have been incorporated due to the availability of the

[80] This credibility was built slowly from completely negative to decreasing negative and increasing positive. However, the Chinese institutional framework was still considered to be of very poor quality, primarily due to the rule of law in China.

world bank data. The *Worldwide Governance Indicators published* by the World Bank enable the analysis of the quality of major institutions, and their position worldwide.

The table below summarises the main characteristics of each institutional framework. The next three sub-sections will analyse each institutional framework in detail.

Table 4-1 Three stages of Chinese Institutional Development

Timeline	1949-1978(1st IF)	1978-1999 (2nd IF)	2000 onwards (3rd IF)
Level 1: Informal Institutions	Social Ideology (SI): Collectivism, Confucianism Political Ideology (PI): Rigid Socialism Economic Ideology (EI): central planning economy	SI: individualism, Confucianism PI: Socialism with Chinese characteristics EI: reform and open up - socialist market economy	SI: individualism, Confucianism, PI: Socialism with Chinese characteristics EI: Socialist market economy, state capitalism
Level 2: Institutional Environment	Rigid Socialist political institutions. Absolute Public ownership of property, no private ownership	Socialist political institutions with reform. State-ownership is still dominant, but private ownership emerged. Property law, corporate law and contract law were established	Socialist political institutions; Mixed ownership; More private firms; Improvement on property law, corporate law, IPR and contracts
Level 3: Institutional arrangement	State operated enterprises; no real market based contracts; Administrative governance	Corporate governance emerges; contract relations have started to be established and are improving	Corporate governance improved; International governance adapted gradually
Level 4: Market	No market, price is fixed by the state, central planned production and employment	Domestic market starts to emerge; established capital market; Demand and supply partially working; agent problem exists in market and politics. Inward FDI dramatically increased and increased market competition	Domestic market mechanism improved; Chinese market becomes part of the global market, Chinese firms are active players in global resources allocation. Chinese MNE emerge;

Source: Author made based on Williamson's four layer schema

4.3.2 The 1st IF: Closed-door Socialist Era (1949-1978)

From 1840 to 1949, China had experienced a dark age (Scott 2008). There were massive changes, including western intrusion, the fall of the Qing Dynasty, Republican revolution, WWII and the civil war (Perkins 1975). By the time the communist party established the

People's Republic of China (PRC) in 1949, the ideology in the nation was ready to be consolidated as a "new China" and a "socialist community". Communism and Confucianism have mixed and worked as informal institutions at stage one of China's development. A brand new institutional framework consisting of the socialist property regime (Level 2), socialist governance structure (Level 3) and a socialist resource allocation structure (Level 4) which were all established under the socialist ideology and enthusiasm of new China (Level 1).

4.3.2.1 Informal institutions

Under the 1st IF, the mix of the newly established communist ideology and traditional Confucianism formed the basis of informal institutions. There are many common values between these two ideologies, especially the values of collectivism, egalitarianism and high-respect for authorities and the central government. These common values exerted a strong influence on China's economic activities at that time. Both communism and Confucianism promote the values of **collectivism**, and both underlined the value of considering individuals, organizations and the nation as a whole (Earley, 1993). They emphasise the priority of the "public", while rejecting the pursuit of personal benefit. This was therefore in line with the central planned economic policy in China. Especially at the beginning of this period, this ideology was promoted by the state and well accepted by the society. Furthermore, both communism and Confucianism emphasize egalitarianism. Believing in Confucianism, people desire and fight for equality in the thousands of years of Chinese tradition. In this period, the policy implemented an "absolute" equal system. For instance, in the state-owned factory, all workers received exactly the same amount of salary based on the national income level. In agriculture, all the famers received the same amounts of crops based on the national level harvest. The income of every citizen is decided by the state, with no relation to their performance whatsoever. Most importantly, both communism and Confucianism promote the concept of high-respect for authority. The extremely high respect for authority is one of the most important features in Chinese culture. Because of thousands of years of strong centralisation of state power, people were used to accepting the statements, guidelines and plans rather passively from the government (Redding 2002).[81] The socialist's ideology also promotes the central power of the government. The whole country recognized the top-down implementation of institutions. This culture made the central government very powerful in history, and the same applies to the new government of China. Therefore, the formal institutions, even the really unreasonable ones[82], were mostly implemented smoothly. The power of this ideology, however, decreased over time after a number of destructive

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[81] In his book, Redding describes his understanding of how this culture was so embedded in China. "This a 'high power distance' culture, with a great respect for strong vertical order, founded in the Confucian tradition which determined the design of both the state, and roles learned by individuals. The primary moral basis for authority is paternalism, and concern for employees and their welfare will legitimate the holding of power, and the exercise of discipline. The equivalent at the state level is patrimonialism. Socialization into clearly understood role behaviour vis-à-vis authority has been apparently maintained. Communal norms governing authority relations remain strong, and serve to preserve vertical order along recognizably traditional lines, albeit with new social structures incorporating the tendency."

[82] There were numerous unreasonable institutions and institutional arrangements that were implemented during this era. For instance, the employment conditions and the quota of food (Naughton 1996).

ideological campaigns. For instance, the Great Leap Forward, between 1958 and 1960, was an economic ideology campaign undertaken by the government and aimed to catch up with western industrialization, especially to increase the output of steel. The plan was unrealistically ambitious, many economic sectors, even schools, were pushed to join the steel production (Xie and Oliver, 1996). Six years after the disastrous Great Leap Forward, the Cultural Revolution was launched by Chairman Mao Zedong. Although it was a cultural campaign, it severely interrupted economic development. The Cultural Revolution lasted 10 years till 1976, while people's political and economic ideology was shaken because of the disastrous campaigns. The social and economic situations were only normalized in 1978.

4.3.2.2 Formal institutions

During this period, based on communism and socialism the policy makers quickly established a new set of level two institutions including constitution, property rights, etc. In this institutional environment, almost all economic activities were centrally-planned, from industries to agriculture. The companies were all state owned (SOE), the managers were all state-assigned and the employees were all state selected. The "socialist-style" separation of ownership and control is the basic feature for SOEs. While the owner of all enterprises is the "whole population of Chinese people", the government represents the Chinese people in the "public ownership of properties". Therefore, the institutional environment was very confusing. Everyone owns everything and no one owns anything at the same time. There was no private property whatsoever. Every property was either state owned or "community" owned. The whole economy was arranged like a giant company: supply and demand were centrally planned.

Not surprisingly, the level three institutions, such as contract law, were absent. All contracts were centrally planned among SOEs with fixed terms and prices; therefore, there was no market oriented competition. For instance, the State distributed raw materials among SOEs and commanded the delivery of goods and services. The government also drafted the employment plan and determined the salary system. Therefore, the production cost and output was not a reflection of the market.

It was also troublesome that the state, as the agent of the Chinese people in reality, was a pseudo player because the state delegated its tasks to governmental bureaucrats through a hierarchical structure. Bureaucrats held control rights of the companies under the name of the state and people; then the residual belonged to the state, there was no economic incentive for a manager or bureaucrats to improve productivity. But the bureaucrats and managers typically had a hidden agenda because of the different political and economic interests (Naughton 1996). Bureaucrats and SOEs managers were often interchanged. Therefore, the special "principle-agent" relationship among the state, bureaucrats and managers created huge agency problems. Under these circumstances, the informal institutions such as personal connections (Guanxi), were a very important factor in the economic activities at the time, which was also a source of corruption. For instance, since the jobs were assigned by the State, those who had better Guanxi with the agency assigning jobs got the jobs. The above-mentioned institutional environment not surprisingly leads to distorted resource allocation and an inefficient employment situation (Perkins 1975). Therefore, it was fair to say that economic activities were either formed by the State's arrangement or by Guanxi under the 1st IF. There was no room for the implementation of contract law or corporate law, nor was there such a kind of laws.

Therefore, the 1st IF has no room for "rules" of overseas investment to be built. The 1st IF provided no freedom for companies and their managers to make any decision with an international market perspective. Furthermore, under the 1st IF, the inexperienced managers of SOEs had neither the capability nor intention to engage in any international economic activity. OMAs were not anywhere near the SOEs' agenda.

4.3.3 The 2nd IF: Open-door and Reform Era (1978-1999)

The shaky ideology and the poor performance of the "socialist closed-door" institutions brought China to the path of reform. This happened as a result of a number of endogenous incremental steps. The reform in this period set a fundamental institutional framework for China's economic growth. By 1995, China had become the world's third largest economic power after the United States and Japan. Total GDP grew from $ 148 billion in 1978 to $ 1.0833 trillion in 1999. In the meantime, the problems caused by the institutional framework called for constant reforms on the institutional arrangements and market. The reform nurtured some Chinese companies whose competitiveness greatly improved during this period. Many companies were becoming prepared for participating in globalization during this stage, and started to call for deregulation on OFDI.

4.3.3.1 The Changes in Informal Institutions- Reform and Opening-up

After the death of Chairman Mao in 1976, major changes took place in peoples' minds. The political and economic ideology was weakened by both the disastrous ideology campaigns and the disappointing economic performance. The closed-door policy lost its popularity, the Communist Party of China (CPC) was also losing its legitimacy. The idea of reform became more and more popular. The transformation from the end of 1978 obviously began with the change in ideology, which was motivated by negative feedback of stage 1 and the propaganda of the new leadership of Deng Xiaoping. Consistent changes in the formal institutions of laws and regulations were initiated. The reforms in the formal institutions evolved in constant interaction with the informal institutions. The ideology of individualism was gradually accepted by people and as default propaganda of the government. At the beginning of the reform, slogans derived from Deng's public speech, such as "it is allowed for a minority of people to get rich first", "it does not matter whether the cat is white or black, as long as it catches the mice" and "it is glory to make oneself rich" were seen everywhere in the city and the rural areas. Although the reform went through different stages with various propagandas, the individualism and reformism were enhanced throughout this period.

It is worth noting however, that the institutional changes were exogenous, the government played a crucial role in promoting the economic ideology in society for their interest. The high respect for authority as a political ideology which conforms to Confucianism remained and helped the implementation of the new economic ideology in the reform. Therefore, the informal institutional change during this period featured economic ideology change, which was led by Deng Xiaoping who was seen as the principal interpreter of the values, norms and other elements of the "ideology" of the reform. With a two-decade straight impressive economic performance of the country under the 2nd IF, the government's legitimacy was stabilized. From the 1980s, a consolidated ideology promoted by the CPC called "socialism with Chinese characteristics" was widely accepted by the society. Although there was (arguably) no massive political ideological crisis in the society, the political ideology faced some challenges at the end of the 1980s and early 1990s[83].

4.3.3.2 Early changes on constitution and property rights

At this stage, the institutional changes can be described as gradually relaxing the central planning institutions and the gradual introduction of market compatible institutions. It was an incremental reform of the relationship between the state and the enterprises without fundamentally changing the state ownership structure.

In 1982, property rights were put into the Chinese Constitution for the first time. The 1982 constitution provided the concept 'socialist public ownership', which guaranteed state-ownership and collective ownership. A constitutional amendment in 1988 acknowledged the existence of private business and granted them constitutional protection. What can, with restrictions, be called "economic ownership of land" has also been protected by that amendment. The state protects the right of citizens to own lawfully earned income, savings, houses and other lawful property. This property can also be inherited. The legal rights given to Chinese citizens seemed to extend to non-citizens, since the PRC "protects the lawful rights and interests of foreigners within Chinese territory". Foreign investment in China has even received its own constitutional protection in article 18 which states that foreign enterprises' "lawful rights and interests are protected by the law." [84]

However, the problem with property rights is that it was never clear what the right entailed, since there was no Property Law to implement the property right in the Constitution, and there was, and still is, no constitutional court to enforce it. Furthermore, the constitution further enhanced the legitimacy of State-ownership at that time. State ownership was granted by the constitution. Therefore, no matter how much governance structure changed at this stage, the state's property right continued to dominate. Even after a series of reforms at the end of this stage, the majority of property was still owned by the state. Nevertheless, it was believed that the institutional changes in property rights resulted in the impressive economic performance of China at the beginning of the reform (Smyth 1998; Mertha 2009).

The change of the property right provided legitimacy for reforms on SOEs. **From 1979 to 1981**, the regime of "profit-sharing" between States and the managements in SOEs emerged. "Profit-sharing" meant that an enterprise could share the residual profits after the "quota" which the state made for that enterprise was achieved. **From 1983 to 1985**, the distribution of profit between the enterprise and the government was settled by the introduction of tax substituting for profit remission. The tax system was set up nationally as a legitimate means of profit distribution. **From 1987 to the early 1990s**, the dominant reform policy was the "contract management responsibility system" (CMRS). CMRS is a system to incentivize the

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[83] For instance, the Tiananmen protest in Beijing in 1989 was mainly caused by the doubts in the socialist ideology at that time, especially among young intellectuals. However, from a broader view, the political ideology of China under the current institutional framework is consistent with the previous one.

[84] See P.R.C. Constitution. 1982, amended in 1988.

managers of SOEs to improve the performance of SOEs. The state agency for SOEs would delegate the managerial tasks to managers with articles of profit target and incentive payments in the form of a bonus or a penalty. In 1988, the State Council issued the "Interim Regulation on the Contract Responsibility System in SOEs". At the end of 1989, the CMRS was widely adopted[85] as a formal instrument to allocate decision-authority and residual control rights. The CMRS was quite successful in incentivizing managers; for the first time it drew a clear line between the government and the enterprise. Managers had become controllers of the firm and the residual rights. The rapid adoption of the contract responsibility system stabilized the redistributive changes and further consolidated the managers' authority (Jefferson, 1998). However, many studies showed that CMRS did not work for all circumstances; many SOEs' performance was actually quite puzzling and mixed under CMRS. For instance, Choe and Yin (2000) argue that when managers were exhibiting uncertain performance, they tended to be manipulative and hid information to maximize their own profit.

4.3.3.3 Development and Challenges on Corporate Law and Corporate Governance

Nevertheless, before 1992, there were only fragmented policies of enterprises' reform. These policies aimed at granting more operational autonomy to the enterprises, and to incentivize managers with profit sharing regimes such as CMRS. There was no formal law to govern the enterprises, not to mention corporate governance. However, in 1992, a major institutional change occurred, and the Party for the first time endorsed the "socialist market economy" as China's reform goal. Under such a socialist market economy, market compatible institutions began to be adopted in China. Company Law, Contract Law, Accounting Law and Securities Law were established in the 1990s.

On December 29, 1993, the very first *Company Law* [86]*of the People's Republic of China* (1993 Company Law) was adopted at the 5th Meeting of the Standing Committee of the Eighth National People's Congress. This was the first time companies were regulated by law, it provided the legal foundation for the establishment and operation of companies. It provided rules for the incorporation of all enterprises of different ownership types into limited liability and limited liability shareholding companies and specified governance structures, rules regarding the transfer and sales of shares, and procedures for mergers and bankruptcy. Under the 1993 Company Law, the main corporate governance structure was established.[87] The basic model of corporate governance was that a Shareholders meeting would appoint a board of directors and a board of supervisors, then the two boards appointed would supervise the management (See the figure below).

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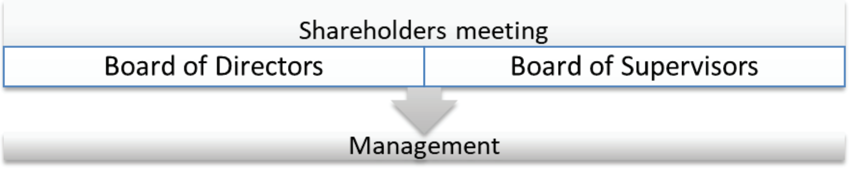
[85] According to some research, CMRS was adopted in around 95% percent of SOEs by 1989 (Fan, 1994; Chen, 1995).

[86] Company law of PRC, is the effective corporation law in China. However, it is different from the general term of Corporate Law. Company Law is broader than Corporate Law. The Chinese company Law does not just regulate corporations with limited liability but also other forms of enterprises with different liability structures. For instance, the rights and liabilities of enterprises based on partnership are also regulated by Company Law in China.

[87] The origin of corporate governance in China is the German model (Tenev, Zhang, and Brefort 2002).

Figure 4-5 Corporate Governance at Stage 2



Source: Author made based on 1993 Chinese Company Law

However, under the 1993 version of Company Law (1993 Company Law), corporate governance was very poorly developed, majority shareholders tended to abuse their power in practice, especially when the largest shareholder was the state. There are extensive legal studies which support this critique. For instance, Xu and Chen (2003) conducted an empirical study during the period when the 1993 Company Law was in effect. They analysed the relationship between shareholders, corporate governance and company performance in 508 listed Chinese firms over the period 1997-2000. They found out that under the governance of the 1993 Company Law, "firms under the control of the government shareholder have lower value, poorer firm performance and weaker governance than comparable firms under the control of a non-government shareholder". The result indicates that under 1993 Company Law, corporate performance could be negatively affected by the governance regime if the largest shareholder was the state.

The policy makers were given negative feedback from minority shareholders and other stakeholders. Furthermore, the poor corporate governance was also a main barrier to attracting inward FDI (Andresosso-O'Callagham and Wei 2003; Ali and Guo 2005), and attracting more foreign capital was considered a priority of the government after 1992. However, policy makers were not ready to make fundamental changes in corporate governance because the state was not ready to reform, which would lead to giving up the dominant position of State-ownership. Therefore, although on December 1999, the Company Law was amended for the first time[88], there were only two minor amendments on supervisors' appointment and intellectual property capital in the amendments. These amendments did not noticeably improve corporate governance.

In an attempt to enhance the corporate governance of listed companies, in December 1998, the Securities Law was adopted in China. The Securities Law itself on paper was close to the common practice, but in practice, it suffered from the same shortcomings as Company Law did.[89] Minority shareholders' interests were not protected because the state, most of the time,

[88] The amendment was in accordance with *Decision on Revision of the Company Law of the People's Republic of China* made at the 13th Meeting of the Standing Committee of the Ninth National People's Congress.

[89] The corporate governance framework of China is modelled after the German style corporate governance. In companies, there is a two-tier system, beside the board of directors, there is also the board of supervisors. The supervisory board consists of shareholders' and employees' representatives, but the ratio is not fixed in China's Company Law as it is in Germany. Most of the time, these employees cannot carry out the supervising role effectively, since it is not common for a Chinese employee to confront their superiors in the company. There is

is the single majority shareholder who holds the absolute shares of the listed companies. Agency problems with the top management were also severe. For instance, there was a clear "insider-control" problem in China's listed companies. Xu and Wang (1999) found that 50% of the board of directors were from the management and 77% of the supervisory board committee were employees of the company. Li (2000) investigated 91 listed companies from 1998 to 1999 and recorded that nearly half of the board of supervisors were employees of the firms.

In summary, China made progress in ownership transformation and corporatization of its enterprises during stage two, but the companies were by no means close to international standards in corporate governance. At the end of stage 2, China still faces a number of corporate governance issues, for instance, 1) the single large shareholder – the State - controlled everything in the SOE. Due to rent-seeking, the state was not ready to give up its power of control; 2) the insiders problem and lack of transparency. Management and majority shareholders consider minority shareholders as outsiders and freeloaders. There was no effective transparent system in firms to ensure outsiders were informed. Minority shareholders protection level was very low 3) Agent problems of managers. Inherited from before, the recruitment of managers, especially in SOEs, was mostly carried out through assignment and connections; there was still no clear link between performance and compensation, and therefore managers in general have low incentives to perform in SOEs. Similarly to the pre-reform era, the political agenda incentivized managers to perform but not always in the best interests of shareholders.

4.3.3.4 Development and Challenges on Intellectual Property Law

Besides corporate governance, Intellectual Property Right (IPR) protection was another major area which was high on the agenda after the reform.

There was virtually no concept of IPR during the first stage of China's economic development. However, at stage two, China quickly established quite a comprehensive IPR legal framework, including multiple international treaties and various domestic laws and regulations. IPR such as trademark, copyright and patent are protected in China by Law. The table below summarises the main legal documents China has committed to domestically and internationally.

Table 4-2 Main IPR Legal Documents

	Legal Documents /Time
International Treaties	Became a member of the World Intellectual Property Organization (WIPO) 1980
	Acceded to the Paris Convention for the Protection of Industrial Property and became an official member (1984, 1985)
	Joint Madrid Agreement for the International Registration of Trademarks (1989)
	Memorandum of Understanding (MOU)with the United States 1992; Sino-US Agreement on

hardly any evidence of supervisory boards performing effective overview functions over the executive board and senior management.

	Intellectual Property Rights 1995,1996
	WTO and Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS), 2001
Domestic Laws	Trademark Law (1982) amended in 1993 and 2013; Patent Law (1984) amended in 1992 and 2008; Copyright Law (1990) amended in 2010.
	Computer Software Protection Regulations (2001), amended in 2013.
	1993 Unfair Competition Law; the regulations for the protection of new varieties of plants and semi-conductor chips published (1997).

Source: www.chinaipr.gov.cn ; Suttmeier and Yao 2011

According to the General Principles of the Civil Code of China, from the moment China adheres to an international treaty, the treaty is automatically a part of Chinese domestic law (except those provisions for which China has declared a reservation beforehand according to the treaty). Therefore, it is not necessary for China's legislative agency to publish any act approving the treaty as domestic law. Therefore, with the international treaties and domestic legislation, the IPR legal framework was already quite advanced in the early 1990s, whilst content-wise, it was closed to international practice. (Suttmeier and Yao 2011; Zheng 1998), and the enforcement of China's IPR was extremely poor. Companies have little awareness of IPR infringement, and violations of copyright, trademark and patent were common during that period. The enforcement of IPR was weak, there were very few cases that were brought to court, the court often judged the cases inadequately (Suttmeier and Yao 2011). Not surprisingly, at stage 2, IPR protection had been a major factor in deterring IFDI, particularly in high-tech sectors where multi-national companies may feel discouraged from bringing their latest technology to China (Awokuse and Yin 2010).

In Summary, during stage 2, a basic market oriented institutional framework had been established. The most notable change was the legal framework underpinning the corporate form (including company law, contract law, accounting, and securities laws) and the property right IPR was created from scratch. The companies, the financial system, and the judicial system have become more diversified and independent of political influence compared to stage 1(Clarke 2003; Tenev, Zhang, and Brefort 2002; Zheng 1998). In this thesis, the standard of corporate governance and IPR protection have been most emphasized because, apart from their importance for domestic economic development and attracting inward FDI, they are very important indicators for Chinese companies to be attractive as investors. International law prescribes that in a cross-border M&A, the target firm becomes a national firm of the country of the acquirer[90]. More generally, the newly created firm will share features of the corporate governance and IPR systems of the two merging firms. At this stage, as described before, China was facing many issues on corporate governance and IPR protection, and therefore in this respect, Chinese companies were not attractive investors on the international market because of their reputation for poor corporate governance and IPR protection.

[90] However, in China, there are cases that the acquired firm doesn't get the national firm treatment. For instance, in the case of Geely's acquisition of Volvo, although Volvo is 100% owned by Geely after the acquisition, it was still treated as a foreign firm when establishing subsidiaries in China.

4.3.3.5 Regulations on Overseas Investment

Although China started to liberalize the domestic market, there were still a number of regulatory controls for both domestic investment and outbound investment. In terms of OFDI, the government was strictly controlling the capital outflow in order to focus on domestic economy. Policy makers also believed that neither the government nor the companies were prepared to embrace overseas investment, yet both started from scratch to learn how the market works. The government started experimenting in the "socialist market economy" and the main goal was to recover from the Cultural Revolution and to develop the domestic economy. Chinese companies were also at the beginning of the learning process in managing modern businesses, considering that before 1979 the enterprises were all managed by the States' planning, enterprises had not enough experience of modern business management. Policy makers therefore adopted a cautious policy towards overseas investment during this phase. In such circumstances, the simple structure of policy and administration of OFDI was established.

Policy. At the very beginning (1979-1990) of Chinese economic reform, there was little discussion of overseas investment and there was no investment policy. In 1979, with the launch of the 'open-door' policy by Deng Xiaoping, the State Council also introduced a concept of 'setting up enterprises overseas' but without any formal institution. (Zhao, 2007, p. 56). In 1984, the Ministry of Foreign Trade and Economic Cooperation (MFTEC, today's MOFCOM) released the first regulations on overseas investment, called 'Circular concerning approval authorities and administrative principles for opening up non-trade joint ventures overseas'. The State Administration of Foreign Exchange (SAFE) also published the first regulations on the administration of foreign exchange: 'Measures for foreign exchange control relating to overseas investment' (1989).

During this period, the Chinese government was perceived as taking the plunge in overseas investment activities. There were some Chinese companies that attempted to invest overseas, but the policy makers responded to overseas investment attempts negatively. In 1991, the State Planning Commission (SPC) [91] submitted the *Opinions on Managing Overseas Investment Projects* to the State Council. It points out that "China does not yet have sufficient conditions to pressure large scale investment abroad", companies conducting overseas investment "shall focus on acquiring technologies, resources and markets in order to make up the disadvantages of China". In reality, there were only a few asset acquisitions conducted and the assets were brought back for domestic production. Although after the concept of "socialist market economy" was introduced to China's economic system in 1992, policy makers started to emphasize the value of OFDI in economic development, [92] but "control" was still the main theme of the institutional arrangement in relation to OFDI.

[91] The State Planning Commission was the authority in charge of planning the central planned economy since 1952. SPC was renamed into National Development and Reform Commission (NDRC) in 1998, in line with the Chinese economy transforming to market economy.

[92] For instance, on 12 October 1992, Jiang Zemin, the representative of third-generation leaders of the Chinese Communist Party, provided a report to the 14th Chinese Communist National Congress, emphasizing the deepening of reform and opening up policy to 'expand OFDI and multi-national operations of Chinese enterprises' (Jiang, 1992).

Regulation. There are two building blocks of regulatory controls with regard to OFDI: administrative approval and foreign exchange control. The role of the this structure is to examine, control and approve the OFDI projects. See *Table 4-3* for details of the key documents and key points.

Table 4-3 Regulatory Documents concern OMAs (Stage 2)

	Key Documents	Key points
Examine and approvals	Approval Authorities and Administrative Principles for Opening up Non-trade Joint Venture Overseas (MFTEC, May 1984)	1. Authorize MFTEC to approve OFDI; 2. Major projects concerning resource and projects exceeding US$10 million to be approved by State Council;3. Projects concerning state property to be approved by NPC and METEC.
	Approval Procedures for Setting up Overseas Subsidiaries (MFTEC, July 1985)	Open overseas greenfield investment for all economic entities which have financial resources and relative capacities.
	Administration and Approval of Establishing Non-trade Enterprises Overseas (MFTEC, July 1985)	1. Approval results should be handed down in no more than 3 months 2. Chinese OFDI should focus on using overseas technologies, resources, and markets.
	Administration of Overseas Investment Projects (NPC, March 1991)	1. Projects exceeding US$1 million to be approved by NPC, exceeding US$ 30 million to be approved by the State Council.2. Projects concerning state-owned assets must be approved by State Council3. Project proposals, feasibility reports, corporate contracts, and articles should be provided by OFDI enterprises 4. Approval results should be handed down in no more than 60 days
Foreign Exchange control	Foreign Exchange Administration of Overseas Investment (SAFE, March 1989)	1. SAFE evaluates the source of funds to be invested abroad as well as the foreign exchange risk. 2. Five percent of the OFDI sum has to be deposited in a special account. 3. Profit earned abroad should be remitted back to China
	Supplemental Provisions on Administration Measures on Foreign Exchange for Overseas Investment (SAFE, September 1995)	Chinese investors are allowed to purchase foreign exchange for an OFDI project; prior to this, a Chinese investor had to earn the foreign exchange
International Treaties	BITs in the 1980s	Initiated by developed countries, aiming to protect their FDI in China.
	BITs in the 1990s	Initiated by China, aiming to protect Chinese FDI in developing countries where the majority of Chinese FDI has gone.

Source: www.mofgov.com,(Ren, Liang, and Zheng 2010; Luo, Xue, and Han 2010)

At the beginning of the reform, the administrative approval was extremely restrictive. Before 1984, only designated trade enterprises were able to apply for OFDI projects, with their own foreign exchange reserve. The application was very high-level, they had to directly apply for approval from the State Council on a case-by-case basis. There was no formal regulation to specify the process and standard for the approval. Therefore, the number of OFDI projects was negligible. In 1984 and 1985, a primary regulatory framework emerged based on relative documents. See *Table 4-3 Regulatory Documents concern OMAs (Stage 2).*The framework allowed enterprises other than trading firms to apply for OFDI projects. Some projects could also be approved by MFTEC rather than State Council. However, foreign exchange reserves were still at a low level and only firms that earned foreign exchange from overseas activities could qualify for OFDI projects. There was no clear time limit for the approval process in this framework either. From 1991 to 1999, the administrative approval procedure was gradually eased and localized. Many projects could be approved at provincial level. The foreign exchange regime shifted from an "earn-to-use" to a "buy-to-use" policy too (Ebbers and Zhang 2010; Wang 2000).

International Treaties. Another institutional arrangement worth noticing was the emergence of a supporting system of the State at international level. For instance, in the 1980s, China signed BITs with most developed countries, although during this period, most treaties were drawn up by developed countries to protect their investment in China, but these BITs helped China to commit to build up a good image of Chinese companies on the international market. In the 1990s, China began to conclude BITs positively with developing countries to protect investment in these countries in order to help Chinese companies to protect their interests in the international arena.

It is clear that, the controls from the state were gradually relaxed, the international horizon certainly started to look better. However, from the company's point of view, initiating an OMA at that time was still extremely complicated and time consuming. Furthermore, with regulatory constraints, only privileged companies (i.e. SOE) and projects would have attempted to conduct any OMAs Projects, other companies had no access or resources to do so. Additionally, the uncertainty imposed by this approval system put Chinese acquirers into a comparatively disadvantageous position in a bidding competition. It would be an unattractive option for a target to accept a bidder whose initiative could be rejected by its home country regulatory authority later on after it won the bid. Furthermore, as analysed in the last section, Chinese companies' poor record on corporate governance and IPR further increased the Chinese acquirers' lack of attractiveness on the international M&As market.

Therefore, caused by the above institutional constraints, there was low OMA demand and low supply from the international market. In such an institutional situation, Chinese managers were not well incentivized to conduct OMAs. As a result, as observed in chapter three, the number and value of Chinese OFDI grew only modestly. The statistical data reflects the consequences of the restricted policies. The number of OMAs was extremely limited. The World Investment Report (2000) of UNCTD[93] shows that until 1999, the OFDI flow was \$ 1.7 billion, and the total stock of OFDI until 1999 only accounts for 0.37 % of the total

[93] UNCTAD. The data here is from its World Investment Report 2000: Cross-border Mergers and Acquisitions and Development. Annex table A .I V4 . A.IV7.

global OFDI.[94] . It is neither compatible with Chinese GDP growth, nor does it reflect the role that China played in the global economy at that time. Moreover, in terms of OMAs, as the purchaser, in 1999, the Chinese companies' OMAs net purchase values were negative[95], and the world total OMAs purchase was $720 billion.

However, as shown in chapter 3, the trend of Chinese OMAs growth was about to change at the end of stage 2. This change was closely related to the new institutional framework and OFDI policy of China which will be analysed in the next section.

4.3.4 The 3rd IF: Go-out Era (2000 onwards)

At the end of 1990s, with both negative and positive feedback from the two decades of reform, Chinese policy makers took another step forward to ensure its institutional changes accommodated the Chinese companies' globalization ambitions. In 2000, Chinese companies officially entered the market for international investment with the support of the government's new initiative, the "go-out" policy[96]. It aimed to encourage Chinese high performing companies to participate in international competition. Soon after, on December 2001, China entered the World Trade Organization (WTO), this marked another milestone in Chinese companies' internationalization. There were two major calls for institutional changes. Firstly, companies and industries lobbied for more compatible institutional changes in order to take advantage of the go-out policy. Secondly, the WTO duties obliged the policy makers to establish new institutions and modify or abolish some existing institutions in China in order for China to gain market economy status worldwide.[97] Therefore, the policy makers have engaged in a series of market-oriented institutional changes, which further facilitated companies' growth both domestically and internationally. Notably, the newly emerged "go-out" policy greatly deregulated overseas investment; it helped the Chinese acquirers to earn a toehold in the international market. However, as the Chinese economy has been growing impressively for 20 years without any "massive intrusions", there were no fundamental changes in the institutional environment (i.e. Constitution, property right, political institutions, etc.,) made during this period.

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[94] UNCTAD: World Investment Report 2012: Towards a New Generation of Investment Policies Annex 4.FDI outward stock, by region and economy, 1990–2010.

[95] The explanation of the negative amount is that in UNCTAD data, the purchase value is the net value. It equals the purchase value of a Chinese company minus sales of foreign affiliates of these Chinese companies. For instance in 1999, the purchase value is $ 497 million and sales value of these companies is 895 million, therefore the net purchase is -398 million.

[96] In Chinese it is "走出去", pinyin is "zou chu qu", in some literature, it was translated into English as "go-global".

[97] According to the protocol of China's accession to WTO, members can treat China as a "non-market economy" until 2016, unless they otherwise grant China market economy status. China has gained market economy status from many of its trade partners. However, China's main ambition is to have market economy status granted by its major trade partners to avoid different anti-dumping measures. However, China's major trading partners such as US, EU and Japan have not granted China market economy status. In December 2016, China launched a legal challenge against the EU and US over their reluctance to treat it as a "market economy" under World Trade Organisation rules.

4.3.4.1 "Go-global" as a newly Added Economic Ideology

China had grown impressively due to the major institutional changes under the 2nd IF. The economic power of Chinese companies was also growing considerably. The economic performance of the country gained the government legitimacy. The consolidated ideology of Confucianism and "socialism with Chinese characteristics" served the majority of the society quite well. The social ideology and political ideology did not experience dramatic changes, however, there are noticeable changes which do play a role.

First, the economic ideology of a "global China" started to emerge among economic actors. Globally speaking, with the development of international trade and inward FDI growth, the Chinese economy began to integrate into the world economy. The state started its propaganda of "go-out" in society as an extension of its "open-door" policy. The government sought an image "make-over" from being the "world factory" of cheap products to a "world factory" of MNEs. The ideology of "national pride" was emerging gradually with the endorsement of the state's propaganda which is the "go-out" policy. Meanwhile the whole country cheered for China to be accepted by WTO, and WTO membership also pushed the policy makers to improve its "go-out" policy in order to fulfil its WTO obligations. The go-out policy not only triggered a series of deregulations on OFDI, it also marked the beginning of the Chinese government's soft-power enhancing initiatives. The Chinese government started to promote a growing global China image, showing its willingness to play its role as a major economy in the global basis. During the Financial Crisis especially, not only did China not suffer from the Crisis, on the other hand it overtook Japan in 2009 to become the world's second economy. With regard to soft power, China hosted the Olympics in 2008 and the World Expo in 2010, both of which have gained China more international attention as an emerging great power.

Secondly, the society's growing confidence in the "Chinese economic power" enhanced the ideologies of national pride; the government started to promote a new propaganda "Chinese dream" which means revitalizing Chinese glories from its five-thousand years of culture. With the growing confidence, "go-out" policy and a growing aspect of institutional support, the image of Chinese companies was gradually transforming in view of the international market. Chinese companies were no longer just foreign companies' trading partners, or their obliged JV parties in China;[98] but also, Chinese companies become investors in the international market.

4.3.4.2 The Institutional Environment Quality of China

After the major institutional changes on property rights and constitutions under the 2nd IF, more than 80 percent of all small and medium SOEs have been transformed into private companies and about 1,200 large companies had diversified their ownership through public listing (Tenev, Zhang, and Brefort 2002). Therefore, under the 3rd IF, the institutional environment (e.g., constitution, property right, judicial rights) has not undergone massive changes as it had under the 2nd IF. The institutional arrangement and domestic markets (level

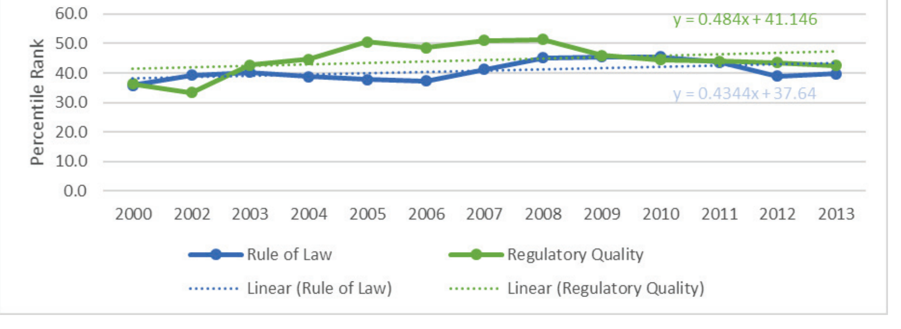
[98] Under Chinese OFDI regulations and industrial policy, there are ownership caps for foreign investors in certain sectors (such as automotive), foreign companies were only permitted to invest in China via joint ventures (JV), and often the JV model was not a choice but requested by law.

3 and 4) also did not undergone massive changes as under 2nd IF, but rather it continued its path of improvement towards a more market oriented economy.

Before a more in-depth analysis, hereunder is an overview of the quality of the rule of law and regulatory quality development under the 3rd IF, based on the World Bank's World Governance database. The database, **Rule of Law (ROL)** captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence; **Regulatory Quality (RQ)** captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.

The chart below provides an overview of the institutional changes on ROL and RQ in China under the 3rd IF according to the World Bank governance indicators.[99] It is important to note that the indicators are not on an absolute term but on a comparative term, i.e., the percentile rank in the chart indicates the country's rank among all countries covered by the aggregate indicator, with 0 corresponding to lowest rank, and 100 to highest rank. Therefore, increase and decrease are comparative terms; it does not necessarily mean any increase and decrease is compared to its own quality.

Figure 4-6 Overview of ROL and RQ changes under the 3rd IF



Source: Worldwide Governance Indicators (World Bank)

As shown in the figure, in 2000, both the rule of law (ROL)[100] and the regulatory quality (RQ)[101] of China still ranked way below the average; the percentile rank of both was around 36 on the scale of 0 to 100. From 2000 to 2013, both ROL and RQ experienced a trend of

[99] The reason for not using these indicators in the analysis of previous institutional comparison is because the data of that period was not available. Data was made available only from 1996 and it was not consecutive until 2002.

[100] In the indicators, the Rule of law mainly captured the quality of property rights, contract law (in a broader sense), police, courts, which are all essential indicators of level 2 institutions.

[101] In the indicators, the Regulatory Quality mainly captures the institutional arrangement at level 3 to permit and promote private sectors.

growth. Noticeably, the rule of law had shown an increase during 2007-2010 with the highest ranking of 45.5 around 2009 and 2010 and then it experienced a slight drop since 2011. It did not fluctuate much. The regulatory quality fluctuated much more, with the highest rank of 51.5 in 2008, with 15 percentile increasing. RQ on average improved 4 more percentile rankings compared to ROL, it also had a 5 % higher growth rate (see equations in the chart of ROL and QR).

It implies that the initial structure of the institutional environment has stronger persistence as suggested by Williamson (2000). First of all, the 2nd IF had gone through a series of changes in the fundamental institutions, such as the Constitution and property rights, which have transformed the institutional environment to a more market-oriented one, but more drastic reforms would go beyond the scope of "socialism with Chinese characteristics" ; Secondly, a positive feedback of the economic growth of China in the 2000s, especially during the 2008 financial crisis suggests the current IF is "efficient", the policy makers therefore did not see an immediate urgency for fundamental changes in the institutional environment. Furthermore, the stakeholders, especially the State, were enjoying the rents provided by the current institutional environment. The State and interest groups, as the most powerful player in the bargain, have no reason to urge the policy makers to change the institutions which may compromise their rent. In case policy makers suggest otherwise, the State and interest groups have the ultimate power to impede changes. Therefore, the persistence of the institutional environment is rooted in itself; the institutional environment does not endorse separation of powers, which leads to rent seeking in rule-making and makes changes of fundamental institutions very difficult. *"....it would be difficult for those who either make suggestions or are suggested to design a road map without letting CPC initially get used to separation of powers"* (Chen 2005).

Although the fundamental institutions stayed rather untouched, the 3rd IF nevertheless has entailed a number of noticeable institutional changes directly or indirectly affecting the Chinese OMAs. For instance, although the RQ (including corporate governance and IPR protection) of China did not make a dramatic improvement under the 3rd IF, they were constantly on the agenda of Chinese policy makers and made further qualitative improvements.

During the 2nd IF, the highest priority on the policy makers' agenda was to facilitate domestic development which was led by SOEs, therefore the persistence to change corporate governance was very high. But circumstances had changed by the end of the 2nd IF, the policy makers had to adapt to the new priorities, one of which was to facilitate Chinese companies to grow their international competitiveness via the "go-out" policy. Furthermore, policy makers were under added pressure from the WTO obligations to further relax the China market. The reality however was that Chinese companies were still considered "world factories" with limited modern governance (Tenev, Zhang, and Brefort 2002) and a high risk of infringing the IPR of their business partners or competitors (Awokuse and Yin 2010). Chinese companies cannot afford to bear this image in the international market. For example, in the international M&As market, both the poor corporate governance and the lack of respect on IPR would negatively affect the attractiveness of Chinese acquirers, which provided Chinese acquirers with little chance to compete with acquirers who have better institutional backgrounds. Chinese companies, especially SOEs, have to improve in order to be competitive in the global settings. Therefore, how to help convince the rest of the world to accept Chinese companies, especially SOEs, as fair players in the international market, was somewhat important to the policy makers. In such circumstances, a series of institutional changes have been initiated by the policy makers to improve the corporate governance and IPR protection.

4.3.4.3 Company Law and Corporate Governance

With negative feedback on corporate governance from the 2nd IF, policy makers were pushed to enhance company law and corporate governance in China. The under-developed corporate law and corporate governance was not just affecting corporate performance and shareholders' rights but also affecting Chinese companies' international competitiveness and attractiveness. Therefore, since 2000, Chinese Company Law experienced several amendments and revisions in order to facilitate the growth of Chinese companies. The major changes of Company Law and its influences are as follows. Company Law was amended for the second time in accordance with the *Decision on Revision of the Company Law of the People's Republic of China* made at the 11th Meeting of the Standing Committee of the Tenth National People's Congress on August 28, 2004; and revised at the 18th Meeting of the Standing Committee of the Tenth National People's Congress on October 27, 2005 (2005 Company Law). The current effective version of Company Law of China is the third revision in accordance with the *Decision on Amending the Marine Environmental Protection Law of the People's Republic of China and the Other Six Laws* made at the 6th Meeting of the Standing Committee of the Twelfth National People's Congress on December 28, 2013 (2013 Company Law). Compared to the 2005 version, 2013 Company Law had made 12 amendments, mainly to loosen the entry barrier for limited liability companies and stock limited liability companies. There was no direct amendment to noticeably improve corporate governance compared to the 2005 Company Law. 2005 Company Law, however, showed major improvements compared to the 1993 Company Law.

As previously stated, the policy environment at this time is both open-up and go-out, China was aiming to increase its international competitiveness by both attracting inward FDI and conducting outward FDI. Furthermore, when China joined the WTO in 2001, a series of economic reforms were initiated by the state in accordance with the membership of WTO. 1993 Company Law at that time was clearly hindering the competitiveness-building of Chinese companies. Policy makers therefore were pushed to improve the 1993 company Law in order to make Chinese companies more accessible and attractive, both as investee and as investor. In this context, the 1993 Company was amended with major improvements under the 3rd IF. In Jiang Ping's analysis (Jiang & Xu 2002), he outlined six major improvements to the 2005 Company Law: Firstly, it abolished all relative articles with regard to the special treatment to SOEs or state investment, which is the sign of equal investment. Secondly, it lowered the minimum capital requirement for the Limited Liability Company and listed company, which is a sign of granting more investment freedom. Thirdly, it gave more autonomy to companies to make their own Articles of Association. Fourthly, it enhanced the protection of minority shareholders' rights and further limited the power of majority shareholder(s). Fifthly, it enhanced the role of the Board of Supervisors. And lastly, it enhanced the protection of creditors of the companies.

Under the 2005 Company Law, corporate governance has been improved substantially, both in legislation and enforcement. Firstly, the 2005 Company Law improved in addressing the principal-agent problem. The 2005 Company Law explicitly regulates the relationships between investors and managers. Minority shareholders in particular have been granted a range of new protections, the most significant of which are the fiduciary duties of loyalty and diligence conferred upon managers in China. This improvement in principle should help change the negative views which the advanced market held about Chinese companies. Under the 1993 Company Law, it was commonly believed by the advanced market that controlling-shareholders in Chinese companies enjoyed immunity from civil action. Under the 2005 Company Law, it was clear that the controlling shareholder will be held liable in case they abuse their power. This signals that SOEs should also comply with a new set of corporate governance rules, which will give confidence to firms who have any business relationship with Chinese SOEs. Furthermore, the protection offered by the new provisions is reinforced by the civil enforcement constructed by the 2005 Company Law which marks another major difference from the corporate governance regime of 1993 Company Law. As mentioned below in *Case 4.1,* the China Aviation Oil bankruptcy case, the head of China Aviation Oil, Chen Jiulin, was sentenced to jail for 4 years, after he pleaded guilty to six criminal charges. As for civil enforcement, Chen was also convicted and ordered to pay a $ 207,500 fine.

The 2005 Company Law and its enforcement were a clear signal that the Chinese policy maker's commitment to keep the corporate governance up-to-date and in compliance with international practice. It was clear to the state that up-to-date corporate governance is necessary to improve Chinese companies' competitiveness and the economic growth of China. However, there is a long way to go for China to achieve the goal. As explained before, the rent-seeking problem remained due to the fact that the fundamental institutions are unchanged. The ownership status of SOEs did not change and does not seem to be on the agenda of being changed any time soon. For instance, the State, precisely the state-owned Assets Supervision and Administration Commission (SOASAC), is still overseeing and controlling the SOEs. For instance, there are still over 160 large SOEs among which are those closely supervised by SOASAC. That is why, although most policy makers and managers accept the best-practice principles under the 2005 Company Law regime, modern corporate governance has not been implemented comprehensively in SOEs. Given the fact that Chinese SOEs are high-profile players in the OMAs market, it is not surprising that the concerns and confusion would arise from foreign companies. Furthermore, the spotlight failures of Chinese SOEs, due to the problems of corporate governance, kept foreign companies more suspicious towards a Chinese acquirer/bidder. For instance, the bankruptcy case of China Aviation Oil (Singapore) Corp is a typical case that SOE's poor corporate governance leads to heavy loss. Details can be found below *Case 4-1 China Aviation Singapore Corporate Ltd.*

Case 4-1 China Aviation Singapore Corporate Ltd

China Aviation Oil (Singapore) Corporation Ltd (CAO) is the Singapore subsidiary of a Chinese SOE-China Aviation Oil Holding Company (CAOHC). CAO was first incorporated in 1993 and mainly deals in jet fuel procurement for the airports in China and international oil trading. The firm commands a near 100% market share of the procurement of imported jet fuel for China's civil aviation industry. CAO went public and was listed on the Singapore main board in 2001. CAO started its option trading in 2002. Enjoying a monopoly in the market the following years showed a marked increase in the profits. However, in mid-2003, CAO started trading in speculative derivative options, "This was beyond the remit authorized by the board" (OECD, 2014). Then the wrong bets on fuel prices in 2004, by taking a bearish stance in the jet fuel market, forced the company into a scandal. The trading scandal CAO was embroiled in caused losses to run up to $550m and the subsequent collapse of the CAO. CAO announced it would be seeking protection from creditors to avoid bankruptcy. CAO's chief executive Chen Jiulin was arrested with the charge of insider trading. The scandal involved several violations of corporate governance. The court made its punishment as follows:

In August CAOHC, the SOE parent company, paid an S$8 million penalty. Because CAOHC breached Singapore's insider trading laws by selling 15% shares of CAO to Deutsche Bank without informing the shareholders.

In February, 2006, CAO's former finance chief, Peter Lim, was sentenced to two years in prison for his part in the derivatives trading scandal. He was found guilty of conspiring to cheat adviser Deutsche Bank and fined S$150,000 for releasing false information.

On March 15, 2006, CEO of CAO, Chen Juilin, pleaded guilty to six criminal charges; he was fined S$330,000 and was sentenced to 51 months' imprisonment.

Source: OECD (2014)

The above case raised the international market's concerns about the corporate governance practice of Chinese SOEs even when they are listed abroad. The Financial Times commented that as one of the biggest corporate scandals in Asia, this case "causes concerns about doing business with Beijing." The case had put in the spotlight the shortcomings of corporate governance, which are common among Chinese SOEs. It made the international market cool down "their enthusiasm" about the country's emergence as a global trading and economic power, and recognize the disadvantages of Chinese SOEs.

The case was also evidence that the State, as the majority shareholder, has a major influence in SOEs. Sometimes, this State ownership was the source of the commercial loss of SOEs. For instance, SOEs' human resource management was not market based. It is still common that SOEs' managers are nominated, directly or indirectly, by the state for various non-commercial reasons. It is not surprising then that these managers are less capable and probably less responsible for the performance of the firm. The CEO of CAO, Chen Juilin, was a typical example. He was appointed by the parent company CAOHC with little experience of running an overseas listed company prior to his assignment as CEO of CAO. Therefore, how the Chinese companies manage their human resources is also a puzzle to foreign companies. Another example is the revolving door situation as mentioned before (Yang, Wang, and Nie 2013). For example, China's current Finance Minister Mr. Lou Jiwei used to be the head of China Investment Corporation (CIC), the Chinese $500 billion sovereign wealth fund, a major SOE which financially supports many other SOEs' investment overseas. His case is not rare in China - a CEO of a SOE can be "transferred" to work as a politician "overnight". A revolving door may lead a manager to a political career, so this is also another factor that potentially may cause a manager's deviation from his management role. For a political agenda, the manager can overlook shareholders' rights. For instance, SOE's OMAs could be driven heavily by managers' political agendas, if that deal could win its rents in the political arena.

4.3.4.4 Development in IPR Protection

With its go-out policy, it became a pressing issue for China to improve IPR protection. The lesson learned in the 1990s was that inadequate IPR protection (i.e. weak IPR protection from the law enforcement, and lack of respect for IPR from the Chinese companies) was a big obstacle to upgrade China's economy from a labour-intensive economy to a technology-intensive economy. It not only discouraged domestic R&D and innovation, but it also discouraged IPR cooperation with foreign IPR holders.[102] A better IPR protection environment would not only enhance the institutional environment to boost domestic R&D, but would also put Chinese companies in a better position in negotiating in technology cooperation with foreign partners, through inward FDI, IP Transfer and overseas investment. The strategic importance of IPR development, of course, led to the growth of the field of IP regulations. Externally, after the accession to WTO, China was under pressure to adjust its IPR protection system to fulfil its WTO obligations on IPR protection. This even speeded up the IP legislation. The case below showed how TRIPS improved on IPR.

Case 4-2 IPR case US VS. China

In April 2007 the United States filed a case against China at the WTO. The case was brought alleging China's failure to comply with the WTO Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement. The main claim was China's deficiencies in the legal regime for protecting and enforcing copyrights and trademarks. The EU, Japan, Canada and Mexico quickly joined the United States in the case as "third parties".
In January 2009 a WTO panel report upheld the complaint that China had not met its obligation to have laws allowing effective action against and remedies for infringing material and providing the same IPR protection to foreign as to domestic IP holders, but also said that China's system for applying criminal penalties on wilful, commercial-scale acts of IP infringement were not violating its TRIPS commitments.

In compliance with a deadline of 20 March 2010 set by the WTO for implementing changes in its laws to remedy the situation, several changes were made to relevant laws and notified to the WTO. For example, the Patent Law was revised and amended, Implementing Regulations of the Patent Law came into force on 1 February 2011. These prescribe stricter conditions on granting patents, an improved examination system for patent design and a compulsory licensing system, a new system for preserving evidence in proceedings, supplementary measures to enforce the patent law.

Source: WTO DISPUTE DS362

Therefore, after China entered the WTO, the landscape of Chinese IP laws have been upgraded to TRIPS standard gradually. But also, China enhanced the enforcement of IP laws. For instance, China initiated anti-counterfeit champions. The empirical study (Suttmeier and Yao 2011) shows that, at this stage, with the improved legal protection for rights holders and expansions to its anti-counterfeiting campaigns, China has encouraged the rise of new

[102] Globally speaking, it has been a long debate with regard to the cost-benefit analysis of IPR protection both academically and practically. The Chinese policy maker was of course also aware of the debate. But it is well-accepted that the IPR situation in China was and still is an obstacle for economic development strategically.

stakeholders who are vocal about protecting their work and contributing to the global discourse on IPR.

4.3.4.5 "Go-out" Policy and Industry Policy

Under the 3rd IF, the government asserted its role in the process of overseas investment, switching its role from control of overseas investment to guide, serve and support overseas investment. With an enormous foreign currency reserve from trading, [103] the Chinese government no longer felt the urgency to mandate Chinese companies to increase foreign currency reserves, but saw the urgency to encourage companies to grow their international competitiveness. Therefore, the government initiated a "go-out" policy environment to encourage companies to autonomously implement their international strategy and grow their international strategy.

Although the sentiment of "go-out" was mentioned internally in the CPC in 1999, as a policy, it was officially addressed in the 10th Five-Year Plan[104] (2001-2005) in 2001. Then it was further elaborated on in both the Eleventh Five-Year Guideline[105] (2006-2010) and the Twelfth Five-Year Guideline (2011-2015). The 12th guideline kept "go-out" as an objective towards more "mature" international investment and the main theme of go-out policy is "accelerating"[106]. It is also "closely intertwined with China's industrial upgrading, and successfully 'catching-up'"[107] in its domestic economic growth" (Yueh 2012). In the 12th guideline, besides the general "go-out" policy, it specified directions of "go-out" in order to enhance certain industries in order to balance the development of domestic industry.

The 12th guideline (2011-2015) encourages the following industries in both overseas M&As and domestic development: new energy; energy conservation and environmental protection; biotechnology such as drugs and medical devices; new materials; new IT; aerospace and telecom equipment manufacturing; clean energy vehicles. The five-year plan therefore, to some extent, encouraged OMAs activities towards the strategically important industries to the State. In the operation level, OMAs in the preferred industries enjoy additional preferential treatment from the relevant governmental agencies.

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[103] China's foreign currency reserve was $165 billion in 2000, and increased to $ 3821billion in 2013. Available at SAFE official website.

[104] Five-year plan is rather a legacy of the central planning era. It started from 1953 in PRC. The plan is shaped by the plenary session of the Central Committee and national congress (commonly called two conference 两会). The five-year plans usually entail a series of social and economic initiatives for the country's priority in the coming five years.

[105] The word plan was exchanged to guideline in the 11th two conferences. The government made the change to make the initiatives more in line with China's transformation from planned economy to market economy.

[106] "We must accelerate the implementation of the "go global" strategy, in accordance with market orientation and the principle of independent decision-making and guide enterprises with different kinds of ownership to invest overseas and co-operate in an orderly manner." Prime Minister Wen Jiabao. Report on the Work of the Government, 2011.

[107] 'Catching up' is the goal and direction Chinese government gave to industries strongly driven by technologies and that play strategic roles in the national economy.

The industry policy clearly encourages Chinese OMAs to step into the industries that have strategic importance for the economy. Not surprisingly, there are many OMAs which have been engaged in these industries, and there were also high-profile failed deals in these industries. For instance, Chapter 6 provides some examples in the automotive industries. The industry policy nevertheless enhanced the domestic 'catching up' strategy. For instance, the empirical evidence from Chapter 3 showed that more than half OMAs investment went to resource seeking deals, which ensure the resources for national development. Furthermore, with the supportive polices, sectors such as automobiles and telecommunications, all observed good performance in the OMAs process (Chu 2011). There is also a study which showed that most cases of SOEs expanding in Africa in the telecommunications sector are successful (Cissé 2012).

4.3.4.6 Deregulation on Overseas Investment

Since the "go-out" policy was initiated, policy makers made detailed institutional arrangements to implement the policy. A series of specific regulations were followed to implement the go-out policy and facilitate the overseas investment of Chinese companies. The main characters of these arrangements are deregulation and facilitation. Deregulation is to ease the regulatory control over OFDI, while facilitation is to support and help the inexperienced Chinese companies. The Chinese government slowly loosened the restrictions, relaxed capital controls, simplified and streamlined the investment approval procedures. Besides domestic deregulation, policy makers also contributed many international investment agreements for a better international investment environment. These institutional arrangements not only eased some institutional obstacles Chinese companies used to face under the 2nd IF, but also helped to facilitate Chinese companies OMAs ambitions.

The go-out policy firstly requested domestic deregulation on investment, which includes relaxing control and streamlining the bureaucratic approval procedures**.**

I. Administration structure

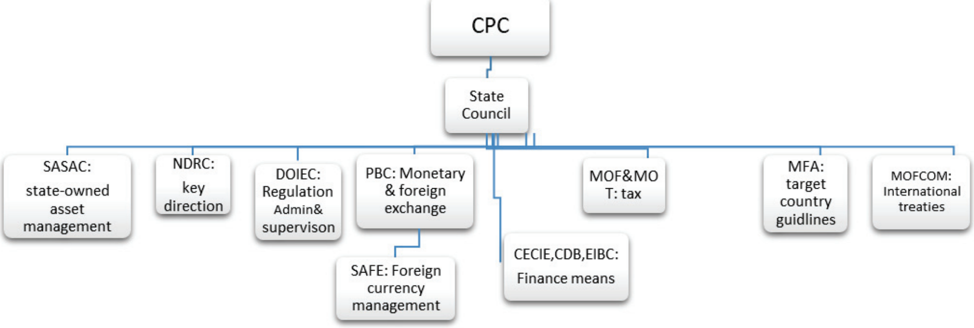
Under the 3rd IF, the government gradually formed a systematic administration structure for overseas investment (Figure 4-7 Bureaucratic Administration System for OFDI). **The first layer** is the State Council, which implements the "go-out" policy of the Communist Party of China (CPC) with overall long-term plans of OFDI. It is worth noting that above the bureaucratic administration is the CPC which ultimately leads the five-year plan, and therefore the administrative system of OFDI too. Under the current Constitution, the CPC still holds superior "leadership"[108] to lead the direction of the economic development of China.

At **the second layer**, under the leadership of the State Council, there are several departments that are involved in regulating, guiding, and supervising OFDI**.** The National Development and Reform Commission (NDRC, formerly SDRC 1998-2003; the National Planning Commission 1952-1998) is the major department of the State Council in studying and advancing strategies and plans of OFDI. SDRC also examines OFDI policies, and provides

[108] The relationship between "rule of law" and the party's leadership has always been a topic of debate. The CPC's leadership is authorized in the constitution of China, and it has a superior status. The superiority of CPC's leadership has been constantly reassured by CPC's various documents and other law and regulations. In his recent book, He (2013) explained the CPC's leadership as the "hidden rule of Chinese Law-making".

policy suggestions to the State Council according to the performance of OFDI. The Department of Foreign Capital and Overseas Investment (DFCOI) drafts the catalogues of guidance for foreign investment industries, and approves key OFDI projects. The Ministry of Commerce (MOFCOM, formerly the MFTEC and MDC), is the primary government unit responsible for conducting negotiations on international investment and trade treaties. The Department of Outward Investment and Economic Cooperation (DOIEC) drafts concrete regulations on OFDI, and it also administers and supervises OFDI. The People's Bank of China (PBC) is responsible for monetary policy and foreign exchange policy; the Ministry of Foreign Affairs (MFA) is responsible for drafting the catalogue for guiding the target countries of OFDI in cooperation with other agencies; and the Ministry of Finance (MOF) and Ministry of Taxation (MOT) are in charge of drafting policies of taxation related to OFDI. The MOT is also responsible for providing financial support to OFDI through special funds. A special organization, the State-owned Assets Supervision and Administration Commission (SOASAC), was established under the State Council to manage and supervise the national state-owned assets in the non-financial sectors, including those that invest in overseas markets. In **the third layer** are bureaus that implement the policies made by the second layer authorities. For example, the State Administration of Foreign Exchange (SAFE) helps supervise and check the authenticity and legality of the receipts and payments involved in OFDI and regulates the management of overseas foreign exchange accounts. Three "policy-oriented" financial bureaus (EIBC – Export-Import Bank of China; CDB – China Development Bank; CECIE – China Export & Credit Insurance Corporation) were in charge of providing credit and insurance for Chinese companies conducting OFDI.

Figure 4-7 Bureaucratic Administration System for OFDI



Source: State Council

II. **Bureaucratic approval system**

With the comprehensive administrative system, the regulations were further relaxed and the process to conduct an OFDI project was streamlined. **Firstly, the administrative approval restriction was significantly loosened.**

In 2004, the NDRC formalized the management model of overseas investment projects by issuing the *Interim Measures for the Administration of Examination and Approval of the Overseas Investment Project* (NDRC 2004), followed by *Provisions on the Examination and Approval of Investment to Run Enterprises Abroad* issued by the MOFCOM in 2004 (MOFCOM 2004) and substituted by the *Measures for Overseas Investment Management* from 2009 (MOFCOM 2009). The 2004 regime (NDRC 2004, MOFCOM 2004, 2009) abrogated or withdrew some examination and approval procedures compared to the regime under the 2nd IF. The authorities only briefly checked the basic information of overseas investment projects before approvals were granted. The application procedure was simplified from a two-step approval to a one step approval. Namely, the investor no longer needs to submit a feasibility study report, as required under the previous regime; the authorities would approve the project based on the adequate information about the project under this new procedure (i.e. investor, investment sector and compliance) without examining the economic and technological feasibility of the project which was the request under the previous regime.

The approval authorities became more flexible and streamlined under the 2004 regime. National level authorities were examining and approving any overseas investment value over $ 1 million under the old regime. With the 2004 regulation, it is only mandatory to obtain approval from national level authorities either if the project needs more than $ 10 million in foreign currency or if the project value is more than $ 30 million and it is in the resource development sector. Furthermore, the MOFCOM 2009 further localized the project approval. Under MOFCOM 2009, even for a resource related project, only when the project budget is above $100million should the application be done at MOFCOM. The local governments have the authority to approve other projects that have fallen outside the criteria. Furthermore, the government agency committed to improve their efficiency in approving OFDI projects. They included articles which indicate a time limit for each step, streamlined the whole overseas investment approval procedure.

However, due to the dramatic development of Chinese OMAs in the 2000s, the workload of the MOFCOM and the NDRC for approval and filing of overseas investment projects sharply increased, even under the 2004 regime there were simply too many projects stalled due to the national level approval. Therefore, in 2011 the NDRC issued the *Notice of the National Development and Reform Commission about Decentralizing the Approval Authority of Foreign Investment Projects* in February 2011(the "NDRC 2011") to further localize overseas investment approvals. This was the first time that decentralization of the approval authority was expressly provided in the form of regulation. In 2014, the *Measures for the Administration of Approval and Recording of Overseas Investment Projects* (the “NDRC 2014”), completely replaced the 2004 regime. The NDRC2014 further liberalized the outbound investment approval regime. Firstly, it increased the investment amount threshold for projects to be approved by the State Council to $ 2 billion and requiring that such projects must be in sensitive countries/regions or relate to a sensitive industry; Secondly, it provides that overseas investment projects requiring NDRC approval must have a total investment amount of US$ 1 billion or above, or relate to sensitive countries/regions or sensitive industries. In December 2014, NDRC issued the *Decision of the National Development and Reform Commission on Amending Relevant Provisions of Measures for the Administration of Approval and Filing of Outbound Investment Projects and Measures for the Administration of Approval and Filing of Foreign Investment Projects* (the “NDRC 2014(2)”). The NDRC

2014(2) cancelled its previous requirement that an investment amount of $ 1 billion or above must be approved by the NDRC.

These series of relaxation of administrative approval improved the efficiency of the application procedure.

III. Foreign exchange approval procedure

Secondly, in line with the reform of the approval procedure, institutions began to relax foreign currency control. At this stage, SAFE and the PBC continually relaxed the restrictions on foreign currency control and simplified procedures and provided support.

In 2002, SAFE approved 14 cities and provinces as foreign exchange pilots for overseas investment; 3 years later, all the measures for those 14 places started to apply to the whole country. Any Chinese company could conveniently arrange the payment in case an OMA deal was reached. In 2002, SAFE abrogated the risk review system and profit deposit regulation for overseas investments which were in effect for 20 years. In 2003, the procedure for examining foreign exchange sources was simplified through the "*Circular on Simplified Examination of Foreign Exchange Sources*". In 2005, the foreign exchange quota was cancelled in the "*Circular on Adjusting Some Foreign Exchange Policies*". All of these policies increased the convenience for companies and helped boost overseas investment. In 2009, a systematic overseas investment foreign exchange policy was published in the "*Management Regulations for Domestic Companies to Make Overseas Investments*". This document further simplified the foreign exchange procedures. This policy removed the requirement for an early-stage review; companies needed only to lodge a record with SAFE when making transfers of foreign exchange. The main materials to be recorded are also much further simplified than previously. They only include basic documents such as a statement about the foreign exchange sources; the business license or the organization registration code; the investment permission; and a certificate of transfer of foreign exchange in the earlier stages of the project.

4.3.4.7 Facilitative Measures

Taxation

In 2007, SAT published the *Opinion on implementing good taxation services and management of overseas companies*, which regulated taxation management for Chinese overseas companies. Since then, SAT has arranged further tax deduction measures through international tax treaties. In 2010, SAT issued measures of regular tax deductions and exemptions of both corporate and individual incomes to avoid double taxation; In 2011, SAT further reduced tax for revenues from oil and gas extraction overseas by Chinese enterprises; and a special corporate income tax (reduced from a normal tax rate of 25% to 15%) for high-technology enterprises certified by the Ministry of Science and Technology. In SAT's official statistics, it is recorded that China had signed 90 bilateral tax agreements (BTA) and two tax arrangements by 2012, which covered most of the countries and regions where Chinese overseas investments take place. According to SAT, through BTA, Chinese investors saved

$ 1.5 billion in tax in 2011.[109] SAT also adopted a bilateral negotiation regime. In case Chinese investors find that the taxation policies in an investing country are not in accordance with the BTA with China, the Chinese investor can submit the case to SAT and SAT will negotiate directly with the investing country's tax authority. According to SAT, in 2011, this regime helped the Chinese investor to save $ 5 billion from double taxation. Taking advantage of their expertise, SAT also included other services to facilitate Chinese overseas investment. For instance, SAT provides information on its website about the taxation policies of different countries, in order to guide companies to optimize their taxation strategy when investing abroad.

OFDI Fund

MOF and MOFCOM issued documents (2004, 2005) to use special funds for a foreign invested project, especially in the resource sector and technical sector. A 2005 circular specified that the sectors can apply for special funds as follows: "overseas investments, overseas agriculture, forestry and fishing cooperation, project contracting, outward labour services, overseas high-tech research and development, and outward design and consultation". It also specified that the funds may be used for the following means: subsidies for pre-operational fees; interest discounts for medium- and long-term loans; subsidies for operational fees.

Post-Investment Evaluation

In contrast with other advanced economies which have minimum direct involvement in companies' post-deal performance, the Chinese government established a post-investment evaluation system to help investors to study and examine their investment. Under this system, Chinese investing companies are obliged to file an annual report, providing key information about their OFDI project's performance. Through analysing the real-time information which is collected, the government agency (MFTEC, MOFCOM) therefore can further develop the governmental support system in order to avoid the risks and enhance the performance of Chinese OFDI. However, there has been little study in the economic effects of such post-investment evaluation.

Economic Diplomacy

In order to create a favourable environment and to avoid investment risks for Chinese companies investing overseas, with the development of the go-out strategy, China has been positively participating in international organizations and forms more bilateral investment treaties (BIT) and multilateral investment agreements (MIA). Firstly, China's accession to the WTO in 2001 enormously increased the international recognition of China's market oriented reform, and therefore the image of China. Although the major economies such as the US and the EU did not recognize China as a market economy back then, according to the WTO

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[109] Data is from Chinese news. http://finance.people.com.cn/GB/70846/17542788.html 30, March, 2012.

protocol, China should be recognized as a market economy 15 years after joining the WTO, which means December 12, 2016.[110]

Since 2000, China has also signed more bilateral investment treaties (BIT). Up to now, China had signed BITs with more than 110 countries and regions. The agreements signed after the go-out strategy include: China–ASEAN Free Trade Agreement (2002); China–Pakistan Free Trade Agreement (2003), China–Chile Free Trade Agreement (2005), Asia-Pacific Trade Agreement (2005), China–New Zealand Free Trade Agreement (2008), China–Singapore Free Trade Agreement (2008) and China–Peru Free Trade Agreement (2009) (Huang and Wikes 2011). China-Korean Free Trade Agreement (2014), China-Australia Free Trade Agreement (2014). These BIAs and MIAs support bilateral trade as well as investment between each other. Furthermore, China is also undergoing negotiations with many other countries and regions, including a BIA negotiation with the US and the EU to boost the Chinese OFDI in the developed markets. [111]

In addition, the Chinese government has also provided diplomatic support to overseas investment. In the international investment environment, diplomacy can play a significant role. Aligning overseas commercial interests with government policy for diplomacy is a common practice in trade and investment. Chinese leaders are often keen to foster stable political environments for Chinese investors in countries in which Chinese investors have significant overseas investments. The Chinese government has also initiated a broad range of non-commercial activities that create goodwill and indirectly benefit investment. For example, the Chinese government has been providing development aid to Africa since the 1950s. Indirectly, it cultivated a good investment environment for Chinese investors in Africa. In some other cases, Chinese investors have requested diplomatic support to aid in initiating and concluding deals. For instance, Chinese president Xi Jinping's visit to Europe in 2014 significantly eased the anti-dumping tension in the EU's investigation of Chinese telecommunication companies.

In the 2010s, Chinese government has initiated two major diplomacy champions: the One belt One road (OBOR) initiative to link the countries Asia, Europe and Africa both through land and sea. Another initiative is China-Central and Eastern European Counties Association ("China-CEE" or "16+1") to enhance the economic ties between China and 16 central and eastern European countries. Both initiatives offer enormous potential for Chinese investment along the OBOR. There are two funds from the government to support these initiatives. By 2015, $8.5 billion had already been allocated from China's $10 billion credit line OBOR, and the China-CEE Investment Fund, initially backed by $500 million from China's Eximbank, had invested approximately $200 million by the end of 2014.

There are studies which show that economic diplomacy can have positive effects on companies internationalization (Zhang, Jiang, and Zhou 2014; Bergeijk and Moons, n.d.).

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[110] There are voices that the market economy treatment would not be given to China automatically, WTO lawyers and government officials from China, the EU and US are engaging in intensive arguments, therefore it remains to be seen whether China will be granted the market economy status or not.

[111] The details of BITs and MITs can be found on MOFCOM website.

Available at: http://fta.mofcom.gov.cn/english/index.shtml

Chinese companies, especially SOE and large companies will continue to lobby for more diplomatic support from the Ministry of Foreign Affairs and embassies around the world.

In summary, the 3rd IF entails a series of pro-OMAs changes, the table below summarises the major documents regulating these institutional changes towards building a more friendly overseas investment institutional setting.

Table 4-4 Major Regulatory Documents concern OMAs (3rd IF)

	Key Documents	Key points
Examine and approvals	Verification and Approval Procedures for OFDI (SNRC, October 2004)	1. Projects exceeding US$10 million to be approved by SNRC (except projects concerning resources), exceeding US$50 million approved by State Council. 2. Approval result should be handed down in no more than 20 days
	Examination and Approval of Investment to Run Enterprises Overseas (MOFCOM, October 2004)	1. All companies are permitted to run enterprises overseas 2. Project proposals, feasibility reports are substituted by project application 3. Approval result should be handed down in no more than 15 days
	Administration of OFDI (MOFCOM, May 2009)	Projects exceeding US$100 million to be approved by MOFCOM
	Notice of the National Development and Reform Commission about Decentralizing the Approval Authority of Foreign Investment Projects (NRDC 2011)	First official regulation in decentralizing approval regime. Resource development projects to the amount of US$300 million or more and non-resource development projects to the amount of $100 million or more are subject to NDRC, others go to the local NDRC.
	In 2014, the Measures for the Administration of Approval and Recordation of the Overseas Investment Projects (NDRC, 2014)	1. $ 2 billion and in sensitive countries/regions or relate to a sensitive industry are subject to State council. 2. NDRC approval is only needed for projects exceeding $ 1 billion, or relating to sensitive countries/regions or sensitive industries, later the NDRC approval for $ 1 billion worth project is also cancelled.
Foreign Current Control	Cancelling the Deposits that Guarantee Profits from Investments Abroad (SAFE, November 2002)	Deposits that guarantee profits are no longer needed
	Circular on Simplified Examination of Foreign Exchange Sources (SAFE, March 2003)	1. SAFE will only investigate domestic foreign exchange sources. 2. Foreign exchange obtained from a source outside mainland China is no longer examined
	Circular on Adjusting Some Foreign Exchange Policies (SAFE May 2005)	1. Local SAFE named as authority on OFDI projects with a higher threshold (from US$3 to US$10 millions) all over the country. 2. Total foreign exchange available for all investors is increased from USD3.3 to USD5 billion

	Administration Measures on Foreign Exchange for Overseas Investment (SAFE, 2009)	Investors' self-owned foreign exchange, which is allowed to be invested abroad, can be in the form of the foreign exchange purchased by RMB, intangible assets, the domestic and overseas foreign exchange loans, and other permitted sources.
Financial Support	Providing Credit Support to Key OFDI Projects Encouraged by the State (NDRC, May 2003)	OFDI projects fulfilling specified requirements will be provided with a lower lending rate credit fund
	Guiding Directories of Target Nations and Industries for OFDI (MOFCOM, July 2004; MOFCOM, October 2005; MOFCOM, January 2007)	Provides industries and countries with information for enterprises to conduct investment encouraged by the state through preferential treatment concerning funding, tax collection, foreign exchange, customs and others
	On implementing funding for pre-project costs of overseas resources investment and economic and technical cooperation (MOFCOM; MOF 2004)	1. Emphasised large- and medium-scale resources and economic and technical cooperation projects. 2. Eligible projects included oil resources and non-metal and metal resources
	Circular of the MOF and the MOFCOM on Printing and Distributing the Measures Governing Special Funds for Foreign Economic and Technical Cooperation. (MOFCOM; MOF, December 2005)	1. Sets up special funds to encourage Chinese enterprises to invest abroad in some specific sectors. 2. Special funds may be used to support foreign economic cooperation by the following means: subsidies for pre-operational fees; interest discounts for medium- and long-term loans; subsidies for operational fees
Post-investment Evaluation	Interim Measures for the Joint Annual Inspection of Overseas Investments (MFTEC, October 2002)	Provides post-investment evaluation of OFDI projects
	Measures for Comprehensive Assessment of OFDI Performance MFTEC (October 2002)	Clarification of standards and procedures for evaluating OFDI projects which have been operating overseas
	Annual Report System on Operational Obstacles in Major Target Countries (MOFCOM, November 2004)	Using annual reports from overseas investors, MOFCOM collects all information about obstacles and problems confronted by Chinese OFDI
International treaties	WTO (2001)	Mandate institutional changes, and recognition as market economy
	MITs and BITs	Investment protection overseas

Source: Author made based on multiple sources, including MOFCOM website; Luo, Xue, and Han (2010); Ren, Liang, and Zheng (2010)

4.3.4.8 The Anti-Monopoly Law and Merger Control

As discussed in Chapter 2, Anti-Trust review plays an important role in the process of cross-border M&As. Chinese OMAs must be subjected to a merger review in China, host-countries and other relevant jurisdictions. However, it was not until August 2008 that China has its official merger control regime, when the first Chinese codified Anti-Monopoly Law (AML) came into effect. The AML consolidated the fragmented competition laws and regulations into a unified law, which also put the merger control for Chinese OMAs, among others, into practice.

Having a close tie to the European Union competition model, the AML aims at prioritizing economic integration, promoting fairness for business operators of varying sizes, and promoting technological development alongside consumer interests[112]. The AML includes prohibitions on monopoly agreements and abuse of dominant market position and it provides a system for merger control [113]which previously was a legislative gap in the anti-competition regime in China.

Although the main provisions on merger control are very similar to the EU approach, there are some Chinese characteristics in the M&As related provisions in the AML which deviate from the EU approach. For instance, it encourages M&As as a means to achieve economic scale (Article 5), it includes national security reviews of Chinese M&As transactions with foreign companies (Article 31)[114] and prohibits the abuse of intellectual property to eliminate or restrict market competition (Article 55)[115].

Following the AML, some implementing regulations and measures have been issued to govern the jurisdictional and procedural aspects of the merger notifications and review process. For instance, four implementing documents were issued to regulate merger filing thresholds, and to address merger investigation and remedies: 1) *State Council Regulations on the Notification Thresholds of Concentrations; 2) Measures for the Computation of Turnover for Notification of Concentrations by Business Operators in the Financial Sector; 3) Measures on the Review of Concentrations of Business Operators; 4) Measures on the Notification of Concentrations of Business Operations.*

Based on these documents and the AML, an OMA may be subject to a merger review if either of the following thresholds is reached. First scenario: the combined worldwide turnover in the most recently completed accounting year of all parties to the transaction exceeds RMB 10 billion and each of at least two of the parties to the transaction had a turnover in the PRC in the most recently completed accounting year exceeding RMB 400 million ; Second scenario: 1) the combined turnover in the PRC in the most recently completed accounting year of all parties to the transaction exceeds RMB 2 billion and each of at least two parties to the transaction had a turnover in the PRC in the most recent completed accounting year exceeding RMB 400 million.

In practice, MOFCOM is in charge of merger reviews, MOFCOM has established a special unit, the Anti-Monopoly Bureau, to be responsible for reviewing M&As and other types of proposed business concentrations. In the event that MOFCOM deems that an enterprise would

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[112] See the AML, Article 1.

[113] See the AML, Article 3.

[114] See Table 2-2 General or Trans-Sectoral Measures with a Bearing on Essential Security in the major economies

[115] Too read the full AML, see www.gov.cn.

constitute a monopoly in the market (principally the domestic market) after an acquisition, it can prohibit the acquisition or it may approve with remedy conditions. According to MOFCOM statistics, since the launch of the Anti-monopoly Law in August 2008, up to 2014, there were two rejected merger deals (see *Case 4-3 Rejected Deals by MOFCOM under Merger Control)* and 24 conditionally approved ones, out of 996 proposed merger deals.

The MOFCOM statistic also shows that the annual number of merger reviews grows noticeably (see below table), furthermore, as a newly emerged Merger control jurisdiction, the enforcement intensity of Chinese AML has room to grow due to the size of China's economy and the great number of merger deals which MOFCOM has jurisdiction to review[116]. For instance, the EU DG competition usually gets 300 merger reviews each year; it is reasonable that MOFCOM's workload will quickly catch up to a similar level.

Table 4-5 Yearly Merger Review numbers of MOFCOM

Year	2008(August onwards)	2009	2010	2011	2012	2013	2014
Deal Reviewed	17	77	114	168	164	215	241

Source: MOFCOM

Among all the 996 reviewed deals from 2008-2014, 97.4% of them (970) were unconditionally approved by MOFCOM. It is worth noting that the remaining 26 cases that were either approved with conditions or rejected, all involved foreign companies. But none of the 25 cases involved a Chinese OMA. Below are the two cases where the proposed M&A was rejected by the MOFCOM.

Case 4-3 Rejected Deals by MOFCOM under Merger Control

Proposed Deal	MOFCOM Decision
In March 2009, Coca-Cola the world leading beverage producer announced a proposed acquisition of Huiyuan, a leading Chinese beverage brand. The proposed deal is subject to merger review in MOFCOM because the market position of both Coca-Cola and Huiyuan.	MOFCOM asserted that the proposed acquisition would enable Coca-Cola to leverage its dominant position in the carbonated soft drinks to dominate the neighbouring juice market. Such dominance would raise entry barriers and limit the ability of medium and small-sized juice companies to compete and innovate. However, MOFCOM stated that two parties were given the opportunity to consult with the Bureau on the details of a possible conditional clearance, but they eventually failed to agree on an acceptable remedy with MOFCOM, therefore, MOFCOM rejected the transaction after 183 days of reviewing the case.
Three leading European shipping companies – Denmark's Maersk, Switzerland's MSC, and France's CMAGCM – announced in June 2014 their intention to form a shipping alliance that would allow the companies to share ships and	MOFCOM rejected the merger. In its decision, MOFCOM noted that the three companies involved in the alliance already held a 46.7 percent market share in the Asia-Europe container shipping line market, and that the alliance would allow them to enhance their market dominance in ways that would restrict competition and unfairly increase their bargaining power against consignors and ports.

[116] See AML, Article 2.

port facilities.	

Source: MOFCOM

The above cases show that the MOFCOM has taken action not only concerning M&As involving Chinese parties, but also M&As which do not involve Chinese parties but only affect the competitive market in China. The increasing AML enforcement from MOFCOM has attracted considerable attention from a wide range of stakeholders around the world, including foreign government agencies and MNEs. However, given the fact that the AML only took effect in 2008, implementation and enforcement are only slowly falling into place, especially as there is not enough empirical evidence to show the influence of the AML on Chinese OMAs. For instance, none of the above rejected deals is OMAs related. Therefore, there is little study on the AML's effects on OMAs. However, how the AML plays its role in Chinese OMAs in the future remains to be observed and studied.

There is a study (Song, Yang, and Zhang 2011) which argues that certain SOE OMAs may pass the merger review in China but it could strengthen their monopoly position in the domestic market and hinder innovation, which is inconsistent with the objective of anti-competition. Policy makers should consider the SOEs' OMAs experience in evaluating the effects of the AML. Song, Yang, and Zhang (2011) suggest that in order to promote competition-enhancing OMAs and the implementation of AML, it is important to look inward and improve fundamental institutions, such as property rights, to be more market compatible. They argue that the quality of property rights is fundamental for generating domestic innovation which also provides better opportunities for Chinese OMAs to effectively integrate advanced technologies from targets and to remain competitive both in the domestic market and in overseas markets. However, these arguments may need more theoretical and empirical examination.

4.4 Discussion

This chapter introduced the theoretical tool of this thesis – NIE. The fundamental theory of NIE is that a country's institutions have controlling power over the behaviour and performance of the Country's economic actors. To breakdown the institutions based on their effects on the specific economic activity- Chinese OMAs, this chapter reviewed the evolution of the Chinese institutional framework. It underpinned the most relevant institutional changes.

In summary, the Chinese institutional framework went through two major changes and evolved from a plan-oriented IF into today's market-oriented IF. The Chinese companies today enjoy a relatively market-oriented institutional background compared to before-2000 but with limitations because of the still lower ranked overall institutional environment.

With more domestic institutional improvement and more frequent international level cooperation (i.e., trade and investment) among companies, the institutional background of Chinese companies is better understood in the international market. But by and large, the divergent and complicated institutional framework of China is very different from other countries, and therefore it is still quite hard for foreign firms and managers to understand the influence of such an institutional background on Chinese companies. Therefore, it takes time, and it is often delayed, to convince foreign companies that Chinese acquirers are fair players and market oriented, given the low rank of China's regulatory quality on the global scale[117].

The question is, to what extent the institutional background of Chinese acquirers affects their OMAs process in the international market. What part of the institutional background is in favour of Chinese acquirers? And what parts put them in a relatively disadvantageous position on the international M&As market in winning the hearts and minds of targets? And why? The next chapter attempts to answer these questions by linking the characteristics of Chinese OMAs and the Chinese IF.

[117] see Figure 4-6 Overview of ROL and RQ changes under the 3rd IF

Chapter 5. The Characteristics of Chinese OMAs and the Home-country Institutional Factors

5.1 Introduction

The empirical findings in chapter 3 tell the story of the "uniqueness" of Chinese OMAs: Firstly, Chinese OMAs only began to be visible at the beginning of the 2000s, and gradually grew away from a very low base line after the domestic deregulation of overseas investment; the 2008 financial crisis was a noticeable event that generated a Chinese OMAs spike. Secondly, there was a cluster of Chinese OMAs in the developed market around the crisis period, among which half of the investments were undertaken by the resource seeking SOEs. However, a "new" style of Chinese OMAs emerged. These were the so-called 'merging-up" deals in the 'advanced market' led by the non- SOE acquirers, who were seeking strategic assets. Thirdly, Chinese OMAs had very low deal completion rates regardless of their ownership structures. The deal level factors such as target industry, target nation, and whether or not to hire advisors, etc., can explain why some deals have a higher and some have a lower completion rate compared to others, but they cannot explain why Chinese OMAs have an overall low completion rate. Fourthly, by examining the short-term stock market performance of Chinese OMAs with high transaction value (2004-2012), it was also found that the market rewards Chinese overseas acquirers; Chinese OMAs stand to gain positive returns for acquirers' shareholders, which confirm some previous empirical studies on Chinese OMAs performance.

Chapter 4 revealed a picture of the "economics of institutions" of China based on the NIE theories. It showed that the 2nd IF had undergone revolutionary changes under the "open-door and reform" policy; by the end of the 2nd IF, although the informal institutions (level 1) and institutional environment (level 2) were still shadowed by the planned economy, the institutional arrangements (level 3) and market institutions (level 4) evolved to be fairly market oriented. Around 2000, with the positive and negative feedback from the economic agents, policy makers initiated another major economic policy -"go-out" to encourage Chinese companies to invest overseas. A series of OMAs related institutions were improved, noticeably, the market for OMAs was deregulated and the approval system was simplified and decentralized. Furthermore, many background institutions (corporate law, AML, IP law) and enforcement were further improved. Chinese companies were equipped with a more and more market-oriented institutional background.

This chapter takes the NIE approach to analyse the link between the institutional background and the Chinese acquirers and the characteristics[118] of their OMAs. This chapter will touch upon the following questions: what are the main transaction costs in the process of Chinese OMAs; how does the institutional background of Chinese acquirers influence the transaction cost in each stage of the Chinese OMAs process.

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[118] As explained in chapter 3, the characteristics of Chinese OMAs include the growth pattern of OMAs deals, the deal-completing situation and the stock market outcome of OMAs.

The rest of the chapter is organized as follows. Section 5.2 identifies and analyses the transaction cost in OMAs process. Sections 5.3, 5.4 and 5.5 analyse how the institutional factors impact upon Chinese OMAs in the different stages of Chinese OMAs. Section 5.6 concludes the chapter.

5.2 Transaction cost and Acquirers' Institutional Background

Based on the literature on cross-border M&As (see chapter 2), transaction cost economics (Williamson 1994; Williamson 2008) and the new institutional economics (Williamson 2000; North 1994; North 1990)[119], this section develops the theoretical arguments to analyse the relationship between the acquirers institutional background, transaction costs and the process of OMAs.

5.2.1 OMAs and Transaction cost

As studied in Chapter 2, an OMA is one of the most complex corporate strategies, which acquirers should plan their best at each stage of the deal. An OMA is also one of the most costly corporate strategies and failure at any stage would result in huge loss to the acquirer. When a Chinese acquirer faces an OMA opportunity, it firstly should evaluate the economic rationale of the deal, i.e., to estimate the future synergy gain. A potential future synergy gain is the pre-condition for the acquirer to engage itself in an OMA. Over-estimating the synergy gain would have a negative impact on the profitability of the deal. Secondly, if the synergy gain is assumed, the acquirer should estimate the chance to realize the expected synergy gain. According to the statistics of Chapter 3[120], almost half of the Chinese OMAs attempts are not completed. Therefore, the probability of completing the deal should be taken into consideration for a full picture of the expected synergy gain. Thirdly, the company should identify and estimate transaction cost which would be incurred during the process of OMAs. The potential synergy gain is not a sufficient condition for an acquirer to engage in an OMA. If the risk is not properly controlled the deal may not be completed and it may turn out to be nothing but a sunk cost. And even if it were to be completed, if the costs have exceeded the gain, the deal would not be profitable nevertheless.

To sum up, a Chinese acquirer's motivation to initiate an OMA deal should be related to three factors: 1) the potential synergy gain; 2) the probability of completing the deal; 3) and the transaction cost. How these three factors are properly evaluated and controlled affect the outcome of the OMA. To correctly evaluate the synergy gain and probability of completing the deal are not the focus of this thesis and it requires an efficient management and efficient professional services. There is extensive finance and management literature focusing on the deal evaluation. Although analysing these two factors is not the task of this thesis, it is worth noting that how efficiently these two factors are estimated directly affects transaction costs in a deal which is one of the main focuses of this thesis. For instance, many studies show that managers' hubris tendency is common in M&As (Roll 1986; Billett and Qian 2008), which

[119] See *Figure 4-4 Economics of Institutions*

[120] See Figure 3-4 Yearly Deal Number and Completion Rate; Figure 3-5 Public status of acquirers and the deal completion. Figure 3-7 Deal Value by Target Nation (Announced vs Completed) Figure 3-8 Deal Value by Target Industry (Announced vs. completed)

results in a value destructive OMA. Therefore, it is crucial to establish a governance structure to make sure that the managers hubris can be minimized and the deal is evaluated, not only by relying on the manager's internal judgement but also based on the merit of the deal with external M&A professionals' analysis.

5.2.1.1 Transaction cost in an OMA

This section identifies the transaction cost which the Chinese acquirers of OMAs incur. As analysed in chapter 2, there are various costs that would be incurred in an OMA deal. Based on the literature and the nature of the cost, the cost of the deal can be divided into two broad categories, the normal deal cost and the extra transaction cost. The equation below summarises the contents of the deal cost.

Equation 5-1 Deal cost

Deal cost =M&A transaction cost (sunk cost+ paid premium + integration cost) + OMA transaction cost (LOF + LOO + LOM)

Source: author made based on literature

The M&As **deal cost** means the deal cost which is incurred by every acquirer in the process of an M&A deal, no matter whether it is domestic or cross-border. It includes **sunk cost** (the cost of identifying the target, negotiation, due diligence and professional services) at the pre-deal stage, the **over-paid premium** during the deal and the **post-deal cost** on integrating the acquirer and target. The OMAs **transaction cost** refers to the extra cost which is incurred while acquirers conduct overseas M&A. Based on international management (IM) literature, the extra transaction cost which would be incurred by a Chinese acquirer in the process of an OMA can be divided into three categories: liabilities of foreignness (LOF), liabilities of origin (LOO) and liabilities of multi-nationality (LOM).

Since the M&As' TC has been introduced in chapter 2, this chapter will focus on introducing the OMAs TC. The OMAs TC has not been systematically studied in the literature. In this section an attempt is made to give an analysis borrowing some concepts from management literature.

5.2.1.2 OMAs Additional Transaction cost

Liabilities of foreignness (LOF)

LOF is the additional costs incurred by the Chinese acquirers as compared to the cost domestic acquirers bear in the host country (Hymer 1960; Pitelis 2005). The LOF occurs because of where the acquirers are not from, all the acquirers that are "not local" suffer from this cost caused by the unfamiliarity of the host countries' IF, including the regulatory approval, business culture, labour union, etc..

LOF could be decreased through diligent preparation and experiential learning by the acquirers themselves. However, in the Chinese institutional framework, there are some institutional factors that can help ease the LOF, such as some foreign institutional framework guidance that MOFCOM provides, an administrative screening system which automatically screens out non-feasible projects and investment protection via Chinese BIT networks and investment diplomacy once the Chinese acquirers have completed the deal and start to operate in the host country.[121]

Liabilities of origin (LOO)

LOO means the additional cost the Chinese acquirers bear as compared to other nationality acquirers. An acquirer as an economic entity is the outcome of the institutional contexts of the country of its origin (Ramachandran and Pant 2010; Kostova, Dacin, and Roth 2008). In contrast to the LOF which occurs because of "where the acquirers are not from", LOO occurs because of "where the acquirers are from". LOO was the additional costs Chinese acquirers bear compared to acquirers from other countries of origin. There are two kinds of LOO, the first kind is the costs incurred by Chinese institutional constraints, such as the lower competitiveness level of the Chinese acquirers due to the regulatory controls which Chinese acquirers are subject to**.** The second kind of LOO is the "discrimination" the Chinese acquirers bear due to their country of origin, for instance, the host country may have "special treatment" for Chinese acquirers in their regulatory approval; the Chinese acquirers may be considered unattractive acquirers by the targets in a bidding competition; the Chinese acquirers' products may be considered "cheap and low quality" after they operate in the host countries. The problem of LOO is that there is very little, firms can do to immediately decrease such liabilities. It takes time for the MNEs with Chinese origins to gain legitimacy (Kostova, Dacin, and Roth 2008; Kostova and Zaheer 1999). However, the systematic improvement of the Chinese institutional framework can help to reduce the LOO from which the Chinese acquirers suffer. Firstly, a more market compatible institutional framework which releases Chinese companies from state intervention can improve the competitiveness of Chinese companies and decrease the administrative costs for preparing OMAs. Secondly, a market compatible institutional framework that increases the level of CG and IPR will increase the attractiveness of the Chinese acquirers. BIT's, investment diplomacy and soft power campaigns also help to improve the image of Chinese acquirers.

Liabilities of multi-nationality (LOM)

LOM refers to the additional cost the Chinese MNEs suffer compared to a domestic Chinese company in China. LOM occurs because Chinese acquirers are inexperienced as parent companies to manage foreign subsidiaries; for instance they would suffer the cost of co-ordinating its acquired overseas subsidiaries and the cost of transferring or accessing the firm-specific advantages of the subsidiaries (Eden and Miller 2004). The Chinese MNEs can decrease the LOM with experience and learning. However, from the institutional perspective, the competitiveness building via the market (level 4 institutions[122]) is helpful to decrease LOM; a streamlined administrative system for MNEs (level 3 institutions[123]) also helps to decrease LOM given the fact that MNEs are subject to more administrative procedures in China.

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[121] See Table 4-4 Major Regulatory Documents concern OMAs (3rd IF)

[122] See section 4.2.2.1 The Four-layer Institutions.

[123] See section 4.2.2.1 The Four-layer Institutions.

The table below defines the three kinds of transaction cost; it provides examples for each transaction cost and identifies institutional factors that may affect such cost in China.

Table 5-1 Three Kinds of Transaction Cost for Chinese Acquirers

	Definition	Examples	Home-country Institutional Factors to decrease the TC
LOF	Additional cost that the Chinese acquirers suffer as compared to host countries domestic acquirers – Chinese acquirers can decrease such a cost with preparation and experiential learning.	Pre-deal: Unfamiliar with the regulatory approval, business culture and labour union;	Administrative guidance, project screening.
		Post-deal: unfamiliar with the operation environment, labour law; customer and market of host country	BIT for investment protection, investment diplomacy for major hurdles.
LOO	Additional cost the Chinese acquirers suffer as compared to other nationality acquirers- there is very little that Chinese acquirers can do to immediately decrease such cost	Chinese companies' disadvantages in competitiveness	Major institutional changes in the 2nd and 3rd IF towards market economy
		Chinese Regulatory Approval on OMAs	Streamline and simplify the OMAs approval procedure under the 3rd IF
		Host countries' special treatment of Chinese acquirers.	BIT, investment diplomacy
		Unattractive acquirers to the targets due to the poor image of Chinese firms. CG, IPR, non-competitive managers	Pre-deal: soft power building; reform towards market-compatible institutions, notably CG and IPR
		Unattractive products in the target's market.	Policy focus towards promoting R&D to improve the country-product image.
		Operational inability due to the different business operation system and manager incentives	Institutional framework towards a more international standard CG and management culture.
LOM	Additional cost Chinese acquirers suffer as compared to the Chinese domestic companies-companies can decrease such cost by learning.	Inexperienced as parent companies to manage foreign subsidiaries, for instance cost of co-ordination, cost to transfer firm-specific advantages	Informal institutions, culture; Institutions enable more international competitiveness building
		Domestic administrative costs caused by the regulatory controls	Streamlined administrative procedure with regard to tax, IP transfer etc.

Source: author made based on IM literature and Chinese IF

5.2.2 A Theory on Chinese OMAs and Acquirers' Institutional Background

The literature on M&As has showed that M&As TC can be minimized by increasing the quality of the management and professional service. However, as analysed above, OMAs' TC involves more stakeholders. How to minimize the OMAs' TC is not only in the hands of the managers, but various stakeholders (e.g. policy makers, public opinion). The above analysis of OMAs' TC shows that the institutional arrangements may play an active role in minimizing the OMAs' TC, which then affects the decision and outcome of the OMAs.

That is to say the quality of the institutional background of a Chinese acquirer (i.e., the Chinese IF) affects the OMAs' TC, then affects the decisions made by relevant stakeholders in the process of a Chinese OMA deal, and results in the characteristics of Chinese OMAs, as shown in the below figure. It is important to point out that this chapter does not claim causality between the institutional background, OMAs' TC and decision- makings in OMAs, given that there are many omitted variables in analysing this dynamic. Rather, this thesis provides an additional institutional angle to look at the matter and pointing out one possible variable which is the institutional background of the Chinese acquirers.

Figure 5-1 Institutional Framework, Transaction cost and OMAs

Source: author made based on NIE

Section 5.2.1.2 analysed horizontally how each of the OMAs TC were affected by the specific institutions. The following sections take the Chinese OMAs from the process perspective, and analyse vertically how the institutional factors have a direct or indirect impact on the Chinese OMAs in each stage.

5.3 Institutional Changes and OMAs Motivation and OMAs Wave

As described in chapter 4, there were two major changes in the Chinese institutional framework (IF). The first change included major improvements at each level of the institutions, which resulted in the 2nd IF. However, the 2nd IF was still not overseas investment friendly. The second change included major improvements related to OMAs in the level 3 and 4 institutions and comparatively minor adjustments of level 1 and 2 institutions which resulted in the current IF. Linking back to the empirical evidence in Chapter 3, the data of OMAs reflect the results of institutional changes: there were no real Chinese corporations under the 1st IF let alone Chinese OMAs; Due to the highly controlled regulatory environment there was only a very limited number of Chinese OMAs that emerged under the 2nd IF; There was a strong Chinese OMAs wave after China entered the 3rd IF, given the fact that the 3rd IF is OMAs facilitating.

This evidence is in line with both FDI literature and M&A literature. Firstly, there is a growing body of literature that has argued that institutional change in China is a driving force of China's growing OFDI (Buckley et al. 2008; Cui and Jiang 2012; Luo, Xue, and Han 2010). The growth pattern of Chinese OMAs is in line with this strand of FDI literature. Secondly, in the empirical literature of M&A, empirical evidence shows that deregulation is the most important determinant of the M&A wave (Andrade, Mitchell, and Stafford 2001). The timing of the emergence of a Chinese OMAs wave (after domestic deregulation) is in line with this strand of empirical literature. Furthermore, it is important to point out that the second institutional changes also nurtured the Chinese companies and reduced the LOO for Chinese companies in the international market, so that Chinese companies built their competitiveness under the 2nd and 3rd institutional framework.

5.3.1 The Institutional Changes and the Chinese OMAs Wave

Williamson (2000) argued that only when society economizes its level 2 and level 3 institutions, provided that these institutions are not in conflict with the level 1 institutions, will the market be functional and the competitive firms would emerge. And being comparatively competitive is the pre-condition for participating in the international M&A market.

In China, when the 1st institutional framework (1949-1978) ruled the country, there were no conditions for a market and competition to emerge, nor for any sort of companies. (See section 4.3.1). The 1st institutional framework had already failed at the "first order economizing"[124]. The then so-called "companies" were SOEs which were not functioning as companies but were stated-owned and state-run entities which worked according to the central planning.

The 2nd institutional framework (1978-1999) on the other hand started to promote companies' competitiveness by adopting institutions which were more market oriented. The 2nd institutional framework gradually evolved towards pro-market. The institutions under the 2nd IF were more economic for competitive companies to emerge. Some of the highly competitive companies had been ready to engage in international competition towards the end of stage 2. However, the downside of the 2nd IF is its tight control of overseas investment. Chinese companies were still highly controlled by overseas investment regulations. As a result, the transaction cost caused by domestic regulation made Chinese OMAs extremely costly and the Chinese acquirers were at a disadvantage on the international M&A market. (See section 4.3.2). Therefore, it was still not the right time for Chinese companies to realize their international expansion via OMAs. Consequently, there were very few Chinese OMAs except some asset purchasing until 2000. *See Figure 3-4 Yearly Deal Number and Completion Rate.* The domestic regulatory control under the 2nd IF is a factor that Chinese companies have missed out on in the first cross-border M&A wave.

The 3rd institutional framework (2000 onwards) entails more continuous improvement in institutional arrangements and greatly relaxed overseas investment control. Firstly, the transaction cost caused by regulatory control was greatly reduced, and companies which were constrained by high regulatory costs have started to expand internationally via OMAs. Furthermore, the 3rd IF continually promotes cooperation and competition on the domestic market and with the experience of international expansion, many companies increased their international competitiveness which in turn encouraged more OMAs. The number of internationally competitive companies was increasing under the 3rd IF.

In conclusion, the timing of the Chinese OMAs boom was seemingly linked to the Chinese institutional framework changes. It was not until the 2nd IF that those competitive Chinese companies emerged on the domestic market, and it was not until the 3rd IF that the competitive Chinese acquirers emerged on the international M&As market. The next section

[124] See Figure 4-4 Economics of Institutions

analyses how the 3rd IF (the current IF) has facilitated the ambitions of Chinese acquirers in the international market.

5.3.2 The 3rd IF and the Motivation of Chinese acquirers

The current IF has two main features. Firstly, the policy makers have improved the level 3 and 4 institutions to be more market-oriented (i.e., corporate governance and the regulatory environment of the market have improved). Secondly, the informal institutions and institutional environment (level 1 and 2) have not made fundamental changes (i.e. the fundamental rules of Constitutions, State-ownership and the CPC's leadership have not changed). Both features have their influence on the growth of Chinese OMAs after 2000.

5.3.2.1 Improvement on level 3 and 4 institutions encourages more OMAs

Along with a growing number of supportive institutions, the institutional arrangements and market mechanism (level 3 and 4) have improved the governance of various relations which OMAs would be involved in. As a result, the LOO has greatly decreased, and this supported a continuing growth of Chinese OMAs up to now. The major LOOs that decreased under the 3rd IF are as follows:

i) **Agency cost.** The principal-agent relation between managers and shareholders became more efficient. The improving corporate management (i.e. enhanced corporate governance and market-oriented employment) has given the Chinese managers better incentives to engage in international expansion. For instance, enhanced supervision by the board of directors and supervisors, fiduciary duty of the managers and market-oriented performance mechanisms (level 3 and 4) have incentivized the managers to put shareholders' value as their primary goal in OMAs.
ii) **Regulatory cost.** The relation between government agencies and Chinese acquirers has been improved due to the deregulation and relaxation of regulatory controls, which has significantly lowered the transaction cost for companies in obtaining home approval to conduct an OMA deal. Since the procedure of administrative approval and foreign currency approval has been continuously streamlined, a more economic, efficient and convenient approval system encouraged the acquirers to engage in OMAs.
iii) **Unattractiveness of Chinese acquirers to the targets.** The relation between Chinese acquirers and the targets has been improved under the current IF. The market approach significantly improved Chinese firms' attraction as acquirers, and lowered the "liability of origin". The improved corporate governance not only enhanced companies' competitiveness and cultivated many capable managers, but also gave target companies more confidence and assurance that Chinese companies respect up-to-date corporate governance and play fairly on the international market (level 3 and 4). Therefore, over time, the comparative disadvantages of Chinese companies are gradually decreasing, which has also boosted the confidence of Chinese acquirers in the international M&As market.
iv) **Host countries' special treatment of Chinese acquirers.** The relations between Chinese acquirers and OMAs host countries has been improved under the current IF. Firstly, the government agencies, notably MOFCOM and SAT have signed various

international treaties (i.e. investment protection, tax treaties, IPR protection) to create good relationships with host countries for Chinese acquirers. Secondly, other investment diplomacy measures, such as high-level politician visits, have been playing an important role in building good relations between Chinese investment and the hosting countries. Empirical evidence shows that host countries' screening on cross-border M&As can be affected by political reasons. (UNCTAD 2013). Furthermore, various government agencies, such as MOFCOM and Chinese embassies also provide information with regard to the investment climate of most of the host countries, which greatly decreases the information cost incurred by the Chinese acquirers. These international support measures, on the one hand, help the Chinese acquirers to better understand the hosting countries, and therefore better control their investment risks with regard to the legal environment, and political stability. These efforts from the Chinese government to some extent reduced the LOO in some host countries. Chinese companies are less and less "discriminated" against, which also encourages the Chinese acquirers to engage in OMAs.

5.3.2.2 The relative consistency of Level 1 and 2 institutions facilitates Chinese OMAs

As pointed out by Williamson (Williamson 2000), level 1 institutions- informal institutions in a society are usually consistent and not subject to public or private intervention. Although the informal institutions can be influenced by the government or interest groups when such government and interest groups are perceived as legitimate and efficient, they are spontaneous in origin and non-calculative. Williamson also pointed out that level 2 institutions (institutional environment) also enjoy continuity since it changes rather cumulatively and progressively. Unless there are massive intrusions, level 2 institutions in a country will not be modified abruptly.

The changes in the history of Chinese IF in the past 65 years are in line with this theory. As analysed in section 4.3, although the ideology in Chinese society has not been completely homogenous in the past 65 years, and sometimes there have been rather noticeable modifications[125], the main characteristics of Chinese informal institutional environment has been consistent: Confucianism (social ideology) and socialism (political and economic ideology) (See *Table 4-1 Three stages of Chinese Institutional Development*). The institutional environment in China also shows its continuity. Although there are more changes and improvements in the institutional environment compared to the informal institutions, the fundamental rules of constitution, property rights and CPC's political institutions have not been changed fundamentally in the past 65 years.

[125] For instance, the socialist political and economic ideology in Chinese society has been through a considerable amount of modifications along the political and economic development in China. Although in the past 65 years the dominant political ideology was always socialism, the content of socialism in 1950s and today are very different. During three stages of transformation, the informal institutional environment of China has gradually transformed from pro-collectivism and pro-centralization to pro-individualism and pro-market. Furthermore, the socialist ideology itself has been challenged to some degree.

The consistency of the level 1 and level 2 institutions has proven facilitative on the rise of Chinese OMAs in some aspects, but also it may negatively affect the attraction of Chinese acquirers and cause LOO.

i) **A Stable environment for companies' growth.**

The biggest benefit of the stability of level 1 and 2 institutions is the stable environment for the economy to grow. China's economy has been developing in a more market-compatible direction, it has continued its impressive progress under the current IF. Since 2000, China has achieved a series of economic goals due to stable economic growth, for instance China became the 2nd biggest economy in the world in 2009. Meanwhile the market players merged under the 2nd IF and they have been growing more competitive in the stable environment. For instance, under the 2nd IF, the SOEs were either privatized or remained with the implementation of modern management. Some low performing SOEs went bankrupt or were restructured. The high performing SOEs grew fundamentally from a state controlled entity to modern corporations. Under the 3rd IF, the remaining SOEs in the market are more competitive and have accumulated considerable international competitiveness. The empirical evidence shows that the SOEs were the leading force in the Chinese OMAs. They were motivated by the state directly, and the majority of resource-seeking deals were conducted by them. More importantly, within a stable environment, a growing number of private companies emerged to become important players in the economy. As the data shows, they are playing a leading role in acquiring strategic assets, and in the international market they outnumber the SOE acquirers although the private companies initiated deals with values less than the SOE initiated deals [126].

ii) Managers' behaviour is positively constrained by the informal institutions.

Management literature has revealed that different cultures lead to different management styles (Hofstede 1993; Ito, Fujimura, and Tamiya 2012). Managers coming from Western culture and Chinese culture have different management styles due to different incentive structures. In the M&A literature, managers' hubris and over-confidence were found to be important drivers of some value destroying M&A, especially when glamour acquirers initiated the deals (Sudarsanam and Mahate 2003; Raghavendra Rau and Vermaelen 1998). Rau and Vermaelen, Sudarsanam and Mahate found evidence that managers of "glamour" acquirers are often over-confident about their abilities to manage an acquisition, and in glamour acquiring companies, managers actions are not closely monitored by other stakeholders.

However, the current IF which is dominated by Confucianism and Socialist capitalism offers a rather positive constraint on managers' business decisions. Under the current IF, Chinese managers' management style is shaped by the "communist party, socialism, feudalistic values and guanxi"[127] , therefore they are less likely to suffer from hubris and over-confidence. First

[126] See Table 3-2 Acquirer's Ownership Status.

[127] See *Organizational Behavior: Science, The Real World, and You* (Nelson and Quick 2012) p 40.

of all, the Confucianism-rooted business culture has been well respected in business for centuries in China (Hill 2006). It implies that the managers are more cautious and modest in assessing potential targets, especially when the targets are from advanced markets (Dikova and Rao Sahib 2013; Eden and Miller 2004). Secondly, under the current political system, Chinese managers have extra stakes in the OMAs compared to the western managers. Especially for the managers of glamour acquirers which are often SOEs, they are very cautious about the OMAs because a failed high-profile OMA may jeopardize their career in both business and politics. Thirdly, an OMA decision is usually not only made by the manager alone but is a collective decision which is agreed by various stakeholders, such as relative government agencies and interest groups. Therefore, there is little room for a manager's hubris or over-confidence to dictate the deal.

iii) "Socialist" Institutional Environment Image Remains as a Negative Impact

The "socialist-coloured" fundamental institutions such as CPC's position above the Constitution, property rights and state ownership are a source of LOO for Chinese acquirers. Such an institutional background of Chinese acquirers often raises red flags when they acquire targets from advanced economies which have different rules of law and ideology. This is specially the case for SOEs or perceived SOEs. Many high-profile rejected precedents[128] may deter some of Chinese acquirers' motivation in OMAs.

5.3.3 The Institutional Environment and the Strategic Asset Seeking Deals

In the data (1990-2013) of chapter 3, it was observed that strategic asset seeking deals in the advanced market rank second in deal number. The data also showed that the trend was particularly enhanced during and after the financial crisis (2009-2013). This phenomenon is likely to continue since there are frequent headlines that Chinese acquirers are buying valuable companies in the EU or the US (Godement, Parello-plesner, and Richard 2011; Schuman 2014). The trend was shaped by the current institutional framework which is continuously endorsing the merging up trend in the advanced markets.

Firstly, the strategic asset driven OMAs are stimulated by industrial policy. As introduced in section 4.3.3, the current 5-year plan encourages and supports R&D and industry innovation with great effort. Due to the competition both in the domestic market (with OFDI companies) and the international market, China urged its own companies to upgrade themselves from labour intensive companies to technology intensive ones. Therefore, a series of favourable policies has been initiated to encourage companies to search for access to advanced technology on the international market. Therefore, after some experiments with the neighbours, Chinese acquirers switched their focus to the advanced markets where they have leading strategic assets to offer (Deng 2009).

Secondly, in contrast to acquirers from an advanced market, Chinese acquirers apply a "reversed" OLI paradigm in order to access strategic assets of the targets.[129] In a way, this

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[128] See more analysis on section 5.4.2.

[129] See Table 3-7 A reversed OLI Paradigm for Chinese OMAs

trend is also influenced by the weak IPR protection environment in China. OMAs are not the only way to access the technology of a foreign firm; Chinese companies have various governance choices. For instance, contract relations such as License Agreement, Joint Venture and R&D cooperation, etc., can be used to access foreign companies' brand, technology and know-how. But the governance choice between contracts (i.e. License agreement) or equity (i.e. M&A) is determined by the degree of IPR protection. In a weak IPR environment like China, potential partners who are IPR holders are often reluctant to enter IPR contracts (for their core IP or knowhow) with Chinese companies. To the IPR holder, being bought with a clear plan of intangible asset transfer is a preferred governance structure in terms of the level of their IPR protection (Oxley, 1999). Chinese companies sometimes also prefer OMAs over contracts. In a contract relationship, due to the incompleteness of contacts, Chinese companies are often not able to share the key updates of the technology. Plus, to enforce a cross-border contract is often complicated and costly for a Chinese company. Therefore, Chinese companies choose an equity mode which can internalize the transaction cost for both themselves and the targets.

5.4 Institutional Factors in the Deal-making Stage

5.4.1 China's Unique Institutional Framework May be a Cause of the Low Completion Rate

There are very limited studies on the OMAs deal completion from an institutional economics perspective. The current studies which examine the results at the deal-making stage are mainly from international management literature. This strand of literature focuses on the management level reasons that caused the acquirers to withdraw the bid or not to be able to close the deal[130].

One of the few studies that tackles the deal-making result from a macro-level perspective is that of Zhang, Zhou and Ebbers (2011). They found that the greater the differences between the two countries' institutional environment, the higher the possibility that the deal will be terminated. In chapter 3, the Chinese empirical evidence is, to some extent, in line with their studies.

Firstly, given the fact that the Chinese institutional framework is very peculiar and not similar to any other hosting countries, it would cause the Chinese OMAs to have a very low deal completion rate in all the target nations. The empirical evidence has shown the same[131]. The Chinese OMAs completion rate is overall very low and is not sensitive to the target nation; the fluctuation was not significant (the difference between the highest and lowest completion rate among all the target nations was 5%). The distance did not play any positive role either[132], the Chinese OMAs in the Asia Pacific area had an even lower completion rate compared to the ones in the Americas and Europe, meaning the familiarities of each other's institutional framework is even a slightly negative factor in the completion rate. This implies

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130 See chapter 2, section 2.3.3.

131 See Figure 3-7 Deal Value by Target Nation (Announced vs Completed) and Figure 3-10 OMAs number by target nation (2009-2013)

132 See Figure 3-6 Deal Value and Number by Target Region (Announced vs Completed)

that during the deal-making stage, Chinese acquirers suffer LOO broadly in most hosting countries.

Secondly, the empirical evidence shows that the Chinese OMAs completion rate is not only significantly (25-28%) lower than the advanced economies OMAs completion rate, but also considerably (11-13%) lower than the emerging economies OMAs completion rate. [133] The comparison implies that during the deal-making stage, the degree of LOO Chinese acquirers suffer is greater than any other acquirers (from any other country of origin.)

5.4.2 The Institutional Factors may be a Source of the LOO at Deal-making Stage

Chinese policy makers have been consistently relaxing the regulations on OMAs and these institutional arrangements have had very positive effects on motivating the Chinese acquirers to conduct OMAs. However, these institutional changes have had little effect on reducing LOO, which is still a source of failure in deal-making. The reason why the current IF did not increase the credibility of Chinese acquirers can be explained by the following reasons.

Firstly, LOO is closely related to the quality of the institutional framework of a country. The quality change of a country's IF requires fundamental changes in its upper level institutions. Therefore, only the fundamental institutional changes in a country's IF can have a noticeable effect on decreasing the LOO from which its companies suffer.

China's current IF lacks fundamental changes. As shown in *Figure 4-6 Overview of ROL and RQ changes under the 3rd IF*, given the massive institutional changes China had gone through under the 3rd IF, there was very little improvement of the fundamental elements of the IF such as rule of law and regulatory quality. China's ranking on these governance indicators had shown little change over the last 14 years. Another indicator is the public opinion change in host countries. Survey shows that international public opinion on the rise of China in recent years has not improved, but on the contrary, it has become more negative. The *Global Public Opinion in the Bush Years (2001-2008)* showed that China's favourability ratings have fallen since 2002, particularly in Europe[134]. Given the fact that Chinese acquirers are primarily targeting European companies, the negative public opinion in Europe is also a source of LOO which has not been decreased.

Secondly, as a consequence of a lack of fundamental changes in China's IF, the LOO which are caused by "discrimination" (Moeller et al. 2013; Ramachandran and Pant 2010) cannot be noticeably decreased either. Whilst LOF caused by the discrimination of a host country is usually outside the protection of host countries' domestic companies, the source of LOO- "discrimination" against a certain country's acquirers is often driven by ideological differences, political differences or strategic concerns. Therefore, the positive development on the 3rd and 4th level of institutions under the current IF did not have an obvious impact on the LOO caused by "discrimination". Therefore, many Chinese acquirers are still victims of LOO caused by "discrimination". For instance, when the Chinese oil company CNOOC withdrew its $18.5bn bid on American Oil Company Unocal in 2012, CNOOC called "unprecedented

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[133] See Table 3-7 A reversed OLI Paradigm for Chinese OMAs

[134] See Pew Research Center survey: http://www.pewglobal.org/2008/12/18/global-public-opinion-in-the-bush-years-2001-2008/

political opposition" its primary reason for withdrawing its offer[135]. Internationally, it was also widely believed that the political economy played a role (Kling and Weitzel 2011; Graham and Pettis 2005). The CFIUS posited that the bid of CNOOC was an economic strategy aimed at threatening US national security. Even some private acquirers can be perceived as acting on behalf of the state also. For instance, in 2012, the Australian government banned Huawei from bidding to help build the Australian high-speed internet network, due to concerns about Chinese cyber-attacks.[136]

Thirdly, some government supportive institutions have adverse effects at the stage of deal-making. For instance, the financial support the Chinese acquirers receive may appear attractive to targets who need liquidity. But it can be a problem in acquiring regulatory approval from the hosting country. For example, the above mentioned CNOOC deal, the bid was refused by the regulatory authority based on an alleged state subsidy (Graham and Pettis 2005). Therefore, policy makers should pay attention to the risk of adverse effects when making OMAs financial policies.

Furthermore, there are massive "misunderstandings" between the Chinese acquirers and the foreign targets. The Chinese acquirers are newly emerged, yet they are growing fast and they play the OMAs game very differently. For instance, they are either looking for strategic assets and markets or they are acquiring resources which sometimes are troublesome to the targets (Nolan 2012; Godement, Parello-plesner, and Richard 2011). Furthermore, China's current institutional framework still emphasizes the state property rights which are often perceived negatively by the international market, in terms of its corporate governance, management skills and IPR protection. Therefore, as acquirers SOEs are often in a disadvantageous position compared to private companies. This is, to a large extent, due to the way international markets perceive state-ownership over the years. Chinese SOEs' untrustworthy image cannot easily be changed without fundamental change in Chinese institutions.

5.5 Institutional Factors that Influence OMAs post-deal Performance

5.5.1 Institutional Framework and Managers Behaviour

The empirical literature (Erel, Liao, and Weisbach 2011; Gugler, Mueller, and Yurtoglu 2006; Duncan and Mtar 2006) shows that managers' behaviour is a determinant of M&A and cross-border M&A performance. The theoretical argument for the empirical findings is that managers are self-interest maximisers and they suffer from hubris behaviour; therefore, they tend to engage in cross-border M&A combining their self-interest with corporate interest.

The evidence from Chinese OMAs shows that the unique manager incentive structure in China somehow favours the performance of Chinese OMAs.

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[135] See *CNOOC withdraws bid for Unocal, citing politics* - Oil & Gas Journal, http://www.ogj.com/articles/print/volume-103/issue-30/general-interest/cnooc-withdraws-bid-for-unocal-citing-politics.html

[136] See http://phys.org/news/2012-03-australia-chinese-company-huawei-web.html#jCp

There are two main characteristics that constitute the Chinese manager: firstly, although they are also self-interest maximisers, their self-interests are not limited to monetary compensation; secondly, Chinese managers suffer less from hubris, as they are more cautiously oriented. These two characteristics cultivate them to be careful mangers in choosing OMAs targets and diligent managers to make the OMAs profitable.

There are a number of institutional factors that have influence on their cautious and diligent behaviour. Firstly, cultural factors. The business culture of China is in line with the social ideology of China. In general, Chinese managers are less aggressive and more cautious. For instance, in chapter 3 we found that Chinese managers have rarely engaged in bidding wars, and they have rarely conducted hostile takeovers. The empirical evidence also shows that, although some European targets in oil and gas offer lower profits, they choose European targets over those of the Middle East because of the stability of the region.

Secondly, the political incentives make them even more cautious and diligent. As described in 4.3, under the current institutional framework, there remain certain elements of central-planning legacy, particularly with regard to the human resource management of SOEs. Typically, the institutional framework of China has created the revolving door. Some managers may have political agendas hidden behind their management decisions. For instance, in SOEs resource-seeking deals, the State often pays higher attention given the fact that the resource-driven OMAs are mostly state-supported deals and they have strategic importance for social welfare. In this context, managers would also be more cautious and diligent. Therefore, in the empirical evidence we see high-value deals in natural resources have a higher rate of completion because SOE managers have strong incentives to make high profile deals that can be completed.

Furthermore, under the current central-local governmental regime, managers' behaviour may be influenced by local policies or politicians (Dong 2007; Suzuki 2012). For instance, in some regions (province or city), the number of OMAs by local companies is an indicator of local government performance. Therefore, local politicians encourage local companies to engage in OMAs, managers are often incentivized by the local government by means of economic gains or political promises if the OMAs are successful. Therefore, managers may be extra diligent in making OMA deals. In this context, the extra drive may minimize their hubris behaviour which is common among managers when making M&A deals (Roll 1986; Billett and Qian 2008). The different Chinese managers' incentive structure from the western managers may be one of the reasons that Chinese OMAs tend to gain value for the shareholders (Li and Tang 2010). Due to the difficulties in collecting data on managers' behaviour, statistical data to back up the above proposition is not available in this thesis. However, in the case study, more qualitative analysis on the relation between political incentives and manager's behaviour is provided. [137]

5.5.2 Institutional Framework and the Shareholders' Value

As shown in the empirical study of chapter 3, Chinese acquirers' shareholders earn significant abnormal returns in the OMAs. The Chinese market in general has confidence in Chinese

[137] In the case study, this theory is elaborated with examples. However, ideally this hypothesis should be tested with a larger data set.

OMAs. It rewards Chinese companies when they conduct OMAs. There are various institutional factors that contribute to this outcome.

Firstly, the current institutional framework helps the self-selected high-performing companies to conduct OMAs. Under the current institutional framework, mainly high-performing companies have sufficient means and resources to make OMAs. Whereas, when small and medium sized enterprises (SMEs) are initiating OMAs, they are not sufficiently facilitated in terms of state financial support under the current institutional framework. Therefore, the market recognizes that in the current institutional framework, only high performing companies which have a sound economic rationale and sufficient financial means would conduct OMAs; the market therefore in general perceives Chinese OMAs as game up and profit making, and the high profile successful deals also endorse their confidence. As a result, the market in general rewards Chinese OMAs. As shown in chapter 3, the high-profile cases over the years 2004-2012 were proving shareholder wealth was increasing.

Secondly, the deal specifics are in line with the determinants of cross-border M&A success. (Duncan and Mtar 2006). 1). Chinese acquirers are mostly friendly bidders. They often have formed a pre-agreement with the target about the post-deal management. This is an assurance of smooth management after the deal. 2). Chinese acquirers tend to pay the premium entirely or partially in cash, and this often enhances confidence in the market (de La Bruslerie 2012). 3). In Chinese OMAs, especially when Chinese acquirers are merging up in advanced markets, targets tend to continue to operate as a separate company, even though the Chinese acquirers have gained controlling shares over the target. There has been no hostile takeover in which the bidder replaced the entire management of the targets. These deal specifics showed that the Chinese OMAs are mainly long-term competitiveness enhancing deals, rather than short-term stock market gain deals, which gives confidence to the market. The empirical evidence from the literature also identifies these deal specific characters as determinants of M&A success (Collins et al., 2009; Duncan and Mtar, 2006).

Last but not least, the added ideology of the "China dream" and China "go global" at this stage formed an informal institutional environment which inevitably has influence on the market's confidence over Chinese OMAs. It is rather special that the informal institution played a direct role in the OMAs performance.

However, it is also important to address the issue that the market's confidence can be exaggerated due to the fact that the Chinese stock market is not considered an efficient market. As explained in chapter 3, at best the China market is semi-efficient. Some empirical evidence has shown that due to information leakage, shareholders value is often mainly realized by majority shareholders and insiders (Luo 2005).

5.6 Discussion

Starting from a basic proposition that "institutions matter", the NIE approach set out on the long road to achieve an understanding of how the home-country institutional framework (or one might call it Chinese acquirers institutional background) matters in the process of OMAs. The rise of OMAs from China has enabled this thesis to extend the institution-based view by developing and analysing a new framework centred on NIE and transaction cost minimizing in the process of OMAs.

By linking the phenomenon of Chinese OMAs which in many ways is specific (see chapter 3) to the institutional framework of China which evolved via massive changes (see chapter 4) as well as applying the theoretical arguments (section 5.2), this chapter answers the questions it set out to answer.

The evolution of the Chinese institutional framework is a process to increase the market elements and to decrease the central planning elements. The newly-started and market-oriented institutions incentivized the economic actors (government agencies, companies and managers, etc.,) to build Chinese companies' competitiveness on both the domestic market and the international market. Not surprisingly, the introduction of the market mechanism often overlaps with the remaining central-planning economy mechanism and the interest group that benefits from it. For instance, on the one hand, the policy makers initiated the "go-out" policy with the push of interest groups, due to which the state began to relax regulations in order to facilitate high performing companies to invest overseas. As a result, the level 3 and 4 institutions have emerged as facilitative to the Chinese OMAs. On the other hand, the "rule of the game" (D. C. North, 1990) on a higher level, namely the fundamental market compatible institutions (level 2) have not yet been established in China. The level 2 institutions of China are persistent because it is in line with the interest of the dominant interest group in China, the CPC. The co-existence of, and the dynamics between, the market institutions and the remaining "socialist" institutions, or rather the rise of the former and the fall of the latter, created a unique and dynamic institutional framework for China. With such a mix of institutional circumstances, the behaviour of economic actors displays unique features in the half evolving market economy and half state capitalist economy (Stark, 1997). The international market also perceives Chinese IF with some degree of "doubts" which is a source of LOO, as analysed in section 5.2.

Applying the characteristics of the Chinese institutional framework to explain the empirical findings of Chapter 3, this chapter found that the institutional framework which mixed with stable level 1 and 2 institutions, characterised by Confucianism and socialism, and flexible level 3 and 4 institutions, characterised by the free market, have contributed to the characteristics of Chinese OMAs.

Firstly, this framework allowed China to gradually build up a market-oriented institutional arrangement and a more efficient market through learning without any disturbance to the upper level institutions. This institutional framework therefore prepared Chinese companies to be more market oriented, more competitive as acquirers. Secondly, the special features of the current institutional framework in China also explain why many Chinese acquirers are motivated by a reversed OLI paradigm and tend to merge up in the advanced market for strategic assets. Thirdly, the institutional factors which have a negative impact on Chinese OMAs were addressed. This chapter especially identified the institutional factors, such as the persistence of level 2 institutions (rule of law, regulatory quality) that may contribute to the high rate of uncompleted deals. Lastly, it also explained the institutional factors, such as managers' incentive structures, deal specific characteristics, social ideology, which may contribute to the positive market reaction of the OMAs.

The next chapter will put the analysis of the previous chapters (chapter 3, 4 and 5) in the context of a case study; it enables a more detailed analysis of the relationship between the acquirers' Chinese institutional background and their OMAs.

Chapter 6. A Case study- Geely's Acquisition of Volvo

6.1 Introduction

The previous chapters have reviewed the general motivation and performance of cross-border M&As (Chapter 2); the characteristics of Chinese OMAs (Chapter 3); the Chinese institutional framework (Chapter 4) and how the institutional factors contributed to the peculiarities of Chinese OMAs (Chapter 5). The purpose of this chapter is to "shed credible light" on the previous findings with an in-depth analysis[138] of a Chinese OMA in the automotive industry- Geely's acquisition of Volvo.

On August 2010, Geely, a private Chinese car maker, acquired 100% shares of Volvo from Ford for $1.8 billion. It represented the most ambitious Chinese OMA at that time. It accelerated the process of transforming Geely from a domestic car maker into a multi-national car maker. Volvo is one of the world's most famous auto producers which had started to produce cars in 1927 whereas Geely had 70 years less experience since it only started car production in 1997, not even with a licence at that time[139]. Volvo was already one of the world's 20 largest automobile companies (374,297 cars sold and USD14,679 million revenue in 2008)[140], and enjoyed considerable prestige in excellent quality and performance world-wide, whereas Geely had a far lower production capacity and revenue prior to the deal (204,205 units sold and USD 2,389 million revenue in 2008)[141] and it was still unknown in the international auto industry before the deal; Volvo is known for its safety technology and environmental protection measures, whereas Geely had limited R&D capability and was often accused by foreign car makers of copying their trade mark or design (Shao 2006).[142] It is not surprising that due to the huge gap between the young and "unknown" Geely and the experienced and world-famous Volvo, the process of the acquisition was a marathon of negotiations. Geely had faced numerous obstacles during the long pursuit of Volvo; it took Geely years of planning and constant efforts to finally close the deal. Furthermore, Geely also faced and is still facing challenges to implement its very ambitious integration plan in order to fully realize the integration potential. An acquisition between companies with huge gaps is likely to face more challenges during the integration. The efficiency of post-deal integration is

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[138] Lee J. Alston said that case study is an important methodology in NIE , because case studies "enable us to analyse both the determinants and consequences of institutions and institutional change" (Brousseau & Glachant 2008,p 103-104)

[139] The detail is explained later in section 6.3 of this chapter.

[140] "Volvo Car Group Annual Report 2008", Volvo Car Group. 2008. pp. 3,7.

[141] "Annual Report 2008", Geely Automobile Holdings Limited. 2008. Pp. 2,10.

[142] For instance, on January 2, 2003, Toyota instituted a lawsuit in court against Geely and two car dealers in Beijing for trademark infringements and unfair competition, Toyota lost the lawsuit. It was also rumoured in the market that Rolls may sue over Geely's clone in 2009 for similar industrial design infringements. (Shao 2006)

the key for final success (Doukas and Lang 2003; Martynova, Oosting, and Renneboog 2007; Kruse et al. 2007).

Though it is too early to judge to what extent Geely has been successful in its acquisition of Volvo, this acquisition is a compelling case to study (Russo, Tse, and Ke 2009; Balcet, Wang, and Richet 2012). It is an example of how a private Chinese company with a dubious reputation reversed its image by a well-cultivated OMA. This case represented the main peculiarities of Chinese OMAs, as analysed in Chapter 3.

Firstly, Geely represents the fast-growing Chinese companies in the auto industry under the 3rd institutional framework [143]. The growth path of Geely showed how a company's development and its business strategies are affected by institutional factors in China. The auto industry is usually shaped by the wider political economy in most industrialized countries; this is the case in China as well. The auto makers in China are not only subject to the overall institutional framework as analysed in chapter 4, but are also subject to industrial policy (analysed here in section 5.3). This case showed how the policy makers, with their policy tool kit, shaped the Chinese car makers' corporate strategies, including OMAs. It also showed how Geely and its managers bargained and adapted themselves to the challenges and opportunities under the peculiar institutional framework of China.

Secondly, this case represents the merging-up trend of Chinese OMAs which is motivated by strategic asset seeking. Geely or indeed any other Chinese car maker suffered from liability of origin (LOO) in the advanced market due to its Chinese institutional background. Including the negative country image (e.g. rule of law, regulatory quality[144]), negative product-country image (e.g. Chinese auto industry), which puts them in a comparatively disadvantaged position as acquirers in the international M&A market. However, Chinese auto producers tend to target car makers from an advanced market with strategic assets. For instance, the European auto companies are the most popular targets of Chinese auto companies *(see Figure 6-6 Chinese Automotive sector OMAs announcements by Target Region till 2012).* Furthermore, the Chinese policy maker also tends to encourage and facilitate such merging-up OMAs (see *Table 6-3 Key points of 2004 Automotive Industry Policy).*

Thirdly, this deal represented the "high-performing" Chinese OMAs. Although it is still too early to draw conclusions regarding whether the deal is a long-term success for Geely, nevertheless, four years after the deal, it appears Geely scored well every step of the way thus far. Firstly, the acquisition brought Geely immediately benefit: the stock market reacted to the deal very positively, the deal earned Geely's shareholders positive returns around the announcement; Geely became famous overnight when the deal was announced, the brand value of Geely was undoubtedly enriched by the acquisition; a series of agreements Geely signed with Volvo and its previous parent company Ford also guaranteed Geely's access to Volvo's technology and know-how. Furthermore, the acquisition also seems to have remained

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[143] As shown in *Figure 6-1 Number of new passenger cars produced in China (1958-2012)*, in 1949, China had no car production and after 50 years in 2009 China became the top car producer and as shown in *Figure 6-2 Yearly announced /completed OMAs in automotive industry till 2012*, in recent years Chinese car makers were capable of taking over globally famous car makers .

[144] Here the country's institutional framework is represented by the rule of law and quality of regulations.

rather positive after the event. Volvo's sales increased both in China and world-wide; a new JV between Geely and Volvo is under construction, which is expected to help reduce the cost of Volvo cars on a major scale; it is also likely that Geely's technology access may also be a reason for the increased sales of Geely cars. It is also likely that good integration post-acquisition contributed to a good long-term stock performance of Geely. Although there might be many variables in the dynamic in this OMA, as reviewed in Chapter 2, at first glance, the characteristics of Geely's acquisition of Volvo are in line with the findings in chapter 3. The question is whether the characteristics of this acquisition are related to Geely's institutional background, as analysed in Chapter 4 and 5. This case study provides the chance to have a deal-level analysis based on the previous chapters, which will enable a full picture of a Chinese OMA.

Both quantitative and qualitative data for this case study have been collected. The M&A deal specific data is from Thomson One Banker, the stock price data is from Yahoo Finance and the qualitative data was collected from archives such as governmental statistics, industry reports, governmental reports, newspapers, and magazine articles.

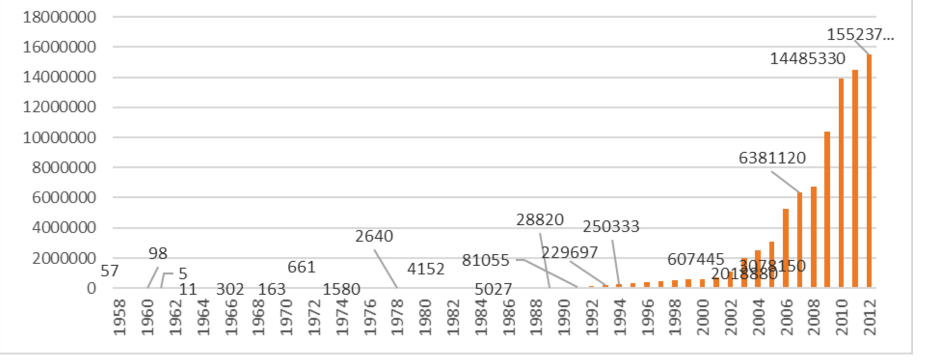
The rest of this chapter is structured as follows: section 6.2 sets the industry background of the acquisition. It briefly introduces the history of the Chinese auto industry and gives an overview of the Chinese OMAs in the automotive industry. Then it introduces the institutions and institutional changes in the auto industry; Section 6.3 analyses Geely's acquisition of Volvo and the role of Geely's Institutional background. Section 6.4 concludes this chapter.

6.2 The Industry-Institutional Background of Geely

Chinese car makers are not only constrained by their institutional background but also constrained by auto industry policy. The growth pattern of the Chinese auto industry policy and auto market is closely linked to the growth pattern of the overall Chinese IF which was outlined in Chapter 4. Therefore, this section will only focus on reviewing the development of the auto sector and auto industrial policies to set the industry-institutional background for the case study.

Figure 6-1 gives an overview of Chinese car production up to 2012. China only started to produce passenger cars in 1958, and up until the 1980s, car production was nearly negligible. From the middle of the 1980s, car production started to take off and in the 2000s, car production grew dramatically, and in 2009, China became the world's biggest car producer.

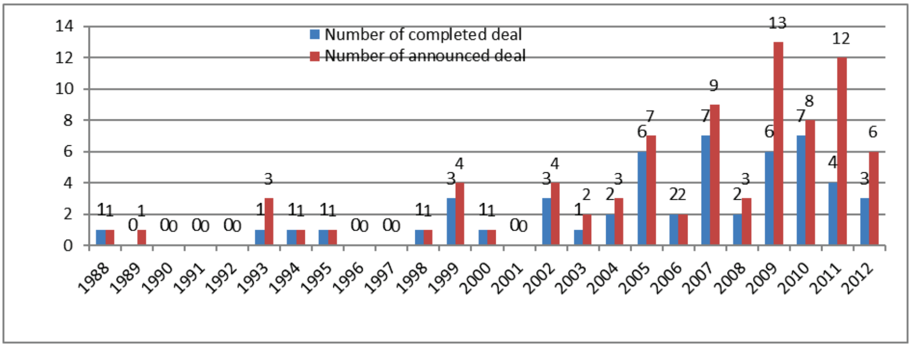
Figure 6-1 Number of new passenger cars produced in China (1958-2012)



Source: 1955–1990: China Automotive Technology and Research Centre; 1991–2000: China Automotive Industry Yearbook, 2007; 2001-2012: Ministry of Transport of China

With regard to Chinese auto OMAs (see Figure 6-2), it was not until 1988 that Chinese auto makers conducted their first asset acquisition, and the growth of auto OMAs did not take off until 2005 after China adjusted its auto industry policy. The financial crisis gave a nudge to Chinese auto makers, and therefore a considerable number of OMAs were made during the crisis period, including some high-profile deals. The figure below shows the trend of Chinese OMAs in the auto industry, both in terms of announced deals and completed deals.

Figure 6-2 Yearly announced /completed OMAs in automotive industry till 2012



Source: Thomason one banker

Based on the theme of this chapter and the important influence of China's joining the WTO on the auto industry, the auto industry can be divided into roughly two periods, namely Pre-WTO and post-WTO.

6.2.1 Auto Industry and the Auto OMAs

6.2.1.1 Pre-WTO: Under-developed and Catching-up

Chinese car market pre-WTO

In the period 1940-1978, the auto industry in China was mainly focused on trucks, buses and military vehicles. With very limited supply and demand, the passenger car market was not established. China began to develop its automotive industry right after the CPC came to power in 1949, with help from the Soviet Union[145]. First Automobile Works (FAW) was the first auto producer that resulted from the cooperation with the Soviet Union. FAW was established in 1953 and a few municipal government-supported auto plants were also established early on. Meanwhile, China invested heavily in military machinery due to the unstable international relations situation China had been facing[146]. A wave of state-owned military auto plants therefore emerged, including Dongfeng, Sichuan Auto Works, Shanxi Auto Works (SAW) and so on. All these state-owned auto makers were created mainly to produce trucks, buses and other heavy vehicles. (Chu 2011). [147] These auto plants had no motivation or capability to produce passenger cars because of the indigenous developing models and the overall economic environment in China. The very few indigenous car[148] brands were reliant on craft production, such as Red Flag (Hong Qi), and they produced a very limited number of cars,[149] which were mainly for the use of government officials or elite families. The market demand for cars was also not developed during this period because of the domestic circumstances. The Great Leap Forward and the Cultural Revolution[150] both significantly distorted the economic development of China. In such a social and economic environment, there was almost no market demand for cars from individuals. Cars were neither a priority of the average Chinese consumer nor could they afford them.

At the beginning of the reform and open-door period (late 1970s to middle 1980s), thanks to the institutional changes in China[151], economic development was back on track. There were also major developments in Chinese international relations[152] during this period of time. The stable domestic and international environment provided policy makers with the chance to focus on the growth of the Chinese auto industry (Naughton 1996). From the demand side, as the economy gradually evolved from a strictly centrally-planned economy towards a market-oriented economy,[153] it resulted in impressive economic growth[154] and greatly increased

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145 The China-Soviet Union relationship deteriorated dramatically in the 1960s, and the Soviet Union withdrew all their technological support from China.

146 For instance, China supported the North Koreans in their war against the USA during 1950-1953; in 1959, the Sino-Soviet Union relations was tense; in1969, there was a clash with Soviet Union troops at Zhenbao Island; in 1962, there was border conflict with India over areas in the Himalaya; there was also the ongoing Vietnam war till 1975.

147 For the purpose of this thesis, unless stated otherwise, passenger car producers are referred to as auto producers in this chapter.

148 "Car" here in this chapter refers to the passenger car.

149 See Figure 6-1 Number of new passenger cars produced in China (1958-2012)

150 See section 4.3.2.

151 See the three stages of China's development in chapter 4.

152 For instance, China re-joined the United Nations in 1971, President Nixon visited China in 1972, and China-US relations were eventually normalized in 1978.

153 See section 4.3.

people's living standards, the market demand for passenger cars started to grow. However, from the supply side, with only the production from the indigenous SOEs[155], the diversity of the passenger cars could not meet the various market demands. There were also a limited number of foreign cars entering the Chinese market because of import controls (see Table 6-1) and the general lack of knowledge of the Chinese auto market. Therefore, with the high demand and low supply, in the middle of the 1980s, some new domestic auto factories began to emerge under the guidance of local governments; and due to the stable international relations China had gained during that period, some machinery factories in the military and aviation industry also began their production of vehicles for civilian use, for instance, Dongfeng Auto switched from military vehicle manufacture to car production.

The China auto industry started its Joint Venture era also from the middle of the 1980s. Witnessing the fast-growing passenger car market in China, foreign car makers also gradually entered into the Chinese auto market. They firstly tested the market through imports. For instance, Steyr-Daimler-Puch, AMC Chrysler Jeep, Volkswagen (VW) and Audi had set up shop in China in the middle of the 1980s. Component manufacturers Delphi, Ford, and Bosch soon followed them to China. However, at that time, the entry barrier through imports was extremely high. Chinese policy makers had put high tariffs and import quota on imported cars. The table below introduces the main changes on tariffs from the mid-1980s.

Table 6-1 Import Controls: pre-WTO vs. post- WTO

	Pre-WTO	*Post-WTO*
Tariff	150%-120% before 1985 220%-180% 1986-1994 70%-100% 1994-2002	Gradually decreased from 80% to 28% 2002-2005 25% from 2006 on
Import quota	Car imports were restricted to a total value of US$6 billion annually.	increase 15% quota yearly; phased out by 2006
Local content requirement	40%	Eliminated

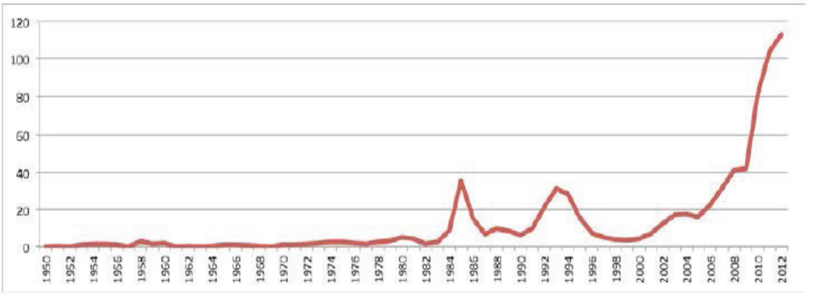
Source: China Association of Automobile Manufacturers (CAAM)

As shown in the above table, when the foreign car makers started to enter the Chinese market in the mid-1980s, the tariff jumped from 150%-120% to 220%-180%. The tariff decreased to 70%-100% in 1994 and it triggered an import surge. Furthermore, on top of the high tariff, the policy maker put on import quota as well to control the volume of import cars. Before joining the WTO, every year, it was only allowed to import 6 billion US$ worth of automobiles into China. The figure below shows the cars imported annually between 1978 and 2012.

[154] Average GDP growth rate of China between 1979 and 1999 was 10%.

[155] There were only two acquisitions of foreign car producers' outdated assembly lines.

Figure 6-3 Number of Imported passenger Cars 1978-2012 (million)



Source: China Auto Industry Year Book 2012

As shown in the figure above, the import controls heavily affected the foreign car makers' footprint in China. Facing the protective import control regime of China and a choice of setting up a joint venture (JV) and Chinese policy makers' preferential JV policies (explained later in 5.3.2), many foreign car companies started to enter the Chinese market through JV instead of exporting completed built-up cars. There were a considerable number of foreign auto producers that set up JV in China during this period. Before China joined the WTO in 2001, there were 531 JV projects in the automotive industry in China (China Automotive Industry Year Book 2007). Car production in China grew massively during this period which was mainly contributed to by the growth of JVs. In 1978, there were only 2640 cars produced in China and by 2000, there were already 607,445 cars rolling off the production lines in China *(See Figure 6-1 Number of new passenger cars produced in China (1958-2012))*.

OMAs in auto industry pre-WTO

The Chinese auto producers were only focused on domestic demand during the first 50 years of development (1949-1999). Chinese auto producers and Chinese passenger cars were rarely on the horizon of the international market until China's joining of the WTO. Before China joined the WTO, Chinese auto producers had almost no chance or capability of participating in the competition to acquire foreign auto companies (See *Figure 6-1 Number of new passenger cars produced in China (1958-2012)*). Moreover, as described in Chapter 4, the institutional framework at this time also heavily controlled any overseas investment.

However, with the industry policy support and more auto makers entering the domestic market in the middle 1980s, domestic competition increased, which encouraged the car makers to improve their competitiveness on the domestic market. Most car companies' strategy was to form a JV with a foreign car producer to increase competitiveness and some were also looking for opportunities to acquire advanced and affordable assets from overseas.

Case 6-1 The First Overseas Automaker Asset Acquisition

In 1988, China's auto part company- General Internal Combustion Engine Factory acquired a second-hand assembly line from General Motors for $16.5 million. It was the first overseas purchase made by a Chinese auto producer.

The acquired plant was closed in 1984 by General Motors because of its outdated model. However, it was considered an advanced engine plant by Chinese auto producers who had just started car production. After purchase, the plant started running in Beijing in 1990.

Source: Thomason One Banker and Bloomberg

Since then, in the 1990s, there were one or two similar acquisitions that were made by Chinese auto companies yearly *(see Figure 6-2 Yearly announced /completed OMAs in automotive industry till 2012*). Those acquisitions were mainly asset (auto parts) acquisitions, such as acquiring engines, tyres, auto batteries, and iron cutting plants from advanced auto producers overseas. The purpose of those early asset acquisitions was to upgrade its technology and to enhance domestic production for the domestic market.

6.2.1.2 Post-WTO: Taking over

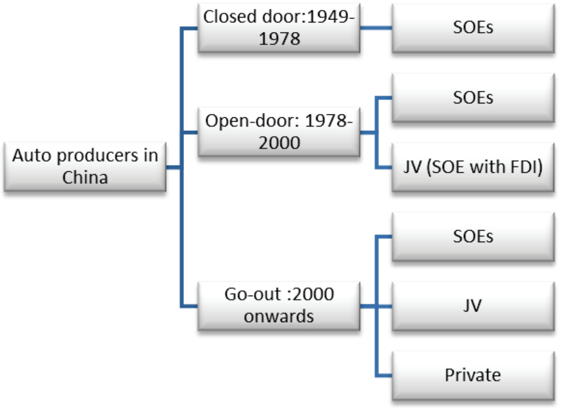
Chinese car market post-WTO

Entering the WTO in 2001 turned a new page for the Chinese auto industry. In accordance with the requirements of the WTO, the policy makers relaxed a number of restrictions in the auto industry, it significantly lowered the entry requirement. Before China entered the WTO, private auto producers faced a high entry barrier and they were officially not permitted to produce completely assembled cars[156]. Entering WTO finally gave the private auto-producers their legitimate status. Therefore, many private car makers entered the market, especially with indigenously-designed and low-price passenger cars which SOEs and JV do not produce.

[156] Before joining the WTO the regulatory environment in China had opened a very narrow window for the private auto producers. Private auto producers officially could not acquire a permit to produce completely assembled cars, so therefore they officially could not produce cars. Some private car producers choose to "borrow" a shell company in order to produce vehicles such as Geely and Chery. See Section 5.3.

The figure below shows different types of car makers at different stages of the Chinese auto market.

Figure 6-4 Different Types of Auto-producers in China

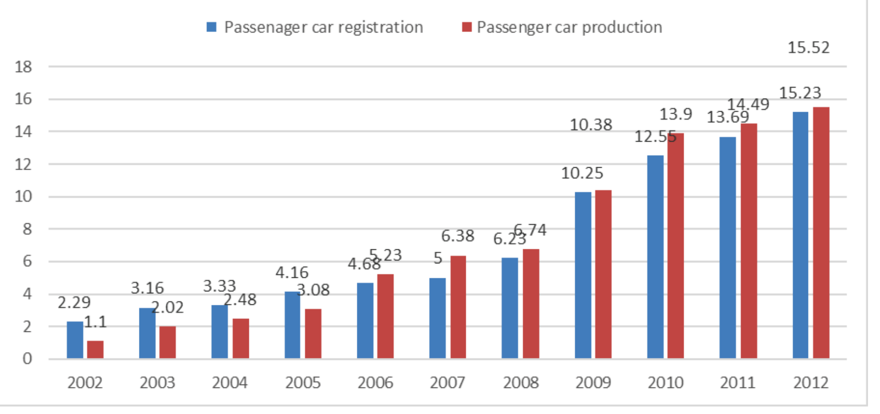


Source: Author composed based on the analysis

The low budget car demand in China helped the private auto companies grow their market shares rapidly (Chu 2011). Furthermore, after China joint WTO, car makers with all kinds of ownership are competing on the Chinese car market, which not only drove down the prices but also introduced more diversity in production and R&D. This competition as well as the stimulus for consumption policies[157] led China to grow to be the world market leader in both passenger car manufacturing (supply) and sales (demand) in 2009 from a negligible base in 2000. As the figure below shows, both demand and supply of passenger cars in China have been growing with unprecedented growth rates.

[157] It is explained in Table 6-2 Key Points of 1994 Automotive Industry Policy.

Figure 6-5 Number of cars produced and new cars registered in China after the WTO (in million cars)



Source: Ministry of Transport of China; National Bureau of Statistics of China

From the supply side, China's total passenger car production was 1.1 million in 2002, and surpassed South Korea[158]. Then it almost doubled the figure and surpassed France in 2003. In 2005, China approached the production level of Germany and then overtook Germany in 2006 with 5.23 million passenger cars rolling off the production lines. During the financial crisis, with the global economy slow-down, global auto production dropped by more than 10 million, Chinese auto producers on the other hand showed considerable strength and continuously expanded. Since the U.S. auto producers experienced difficulties in growth due to the economic downturn, China overtook the US in 2008 and became the second largest auto producer with an output of 9.5 million total vehicles of which 6.7 million were passenger cars. In 2009, China produced 13.6 million vehicles, including 10.38 million passenger cars, and overtook Japan and became the world's biggest auto producer. China has remained the biggest passenger car producer since then with a total production of 14.49 million in 2011 and 15.52 million in 2012.

From the demand side, also shown in the above figure, the sales (indicated by new registrations) of passenger cars soared dramatically from 2.3 million units in 2002 to 3.16 million in 2003; and was then nearly doubled to 6.23 million in 2008; and eventually in 2009, China became the world's largest passenger car market with new registrations of 10.25 million. In 2012, 10 years after China joined the WTO, the sales/registrations had reached 15.25 million units which amounted to 7 times the registration of 2002 when China had just entered the WTO.

OMAs in auto industry post- WTO.

[158] The data of passenger car manufacturing by country is from "Organisation Internationale des Constructeurs d'Automobiles" (OICA), available at http://www.oica.net/category/production-statistics/.

As shown in *Figure 6-2,* Chinese auto producers had already started asset acquisition from 1988, but it was not until 2004 that Chinese OMAs acquired a foreign car maker. In 2004, 2 years after China joined the WTO, China issued a new industry policy (see *Table 6-3 Key points of 2004 Automotive Industry Policy*), meanwhile Chinese auto producers began to emerge as acquirers in the international M&A market, see the case below.

Case 6-2 Chinese Automaker's First Major OMA

In 2005 (after the 2004 industry policy was issued), State owned auto giant, Shanghai Automotive Industry Corp (SAIC) raised its interest to 59.5% from 10.6%, by acquiring a 48.9% stake, or 59.098 million ordinary shares, in Ssangyong Motor Co Ltd., via an auction, from its creditors, for 10,000 Korean won (US $8.89) per share, or a total value of an estimated 590.978 billion Korean won (US $530.698 million). Ssangyong Motor is a Korean motor vehicle manufacturer, and a 51.98%-owned unit of Daewoo International Corp.

SAIC won the bid over other bidders, including General Motors (GM), chemical firm China National Blue Star Corp. and a US pension fund. The deal makes SAIC the first Chinese automaker to have a controlling interest in a foreign carmaker. The deal enhanced SAIC's development and gave Ssangyong a foothold in China.

Source: Thomson One Banker and Bloomberg

This deal was a milestone for Chinese auto OMAs. Chinese auto producers quickly followed the steps of SAIC; between 2005 and 2008, there were 21 OMAs announcements and17 OMAs were successfully completed.

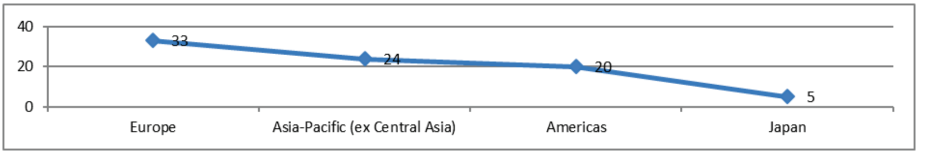
Then the financial crisis started in 2008 and the automotive industry was among the industries that were affected the most by the economic downturn that resulted from the financial crisis, especially in the US and Europe. There was a series of international brands, including the American Hummer SUV line, the Swedish brand Saab and Volvo, that were put up for sale. Meanwhile in China, the auto producers, as well as the whole economy, were not severely affected by the financial crisis. China, in fact, became the top auto producer and auto market in 2009. This international circumstances offered a once-in-a-lifetime opportunity for Chinese auto producers who desired advanced technologies, and managerial skills as well as international markets. Chinese auto producers quickly reacted and seized the opportunity and further advanced their moves in the stressed market. As shown in Figure 6-2, from 2009 to 2012, there were in total 39 OMAs announcements in the auto industry and 20 deals completed, among these deals the Chinese acquirers won some world-famous auto producers such as Saab and Volvo.

The auto industry OMAs were mostly technology oriented, and the Chinese auto producers were lined up to acquire targets with more advanced technology, although market channels and advanced management were desirable as well.

As shown in *Figure 6-6* below, out of a total of 82 deals announced up to 2012, there were 33 deals targeting European brands; the next favourite region was Asia-Pacific, followed by America. The choice of target region reflected the merging-up trend of the Chinese auto industry OMAs. Chinese auto acquirers' main motivation was to acquire advanced technology; Europe, America and Asia Pacific all have many auto makers with advanced technology, know-how and famous brands to offer.

Asia Pacific is a popular region for Chinese acquirers because firstly Japan and Korea are role models for Chinese auto producers due to the fact that Japan and Korea both managed to develop their own competitive cars indigenously, which was also the ambition of Chinese auto producers and the Chinese government. [159] Secondly, as shown in the literature (Reus 2012; Cartwright and Cooper 1990; Ito, Fujimura, and Tamiya 2012), at the beginning of Chinese auto producers OMAs, the similar culture and closer geographic distance attracted Chinese auto producers . Furthermore, Japanese and Korean cars are also well known in the Chinese market.

Figure 6-6 Chinese Automotive sector OMAs announcements by Target Region till 2012



Source: Thomason one banker

Chinese auto producers preferred European targets over American targets. There are several reasons why European targets are more favourable to Chinese auto producers. Firstly, European auto companies have what Chinese auto producers desired the most: intangible assets, including technology, brands, advanced corporate management, etc.; secondly, the European Union, compared to the US, has relatively easier market access for Chinese acquirers[160]. Chinese companies perceive the EU as a much friendlier market compared to the US. In a 2010 survey of the Economist Intelligence Unit (2010), the US was perceived by most Chinese CEOs (49/110) as the hardest country in which to make an acquisition, very few CEOs consider the EU (1/110) or Europe (4/110) to be the hardest country/region in which to make an acquisition (Economist Intelligence Unit 2010).

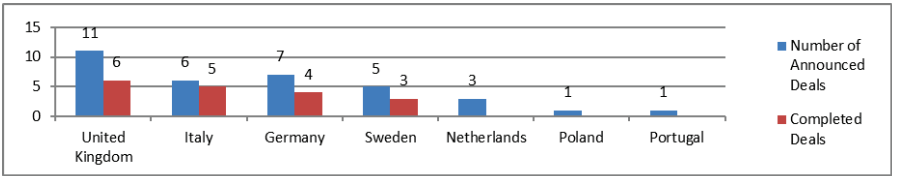
Among the European targets, the most popular nations are the UK, Italy and Germany (see figure below). These three countries have the most developed auto industry in Europe, with both completely assembled cars and key spare parts. Meanwhile, passenger car brands from Italy and Germany have huge brand power among the evolving Chinese consumers. Furthermore, the UK and Germany also have well established financial services. London and Frankfurt became the first Chinese currency RMB settlement centres in 2014, which make M&A in their market more convenient for Chinese acquirers. The UK and Germany continue to be attractive to Chinese auto producers. [161]

[159] Japanese industry policy had a major influence on Chinese auto industry policy making in the 1980s and 1990s. See "The Characteristic of the Japanese Automotive Industrial Development and the Value for China to Learn", *References for Economic Research*, 2004 (82): 38~p44

[160] See *Freedom of Investment, National Security and "Strategic" Industries: An Interim Report* (OECD 2007) for the general comparison of the investment climate of the European countries and the US.

[161] In June 2014, London and Frankfurt became Chinese currency RMB clearance centres. See http://www.bloomberg.com/news/articles/2014-06-19/bank-of-china-wins-the-first-yuan-clearing-deal-in-the-euro-area.

Figure 6-7 Announced/Completed Deals in Europe by Nations



Source: Thomason one banker

6.2.2 Institutional Changes in the Auto industry

The above history of the Chinese auto industry showed the different development patterns of the industry and car makers with different institutional arrangements. This section will provide a detailed analysis of the relevant institutions and institutional changes in the auto industry which shaped the development patterns of the auto industry as well as the performance of the firm (McGahan and Victer 2010). The institutional changes explain how the Chinese car makers had become the way they are today. Chapter 4 has introduced and analysed the overall institutional changes in China. But with the overall institutional framework, the specific institutional arrangement (i.e. industry policy) is a powerful policy tool which the policy maker adopted to shape the auto industry in China. Therefore, this section focuses on introducing auto industrial policies which was the additional institutional arrangement, along with the overall institutional framework, which shaped the Chinese auto industry and triggered the current emergence of Chinese OMAs in the auto sector.

6.2.2.1 Policy Makers in the Auto Industry

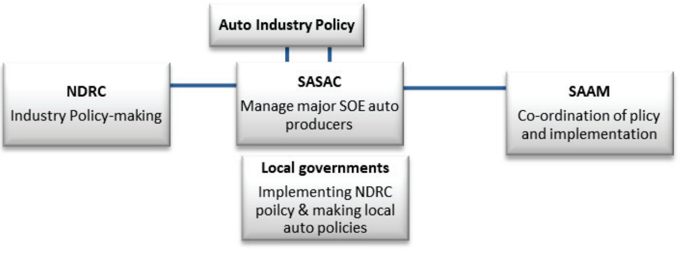
The government agencies involved in industry policy making and implementation have changed several times alongside the development of the auto industry. During the closed-door era (1949-1978), the automotive industry was governed by the Machinery Industry Ministry (MIM), which also directly controlled the two SOE auto makers: FAW and SAW. Conforming to the reform, in 1982, the MIM's auto bureau branched out to form the China National Automotive Industry Corporation (CNAIC), which owned the major SOEs and undertook policy making roles as well. Having problems in managing both roles of operating SOEs and making industry policies, it was disbanded in 1987. Then in 1990, CNAIC was re-established and was still under the MIM. In 1993, against the background of SOEs reform[162], the government separated CNAIC's tasks of carrying out industry policy from the direct management of SOEs, by changing the CNAIC into an industry association. A further administrative reform in 1998 disbanded 15 industry-aligned ministries, and the MIM was restructured into a Machinery Industry Bureau (MIB) under the State Economic and Trade Commission (SETC). Then after China entered the WTO, the MIB was merged with the National Development and Reform Commission (NDRC) in 2003, therefore the industry

[162] See Chapter 4. Section 4.3.3.

policy bureau is now under NDRC. In 2003, the State-Owned Assets Supervision and Administration Commission (SASAC) was established to manage major SOEs, including the FAW and SAW. The state-owned China Automotive Technology and Research Centre (CATRC), which does R&D work, was established in 1985 and came under SASAC in 2003. The semi-official China Association of Automobile Manufacturers (CAAM) handles many of the policy and co-ordination tasks. These administrative changes showed that the State, as policy maker and owner of the major SOEs, had been adjusting itself to find a way to improve its industry policy making as well as managing the SOEs. Besides the central level administrative agencies, there are also local level governments which act both as implementer of a central policy and local industry policy maker.[163] Within China's central–local government structure, the local governments, although they do not enjoy the autonomous governance of an independent state, have some freedom to make their own economic planning. This freedom is quite ambiguous and it varies from region to region. Local government with its entrepreneur "spirit"(Anderson 2012) would take advantage of the ambiguity and make their own auto industry policy or even set up their own auto producer, as long as their local policy is not in conflict with the central policy. Therefore, the extent to which a local government implements the central government's relevant industry policy may also vary per region. Under such central-local government dynamics, some local governments invested in setting up auto producers.[164] [165]

The figure below summarises the current administrative agencies that were involved in policy making in the Auto Industry.

Figure 6-8 Current Administrative Structure of Auto Industry



[163] The complex and unique relation between central government and local government in China has been studied by many scholars (Dong 2007; Chung 1995; Wang et al. 2011). In this thesis, their findings are taken as given. Chung's paper is especially helpful in tracing how the central-local governing system was established and how it has evolved.

[164] From the ownership perspective, there are also SOEs, owned and operated by the local government. For instance, Chery Auto is a typical locally-supported-SOE auto producer which was set up and funded by Wuhu city government (J. Luo 2006).

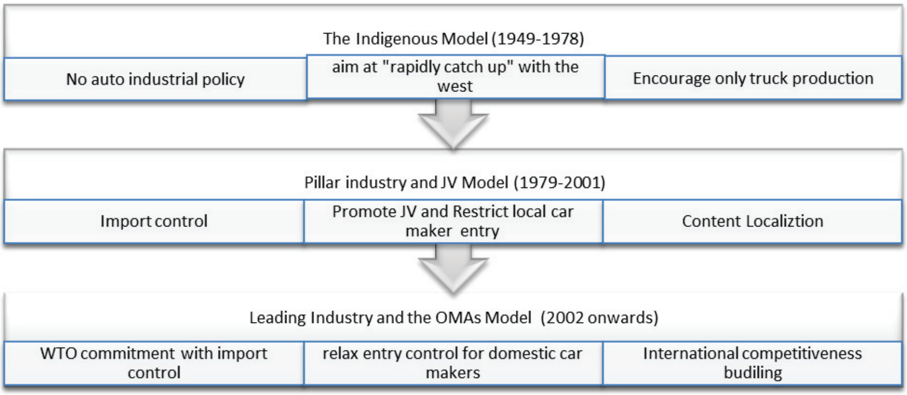
[165] As described in the history of Chinese auto industry, except for the major SOEs that were owned and managed directly by the central government agencies and other SOEs automakers are backed by their local governments, there are also SOEs that are managed by other ministries such as the Ministry of Defense and Ministry of Aviation which also have to conform to the industrial policies made by the central policy maker. Therefore, they are not differentiated from general SOEs.

Source: Author made according to the analysis of this section

6.2.2.2 Pre-WTO: from the indigenous model to the JV model

As shown in the figure below, the Chinese institutional arrangements in the auto industry can be roughly divided into three stages with two major industry policy changes, which is in accordance with the overall institutional framework changes of China.[166] Prior to the accession to the WTO, the Chinese auto industry had undergone two stages in developing its industry: the indigenous model and the JV model.

Figure 6-9 Institutional arrangement changes in three stages



Source: Author made according to the analysis of this section

During the **Closed-door Era (1949-1978),** all aspects of the Chinese economy were under central planning. The policy maker did not have an industry policy as generally defined in a market economy. It set a goal of rapid catch-up and made developing heavy industry a top priority of the country. As described in chapter 5, under the central planning economic climate, the auto industry, as in all other manufacturing industries, was developed as an indigenous model. The policy makers at that time prioritized truck production due to the demand of infrastructure and lack of demand for passenger cars[167]. Furthermore, under the property right at that time, the private ownership of passenger cars was not legitimate; there was no private property right on automotive vehicles until 1979. Meanwhile, policy makers were also aware of the fact that Chinese auto makers in general lacked the experience and technology to start massive production of passenger cars. Therefore, the auto industry policy was nowhere to be seen in the institutional framework at stage one.

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[166] See Table 4-1 Three stages of Chinese Institutional Development.

[167] During the closed-door era, the low living standard of Chinese citizens significantly restricted the demand for cars in China. Furthermore, car consumption was considered culturally impropriate since it was too luxurious. (Chu 2011)

However, along with the economic reforms and open-door policy which was started in 1978, it became urgent for the policy maker to make a systematic industrial policy to develop the Chinese auto industry.

While the economy of China was normalized, auto import was normalized as well. At this time, policy makers had only one policy tool, import control, to avoid foreign cars flooding into China. Policy makers had no other choice but to use a high tariff to suppress potential demand and to protect the auto industry. On top of the high tariff, policy makers put import quotas in place as well to control the volume of imported cars[168]. Car imports nevertheless began to increase, as shown in *Figure 6-3 Number of Imported passenger Cars 1978-2012* , and it put pressure on the balance of foreign currency flow. What made matters worse was that import control triggered widespread car smuggling and corruption, and it was said to exceed imports on a large scale based on the difference between sales and new car registrations (Wang 2000; Chu 2011)[169] .

Therefore, it was urgent for policy makers to come up with other policies to stimulate domestic car production in order to solve the problems the car market was facing. Policy makers were aware of the biggest obstacles to increasing domestic car production: among the domestic auto makers there was a lack of experience beyond truck production, they had no knowledge of passenger car R&D nor of production. Therefore, acquiring advanced car-making skills and technology from advanced foreign auto producers was high on the agenda for policy makers. At the end of 1978, the central government had already begun to consider introducing foreign technology into passenger car production and started negotiations with prominent international automakers. However, policy makers were facing a dilemma. It was necessary to attract high technology and skills from advanced foreign car makers, but meanwhile the auto industry was an infant industry that needed to be protected from international competition. Therefore, policy makers had limited options: they could either promote the model of joint venture (JV) or negotiate technology transfer contracts with foreign car makers. Furthermore, the pressure from car smuggling and payment balance pushed the policy makers to make a policy which could rapidly assist Chinese auto producers to produce high quality cars, rather than a policy to promote a gradual approach through learning. In negotiating with foreign car makers, the MIM realized that it takes more resources and a longer time to grow the auto industry through technology transfer and learning, technology transfer contracting was also not attractive to foreign car makers.[170] Therefore, in order to reach their policy goal which was to quickly fix the car market problem and quickly develop high quality car production, policy makers decided to choose the

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[168] Before joining the WTO, every year, only 6 billion US$ worth of automobiles were allowed to be imported to China.

[169] Then the authority in charge of the automobile industry CNAIC said in its 1985 report to the government, "the current situation of severe shortage and insatiable demand for imported autos manifested our lack of foresight."

[170] As explained in Chapter 4, the institutional framework in China at that time, especially in terms of state ownership, poor corporate governance and low protection of IPR, made Chinese companies very unattractive in any international contracting, including landing a technology transfer agreement.

promotion of JVs which were not only more welcomed by the foreign car makers but can also increase car production in a shorter period of time.

Case 6-3 The birth of the First Automaker JV

In late 1978, MIM sent invitations for cooperative ventures to the major advanced car makers, such as GM, Ford, Nissan, Toyota, VW, Citroen, Peugeot, Renault, and Fiat.

GM was the first foreign car maker who sent a delegation to China to discuss co-operation. It was GM who recommended a joint venture. At that time, neither MIM nor any Chinese policy maker understood what a JV entails. It was GM that explained the concept in detail regarding what is the exact meaning of a JV. Though the policy maker supported the joint venture with GM, in the end the GM board did not approve the deal.

After more than 5 years of negotiations with multi auto makers, SAIC was the first SOE auto maker that signed a joint venture pact with VW in 1984. The joint venture contract took a long time to be finally signed, partially because many legal issues had to be tackled and both Chinese policy makers and car makers were very inexperienced. Furthermore, China even needed to draft and legislate a brand new joint venture law in order to sign such a contract.

Japanese cars were actually the favourite imported cars in China at that time, but Japanese car makers preferred to export finished vehicles to China, and they showed little interest in transferring technology or forming a JV with a Chinese auto maker.

Source: Zheng (2007: 52–56) and Harwit (1995: Chapter 5).

As described in the case above, the birth of the first JV was actually thanks to the visit of GM to China. However, GM's board did not approve the proposed JV due to their assessment of China's uncertainty at that time. However, soon after the establishment of the SAIC-VW, JV, many other SOEs followed. A JV wave emerged in the late 1980s in China. In the auto JV regulations, the policy makers offered preferential treatment to foreign car makers, such as cheap land use, tax exemptions etc., to lobby them to invest in the Chinese auto market. However, the foreign car makers' investment in China was also strictly limited by policy makers. For instance, in the JV law: 1) A JV was the only mode of FDI for foreign auto producers to enter the Chinese car making market. The foreign auto producers were only permitted to set up a JV with Chinese domestic auto producers if they plan to produce completely assembled cars or the three key components (engine, air-bag and ABS) in China. 2) The foreign party in a JV was only allowed to own up to 50% of shares. 3) Such foreign car makers can have at the most two local Chinese partners. The policy makers also expected the JV could enforce the technology spill-over to Chinese partners in a JV. Therefore, policy makers also incentivize a JV to set up R&D divisions, to achieve international level production and to export.

By lobbying for more JVs, policy makers were able to quickly fix the pressing problems the car market was facing, such as a lack of skills and technology, car smuggling, and a lack of capital etc., the JV wave in China increased the domestic car production dramatically as shown in Figure 6-5. [171]

[171] The quick policy-fix was argued to have a long-term negative effect and policy makers later on had to correct these negative effects. For instance, JV policy failed to completely establish independent technological

While lobbying for more JVs, the policy makers formalized their existing auto industry policy. Firstly in 1986, the State Council officially set the automotive industry as one of the "pillar industries" in its 7th Five Year Plan (1986-1990), and continued in its 8th Five-year plan (1991-1995). The strategy to promote the auto industry was to limit auto production sites to three major and three minor joint venture factories,[172] by offering high protection to them and restricting new entries (Thun 2006). In 1994, the *Formal Policy On Development of Automotive Industry (1994 Automotive Industry Policy)* was issued to formalize the auto industry policies from the 1980s. This policy, as it states, aimed to promote market concentration and industrial restructuring of the automotive industry, and to solve the problems of "excessive number of manufacturing factories, scattered investment, disorder in examination and approval of automobile projects, duplicated import of low-level products and the low speed in construction of State-designated key factories and localization of products".[173] The table below provides an overview of the key policies in the 1994 Automotive Industry Policy. It included restricting entry measures, such as production approval, investment and foreign investment approval; and protective measures such as import & export policy; and localization measures. The localization measures which prohibit the knock-down kits and provide preferential tax rates to JVs with high localization rates quickly speeded up the localization rate of the JVs. The 1994 policy continued to promote JVs and continued to provide protection by restricting entry, and encouraged "absorbing foreign technology to establish technological capability."

Table 6-2 Key Points of 1994 Automotive Industry Policy

Policy Goal	To open up car markets; promotion of large scale production; concentration of the industry, eliminating small scale, dispersed operations
Production Approval	Automotive enterprises must submit future product plans for approval; products which are not approved cannot be sold, imported or used
Enterprise Organization	Formation of automotive industry groups to attain critical mass; state support for enterprises which exceed certain production volumes and R&D effort
Technology Policy	Encouragement of independent product development
Investment Policy	Encouragement of automotive enterprises to raise development funds from various sources; trans-regional and trans-departmental investment to support increased industry concentration

capabilities of the indigenous SOEs, and lost control of the Chinese car market to the international brands. Since the Chinese managers in these JVs understood that they could generate jobs, profits and secure their own promotions simply by making and selling foreign cars through the JVs. At the same time, they had no sense of crisis, as due to the auto industry ownership rules, the Chinese partner could keep at least half of the ownership of the JV and a corresponding share of profits. Therefore they had little incentive to promote long-term indigenous development.

[172] In 1988, the government proposed a strategy of supporting "three majors and three minors"—with FAW, SAW, and SAIC named as the three majors, and Beijing, Tianjin, and Guangzhou as the three minors—to limit the total number of car makers and providing a high degree of protection. The joint ventures were formed by these three majors and three minors and enjoyed the same policy support.

[173] Article 1,2 of the *Formal Policy On Development of Automotive Industry*.

Foreign Investment Policy	Encouragement of JV with foreign partners who meet certain conditions (e.g. technology must be 1990s standards; R&D facilities must be established; foreign partners must have independent product patents and trademarks, etc.,)
Import Management Policy	Restriction of imports; entry points limited to four seaports; prohibition of imports of used vehicles
Export Management Policy	Expansion of exports as production rises; priority loans for enterprises whose exports exceed 3-8% of annual sales volume for passenger cars
Localization Policy	Prohibition of knock-down kits; preferential tax rates for enterprises with high localisation rates
Consumption and Pricing Policy	Encouragement of individual ownership of automobiles; prices of civilian vehicles (except saloons) to be decided by enterprises according to market demand. Prices of saloons to follow the state guide price.
Policies on Related Industries	Co-ordination and development of supporting industries (metals, materials, capital equipment, electronics, rubber, plastics and glass)
Industry Policy Planning and Implementation	Local governments and departments should support the Industry Policy; no new complete car facilities to be approved during 1994-1995

Source: The State Planning Committee of China (1994). "Automotive Industry Policy".

However, the central government agencies had problems implementing restriction on domestic entries since many local auto makers were supported by local government that the central government had to rely on in policy implementation. Moreover, central government also had problems reigning in the local government's access to bank financing. For example, the State Council issued a *Statement of Stringent Control of Auto Production Sites* in 1988, to prohibit "local governments and departments from negotiating with foreign business without prior approval," to produce autos in disguise, and to "import knocked-down autos as parts for reassembly via various channels." It showed that the central government could only warn the locals not to undertake such activities without prior approval but not completely restrict the local government. Due to such central-local relations during the reform time, the central government could not completely control the local auto makers to emerge with the support of local government. Therefore, even with the central government's restrictions, some local car makers emerged from the middle of the 1980s.

Thun (2006) identified three patterns of local institutional arrangements in the Chinese auto sector along two dimensions: the nature of bureaucratic organization and the dominant form of inter firm relations. Due to the difference of these two dimensions in different regions, and the different incentives and governing ability of different local governments, the relationship between local government and the auto producers may vary over regions. For instance, Shanghai emerged as the "local developmental state" because of "a unified bureaucracy and hierarchical relations between firms" which originated from history [174]. The Shanghai government made an industry policy model similar to the East Asian one to push forward its auto producers. Although with the central government's close attention and monitoring,

[174] Thun (2006) defined a "local developmental state" is characterized as the combination of a unified bureaucracy and hierarchical relations between firms. Shanghai was considered by him as an example of this pattern.

Shanghai also had little local autonomy, but with a comprehensive economic bureaucracy, which was lacking in most other local states in the early period of the reform, it was possible for Shanghai to carry out its industrial policies. For instance, the municipality set up a taxi company which solely used cars produced by the JV of Shanghai Automotive Industry Corporation (SAIC): SAIC-GM, which significantly helped the growth of SAIC-GM.

In conclusion, during this period, the policy maker had four main policy tools 1) to promote the entry of high standard JV; 2) to restrict the entry of low standard domestic car makers; 3) to control importing cars; 4) to focus on the domestic market and no policy encouraging any overseas auto investment.

6.2.2.3 Post-WTO: from the JV model to OMAs model

As analysed in chapter 4, with the globalization in the late 1990s and beginning of the 2000s, some Chinese companies were eager to participate in the international market to upgrade themselves from local players to international players. Policy makers started the "go-out" policy and relaxed a series of regulations with regard to overseas investment. The overall institutional framework changed towards incentivising and facilitating overseas investment. In the auto sector, the policy makers were also pushed to make institutional adjustments in order to incentivize auto makers to "go-out" and to conform China's auto policy to its WTO commitments. Meanwhile, the domestic car market was facing a number of negative effects of the JV era: 1) after 20 years of increasing production from both JVs and domestic car makers, the car supply exceeded demand at the beginning of the 2000s. This overcapacity increased competition among car makers; 2) Chinese car makers did not grow their own famous brands but lost the Chinese car market to the international brands, and because of the dominant position of JVs. 3) there were few domestically developed high quality indigenous cars with indigenous R&D because SOE car makers relied heavily on their foreign partners in R&D, whereas private car makers had limited ability in R&D.

Under these macro and micro circumstances, Chinese policy makers needed to adjust their industry policy to correct the problems the Chinese auto market was facing. Therefore, in 2004, NDRC issued an updated Automotive Industry Policy (2004 policy), which aimed to cool down the domestic auto market, to promote domestic R&D, to make the policy comply with WTO commitments and to encourage the auto makers to participate in international competition.

The 2004 policy had several objectives beyond the 1994 policy. It included: (1) to drive industrial structural adjustment by encouraging the formation of large automotive enterprises with overseas acquisitions; (2) to encourage self-reliant product development and local brand development, with a view to building up a few famous brands and globally competitive (top 500) automotive groups by 2010; (3) to encourage independent R&D and production on a large scale for key components and parts, and to foster the local suppliers and their international operations and (4) to promote light duty vehicles and new energy-efficient vehicles (5) to relax import control to conform to its WTO commitment.

The table below provides a summary of the key points in the 2004 policy.

Table 6-3 Key points of the 2004 Automotive Industry Policy

Policy Objectives	Encouraging development of **self-reliant product** and **local brand**, aiming to build a few famous brands and world-level automotive groups before 2010; become major global automotive production country and to increase exports to a bigger volume; encouraging the participation of global competition.
Development	NDRC made mid/long term strategic plan for the industry; The **large automotive enterprises** (with > 15% market share) should make their own strategic plans in according with the strategic plan of NDRC
Technology Policy	combing **technology transfer and self-reliant product development**; Encouragement of light duty and fuel-efficient cars; **Promotion of R&D**, electrical cars, hybrids and cars,; the use of alternative fuels
Industrial Structure	Encourage: **big automotive groups** (with > 15% market share) **formation or alliance**; global cooperation and operation of local auto makers**; OMAs**.
Entry Management	Constitute compelling auto product standard criteria for **safety**, emission, fuel efficiency and etc.; ensure uniform management systems for the entries of auto makers and auto products
Brand Strategy	encourage **self-property products**, emphasize intellectual property protection, and improve local brand reputation; strategic planning on local brand development and protection;
Products Standard	**Encourage and support the establishment of R&D centres** to improve independent product innovation capabilities; Encourage the involvement of assemblers and suppliers in national R&D projects.
Distribution and Sales Network	Encourage learning of mature international automotive **sales mode** and establish local brand product sales and service systems
Components and Parts Industry	Form advanced R&D and manufacturing capability and enter the international spare part market; encourage various sources of funds entering the spare part industry.
Investment control	Shares from Chinese parties in assembled cars - JV must be **no less than 50%,** but not applying to exportation-targeted projects; To establish new automotive manufacture, the investment should not be less than 2 billion RMB.
Import control	Relax the restriction of imports according to WTO commitment, but entry points are limited to four seaports and two land ports; Prohibition of bonded service for imported automobiles in bonded areas of the import ports from 2005; Prohibition of imports of used vehicles.
Automotive Consumption	Encourage automobile credit consumption; Improve the automobile insurance policies Encouragement of light duty, low emission and efficient cars.

Source: NDRC (2004). "New Automotive Industry Policy"

The 2004 auto policy, along with general deregulation in China, relaxed the control of the auto industry from the government agencies in many aspects. The auto market became more liberalized compared to the pre-WTO era.

First of all, although the JV format is still a must for FDI in the automotive industry, the local content rate is no longer required. Secondly, the import control has been relaxed in line with China's WTO obligations. The historical automotive import quota was cancelled, and the tariff rate for imported complete built cars was decreased to 30% on January 1st, 2005, and dropped to 25% by July 1, 2006. The tariff for automotive components and parts has been lowered to 30% (Luo, 2005a).[175] Thirdly, more private investors, both foreign investors and domestic ones, have been allowed to operate an automotive industry in China[176]. Almost all the major global car companies have entered the Chinese automotive market, and more considerably diversified car models have been permitted, in comparison to the JV era before 2000 when the policy restricted the entry of auto makers and car models. Fourthly, this policy encouraged competition in the domestic market, and drove the companies, including the state-owned firms, international joint ventures as well the private firms to improve their product quality and design, decrease costs, and lower the price. Lastly, the 2004 policy encouraged Chinese auto makers to grow their international competitiveness. Together with the "go-out" institutional environment during this time Chinese auto makers started to undertake overseas investment, especially OMAs. As shown in *Figure 6-2 Yearly announced /completed OMAs in automotive industry till 2012*, Chinese auto makers gradually started to conduct OMAs starting from 2002, aiming at upgrading their competitiveness.

6.3 Geely's Acquisition of Volvo

Geely, as a Chinese acquirer, is not only subject to the general IF which was described in chapter 4 (ie, informal institutions, rule of law, corporate governance, IPR and OMAs regulations), but also it is constrained by the Chinese auto industry policy described above. With such an institutional background, Geely engaged in its acquisition of Volvo and successfully completed the deal and the continuing integration post-transaction. This section aims to study how the institutional background affected the corporate strategy of Geely and how Geely adapted its institutional background in the process of its acquisition.

6.3.1 Geely's Motivation and its Institutional background

To understand the roots of Geely's motivation for acquiring Volvo firstly requires a good understanding of how Geely developed domestically within the institutional constraints of the time. The development of Geely is closely intertwined with the developments of the overall institutional framework and the auto industry policies of China.

6.3.1.1 Restrictive Institutions on Geely's Growth Path

Although the Chinese IF has been committed to transform to be a market-compatible IF since the late 1970s, the transformation was along with restrictive institutions hindering the growth of firms. For Geely, most notable are the 1994 auto industry policy and the 2004 auto industry policy.

The 1994 Industry Policy and Geely's Manufacturing Licence

Under the 2nd IF of China, a transforming institutional change was that for the first time private companies were granted legitimacy from the late 1980s. During this period, Geely was founded as a private company producing refrigerators. When the first auto industry policy was issued in 1994, which allowed private investors to invest in the auto industry, Li Shufu,

[175] See *Table 6-1 Import Controls: pre-WTO vs. post- WTO*

[176] For instance, Geely only acquired its legitimate status as a car maker in 2001, after producing cars for four years via other means.

the founder of Geely, decided to enter the auto industry and changed its main business to producing motor bikes first and later on cars.

However, in the 1994 auto industry policy, the policy makers were focused on promoting the major JVs and restricting private entries for passenger car production. Therefore, although it officially permitted private investors to enter the market, it also had a high entry barrier which made entry impossible. Though this policy blocked Geely from acquiring the licence, Geely launched its car manufacturing in 1997 nevertheless by sub-licensing car design and production from another auto company that had a licence. Although the 1994 policy did not stop the production, the policy put a barrier for Geely to develop and nurture its own brand; let alone the transaction cost generated in the process of sub-licensing.

2004 Policy and Geely's Legitimacy

It was not until 2002 after China joined the WTO, that Geely obtained the permit from the state to produce cars officially under its own brand. Because in the WTO application China committed to open up its auto industry, the policy makers relaxed the entry restriction in 2001 and that is when Geely obtained its official permit. The first official car production of Geely began in 2002. However, acquiring its legitimate status did not solve many of Geely's obstacles with the institutional settings of the early 2000s. According to the 2004 policy (see *Table 6-3 Key points of 2004 Automotive Industry Policy),* the State primarily supported the SOEs to create an advanced auto industry; private car makers which did not have a big scale are not typically supported by the policy. The 2004 policy specified that auto companies with a big scale (the majority of them are SOEs) are encouraged to form alliances (JVs and OMAs) to gain economies of scale. The "discriminative" industry policy environment closed the door of state support to small scale private companies.

6.3.1.2 Facilitative Institutions enabled Geely's advantage building

However, under the 3rd IF, companies like Geely also took advantage of the facilitative institutional changes and rapidly increased their competitiveness.

Firstly, the overall institutional transformation to a more market compatible setting promoted the economic growth of the home market, which earned Geely two ownership advantages: cost advantages and monetary capital. Based on Dunning's five stage FDI theory (see *Figure 2-8 Framework of Dunning's Five Stages of FDI Theory*), under the 3rd IF, China was transferring from fast growth to sustainable growth with its economy, and therefore the growing internal market and standard of living increased the overall earnings of domestic firms and equity (Dunning and Lundan 2008). A company like Geely gradually increased the available capital for overseas investment and gained cost advantages, both of which were making Geely an attractive potential acquirer.

Secondly, under the 3rd IF, the increasing globalization and especially the financial crisis provided Geely with a market for acquiring the strategic assets which it lacked. And during this period, both the go-out policy and the 2004 industry policy provided institutions for companies to pursue their ambition to seek complimentary resources overseas**.** Although the 2004 industry policy does not directly favour a private car company like Geely, it pointed out the direction for auto makers to gain policy support. These directions included indigenous brand building, R&D capacity building, scale building and international competitiveness building. Geely as a low-cost car producer found itself fitting in the picture. All these directions were in line with the weakness of Geely and growing a brand with good R&D capacity and international competitiveness was also the way Geely could go if it wanted to be something more than a Chinese low-cost car maker.

Learning from its experience to bargain and adapting itself to the institutional environment, Geely looked for alternative opportunities provided by the 2004 industry policy to develop its own path of growth. Having a good understanding of its institutional constraints and its own weakness, the question for Geely was what options did Geely have at the time and how should it make the best of it.

6.3.1.3 Geely's motivation for Choosing OMA

Geely as a Chinese private auto maker had a negative brand image in the Chinese market. Geely was not only "known" as a low-cost and average-quality car producer, but it was also allegedly copying others brands with various law suits brought by foreign car makers as a result.[177] Therefore, Geely's priority was to rebuilt its brand image and increase its R&D capacity. Geely itself lacked the capacity to develop a new brand image and a world-class R&D capacity indigenously; it would be too costly and it would take too long. Li Shufu had expressed repetitively that their best chance to stand out in the competition is to "stand beside the giant and learn from him", namely Geely needed a "mentor" as a partner to guide Geely in realizing its priority. Theoretically, Geely had three choices: 1) to form a JV with an advanced car maker, and learn from the partner; 2) to form contractual relationships with an advanced car maker to sell or lease Geely technology and know-how; and 3) to "merge-up" with such a car producer, acquiring the brand and the know-how.

However, Geely had missed out on the domestic JV wave in the 1990s, and by the time Geely established its legitimacy, the foreign parties of the existing auto JVs were well-established; it was hard to find a foreign car maker who was willing to team up in a JV with Geely, given the still applicable 50% ceiling[178] of foreign shares and the relatively small scale of Geely.

Buying or leasing technology and know-how was also not a cheap option for Geely. Given Geely's reputation in not respecting IPR and the weak IPR protection and enforcement environment in China, foreign companies were very cautious and therefore extremely expensive in dealing with a technology transfer with Chinese companies.

Bound by this institutional constraint, Geely's best chance of obtaining an advanced partner was by "acquiring" such a partner. As explained in Chapter 5, a reversed OLI paradigm would apply. Namely, being the owner of an advanced car maker would allow Geely to exchange its monetary-capital advantage to a knowledge-capital advantage (e.g., brand, know-how, overseas market); it could increase its target's sales in China; it could gain economies of scale for its target by taking advantage of low costs in China. Furthermore, an OMA could also help Geely to rebuild its brand image and increase its competitiveness in the Chinese market.

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[177] See (日本) 丰田自动车株式会社诉浙江吉利汽车有限公司等侵犯商标权及不正当竞争纠纷案 The Case of Toyota VS. Geely & a car dealer for Infringement of Trademark and Unfair Competition, *中国知识产权 China Intellectual Property* (Shao 2006).

[178] See Table 6-3 Key points of 2004 Automotive Industry Policy

Compared to other options, the OMA ambition of Geely was not just less constrained[179] by its institutional background, but there were various facilitative institutions that would support Geely from the policy level, industry level and deal level. The 3rd IF is themed "go-out" and the 2004 industry policy is themed on technology enhancing. Both encouraged the OMAs initiative in the auto industry from the state level. There were also favourable terms for financing the deal. The institutional background encouraged and enabled Geely to go overseas. Especially during the time Geely initiated the acquisition of Volvo (2008- 2010), the institutional arrangements on OMAs had improved with European targets because of China's investment diplomacy in the EU. The Chinese sovereignty fund and SOEs were investing heavily in the stressed Euro zone. The EU and its Member States were viewing Chinese investment as a "white knight" which to a degree also enhanced Geely's attraction as an acquirer during this specific time.

6.3.2 Deal-making Stage and Institutional Factors

To understand how Geely successfully completed the acquisition of Volvo requires an understanding of how Geely maximized its chance to minimize its risks and transaction cost. Especially the liability of origin (LOO) and the concerns of Volvo and other stakeholders.

6.3.2.1 To Complete the Deal

Geely, which has a good understanding of its institutional background and its corporate strategy of merging-up, had long set its target on Volvo. In 2002 right after Geely received its car manufacture licence, it was reported that Li Shufu announced his ambition to acquire "the safest car", Volvo, in an internal meeting. Volvo had long enjoyed high prestige in excellent quality and performance, especially known world-wide for its safety and environmental protection measures. Volvo's technology and the reputation for safety are what Geely admired the most from a partner. Volvo was then owned by Ford (bought from AB Volvo in 1999 for $6.45**bn**) as part of Premier Automotive Group (PAG).

On the contrary, Geely was unknown on the international market and its production was as low as 22000 units in 2002; it had no capability of pursuing such an OMA at that time. However, Geely had quickly grown in terms of scale thanks to the popularity of its inexpensive cars. In May 2005, Geely became listed in Hong Kong and attended the Frankfurt motor show in September. In 2006, Geely completed its first OMA, and became the majority (51.68%) shareholder in the British taxi producer Bronze. With this OMA experience and 5 years quick domestic growth *(see Figure 6-10 Geely Annual car production before the deal),* Geely decided it was time to express his intention of acquiring Volvo officially.

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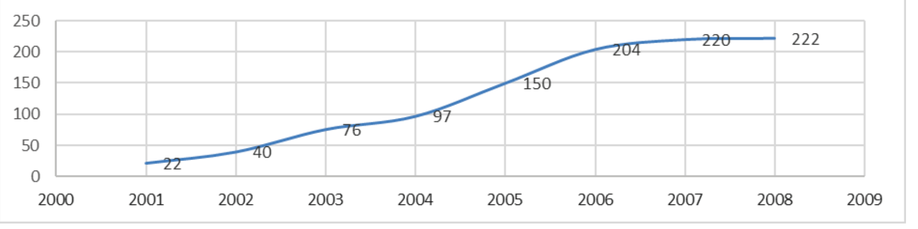
[179] Having a Chinese institutional background will still impose LOO to Geely as an acquirer.

Figure 6-10 Geely Annual car production before the deal (in 1000 units)



Source: Geely's official website

In 2007, after Li's first meeting with Ford's CFO Don Leclair in Detroit[180], Li Shufu sent his first unofficial letter of intent to Ford[181], to express his interest in buying Volvo. Ford, the parent of the Volvo did not reply to this letter. Li did not give up but even sped up the M&A team building in Geely. In early 2008, Li Shufu expressed Geely's interest in buying Volvo again unofficially when he met a Ford executive at the Detroit auto show, Ford listened to him with courtesy but was still not impressed by Geely's offer[182].

The turning point is the heavier loss of Ford due to the financial crisis in 2008. Affecting both the European and American auto markets, the financial crisis offered the best opportunity for Geely to send its offer again. Ford had suffered a $14.7bn loss in 2008, in which, Volvo contributed a big share. Therefore, Ford decided to put Volvo up for sale, and Geely who had repeatedly shown his interest started to get Ford's attention. In early 2009, Ford's CEO Alan Mulally invited Li Shufu to pay a visit, Li Shufu led a delegation to meet with Ford's top management. Thereafter, Geely received an official invitation from Ford to bid for Volvo, which signalled that Geely might be considered as a potential bidder in the sale of Volvo. In March 2009, Geely tendered the first offer, and Ford gave Geely access to its Volvo database and the latter carried out a four-month due diligence. After due diligence, Geely presented Ford with the second legally binding bidding document on July 30, 2009, which reassured Ford about promises Geely made in the first offer including the fact that Geely would protect the IP of Volvo's technologies.

On the 21st of September, 2009, Goldman Sachs Group managed private equity fund invested $250 million in Geely Holding's Hong Kong listed arm, Geely Automobile (about 15% of Geely Automobile's shares). This investment was taken by the market as a sign that Geely was acquiring Volvo. Geely faced competition from the Crown consortium and the Jakob consortium, both of which were supported by Volvo's labour unions.[183] But soon in October,

[180] Special Report: Saving Volvo - Geely buys brand, management test.

http://www.reuters.com/article/2010/07/22/us-geely-volvo-idUSTRE66L2DW20100722

[181] Geely formed a team with investment banker, lawyers and accountants very early on to advise Geely to implement its ambition to acquire Volvo.

[182] A *Financial Times* article has revealed the details of Geely's early attempts to acquire Volvo, see http://www.ft.com/intl/cms/s/0/3a453bbe-20ba-11e1-816d-00144feabdc0.html#axzz3TDbTPtDM

[183] See http://www.ft.com/intl/cms/s/0/9b3acec6-c3b4-11de-a290-00144feab49a.html#axzz3TDbTPtDM

Geely was named as the preferred bidder by Ford[184]. In March 2010, Geely and Ford signed the final acquisition agreement.

Geely then filed merger control in June in 10 jurisdictions, including the EU, US, China, Russia and Australia, Geely got all the clearances in two months. In August 2010, MOFCOM approved the sale of Volvo Cars, Geely completed the deal and acquired 100% of Volvo. According to the terms of the agreement, Geely paid Ford $1.8 billion cash, and raised $900 million to keep Volvo running. The acquisition took 8 years from the day Geely had its original plan.

6.3.2.2 Geely's Success in Completing the Deal

Given the overall low rate of Chinese OMAs completion (56%.7), and some high profile aborted Chinese auto sector OMAs attempts, Geely's success in closing the deal is especially impressive.

For instance, around the time of Geely's acquisition, Tengzhong, a Chinese heavy equipment company, was to acquire the Hummer brand from GM, but it was "unofficially" not approved by MOFCOM and reportedly amid concern about Tengzhong's inexperience. Therefore, Tengzhong withdrew its attempt. Another auto OMA attempt was a consortium including Beijing Automotive Industry Holding Corporation, China's fifth-largest automaker by sales. It failed in its bid to buy Saab from GM, and settled for buying some SAAB designs.

Similar to the two failed Chinese acquirers, as a Chinese private car maker, Geely was not a universally attractive acquirer. Geely was not only subject to 1) the LOO due its institutional background, such as poor corporate governance, poor IPR protection (the case was in favour of Geely), but also 2) Geely suffered from LOO due to the product-country image of Chinese cars. 3) In contrast with the other two failed Chinese acquirers, Geely itself was also considered as a cheap car maker that often copied models from others.[185]

How did Geely minimize the LOOs? Li Shufu had a simple but profound answer to this question. He wrote in his paper *Custodian of a Scandinavian Icon* (2010) that Geely knew that the key to complete its "audacious" offer was to win the "hearts and minds of many people in Sweden and elsewhere". He said that is why Geely put the "trust challenge" at the centre in Geely's bid strategy and proposal. Namely, Geely has well addressed all the concerns from all the stakeholders.

There are a number of factors that may raise concerns and create trust issues and affect the completion of the offer. Chapter 2 provided a list of those factors: on the macro level, the gap between the institutional framework of the home and the host country and the economic relations between the home and host country can jeopardize the trust; on the industry level, industry sensitivity and technological intensity affect the likelihood regarding whether a deal can go through; on the firm level, factors such as the acquirer's ownership, its OMAs

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[184] Ford Motor named the consortium headed by Zhejiang Geely Holding Group Co as the preferred bidder for its Volvo Swedish brand in October, 2009. It brought the Chinese car-making group a step closer to buying it. See http://www.ft.com/cms/s/0/9b3acec6-c3b4-11de-a290-00144feab49a.html#ixzz3TGhSW0b7

[185] See Innovation and Leapfrogging in the Chinese Automobile Industry: Examples From Geely, BYD, and Shifeng, Global Business and Organizational Excellence (Wang and Kimble 2013).

experiences, the quality of the advisors they hire and the level of business matches between the acquirer and target can influence the final completion of the deal.

The following analysis shows that Geely had identified the possible *liability of origin (LOO)* that might jeopardize the deal beforehand and made the right strategies to avoid them.

The institutional difference was the main source of LOO and it was a big concern of Volvo. Firstly, European companies in general still perceive China as an authoritarian state with poor democracy and rule of law[186]. The comparatively low ranking on rule of law and regulatory quality of China also shows that China' institutional quality is perceived as low *(see Figure 4-6 Overview of ROL and RQ changes under the 3rd IF).* Secondly, the corporate governance standard and IPR protection level in China were much less advanced compared to Sweden. These factors inevitably raised Volvo's suspicions of its future under Geely's management. Geely, with the Chinese institutional background (political regime, corporate law and IP law), was not competitive as a potential owner of Volvo compared to its competitors (Crown and Jakob) who have a similar institutional background as Volvo. For instance, when Geely was named as the preferred bidder, Volvo's engineering union expressed its reservations on "whether they (Geely) have what is needed to understand Volvo culture – the way we work here and the values at Volvo." [187]

Therefore, Geely had to reassure all the stakeholders of the acquisition (Ford, employees, unions, suppliers, dealers, politicians, regulators and customers) that Volvo's governance and value would not be affected once acquired by Geely. In order to do so, Geely not only engaged in close and lengthy discussions with the Volvo community but Geely also addressed various stakeholders' concerns in its tender offer. In the tender offer, Geely proposed the following: 1) Volvo will not be turned into a Chinese company, Volvo headquarters and production remain in Europe and all the governance is subject to European laws and regulations. 2) The corporate governance standard remains as before the acquisition. Geely will not interfere with Volvo's day-to-day management. Volvo continues manufacturing Volvo cars in Europe, run by the existing management team. 3) With regard to IPR, Geely will not automatically transfer all Volvo's patents; rather Geely will acquire Volvo's patented technologies through contracts, to ensure the IPR of Volvo is well protected. The above offer from Geely essentially means that Volvo remains a Swedish company after the acquisition, and independent from Geely. The institutional difference China has from Sweden would have very limited influence over Volvo, which greatly eased the concerns of the Volvo community with regard to China's political regime, legal system, corporate governance, etc..

The economic relations between the home country and the host country were also found as a risk factor in the literature that might break the deal. There was no record of economic conflict between China and Sweden; this was important for the deal to be approved smoothly by regulators of both Sweden and China. Furthermore, Sweden is an EU member state, the EU is a major market of Volvo and Volvo has production sites in Belgium, therefore good

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[186] See a survey: Attitudes toward China. http://www.pewglobal.org/2013/07/18/chapter-3-attitudes-toward-china/

[187] See Guardian News: Ford set to offload Volvo to Chinese carmaker Zhejiang Geely. http://www.theguardian.com/business/2009/oct/28/volvo-ford-geely-china-car

economic relations between China and the EU also played a positive role. The EU and China have been important trading partners for decades. Furthermore, China's increasingly active investment diplomacy in the EU was a positive factor for the overall Chinese investment in the EU (Davies 2013). When Geely was negotiating the deal (2009), the overall economic relations between the EU and China had been especially enhanced due to China's economic support during the financial crisis.

The technology gap was a concern of Volvo. Some research has shown that technology intensive industry sees a higher failure rate of cross-border M&A at the deal making stage, especially when the technology gap between the acquirer and the target is big. Incompatible levels of technological ability can ruin a deal (Zhang and Ebbers 2010). Volvo was concerned that Geely was driven by China's auto industry policy which encourages companies like Geely to acquire companies like Volvo to fast update Geely's technology and R&D capacity. However, without a sound plan and commitment, Volvo would be concerned whether Geely would be able to integrate the technologies or simply take and copy what Volvo shares with them. What made it more complicated was that Ford had integrated with Volvo in patents and other technologies in its 10 years of owning Volvo. Therefore, how much technology Volvo was willing to give access to Geely and how to deal with the Ford-Volvo shared patents and other technologies were crucial topics on which disagreements could lead to abandonment of the deal. Therefore, upon the signing of an acquisition agreement, Geely, Ford and Volvo engaged in lengthy discussions and negotiations in great detail with regard to the technology issues, and they agreed in detail about how to deal with all the patents and other technology involved and made a time frame for implementing the agreements (S. Li, n.d.). These agreements and plans were helpful in convincing Ford and Volvo that the technology related agreements ensure that neither Ford nor Volvo will be jeopardized in terms of their technology capital; moreover, these agreements aim to decrease the technology gap between Geely and Volvo. If the plan is to be properly implemented, not only Geely will get access to the technology shared by Volvo and Ford but also both Geely and Volvo will enrich their R&D with a new R&D centre set up by Geely.

Geely's corporate governance is a concern as Geely became Volvo's shareholder after the deal. Companies' ownership often affects their success in completing OMAs (Zhang and Ebbers 2010)[188]. SOEs are perceived poorly because China is largely characterized by active government involvement in business through state ownership (Peng 2000; Child and Rodrigues 2005). But compared to Chinese private companies SOEs are usually considered to have better quality of corporate governance and be rich in capital backed up by state funds. Whereas, private companies in China are often considered young and not yet well-developed. Therefore, targets often raise suspicions regarding private companies' corporate governance, including their management quality to conduct OMA deals and to run the business post-deal, because of their small scale, weak cash flow and lack of international talents.

Although its private status in a way eased Volvo's concern about the Chinese government's involvement in the post-acquisition operation of Volvo, Geely still needed to take measures to minimise the shortcomings as a young private company which was about to make the biggest

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[188] See section 2.4.3.1

auto OMA in China. Geely addressed its quality of management in managing the deal by proposing a sound plan for deal making and post-deal integration as described before. To deal with the shortage of international talent, Geely hired a number of top managers in the field before and during the deal. For instance, Zhang Peng joint Geely during Geely's acquisition of Bronze. Before joining Geely, Zhang was the chief economist of BP Global. In February 2007, Zhang was appointed as Vice President of Geely Motor and was in charge of the department of internationalization. Yuan Xiaolin, then the M&A executive for BP Global, was invited to advise the acquisition of Volvo and was later hired as the head of M&A department in Geely in April 2009. Shen Hui, then vice-president of Fiat China, with experience in European and US companies, was also involved in the deal and officially hired by Geely at the end of November 2009. In December 2009, Tong Zhiyuan, then Chairman and CEO of Hua Tai Motor, and formerly in charge of localizing the Mercedes-Benz luxury cars while working in SAIC, also joined Li Shufu's team as the Chief Operating Officer of the Volvo project. Besides forming an internal M&A team, Geely had also set up a top acquisition consulting team with bankers, lawyers and accountants to deal with the complex financial and legal issues. At a very early state, Geely hired Rothschild (top global auto M&A investment bank) as the co-ordinator of the deal. Rothschild had Hans-Olov Olsson, who was the former President and Chief Executive of Volvo Cars, to provide support and counsel Geely for the negotiations. Geely also hired Freshfields (a top law firm in cross-border M&A) to advise Geely on corporate governance and IP matters[189] On top of the lawyers, bankers and the accountants (Deloitte), Brunswick Group (a public relations company) was also hired to take care of the public relations of the deal, and it was revealed by an anonymous source that Brunswick advised keeping Volvo's "Europeanness" and keeping Geely and Volvo as separate brands,[190] which was essential for winning over Volvo's community.

As for the concerns on Geely's own corporate governance, Geely had invited Ford and Volvo to visit its Chinese sites for them to understand Geely's operation and performance under Geely's management. Geely showed its facilities and corporate values to emphasize the potential to overcome the relatively small scale [191] and the potential synergy the acquisition could bring to Geely and Volvo. With regard to Volvo's concern over the cash flow which Geely would need for completing the deal and to keep Volvo running, Geely gained an early investment from Goldman Sachs[192] and had unofficially secured loans from major Chinese banks. The above measures properly addressed Volvo's concern on Geely's capability and potential under its governance.

Geely smoothed the regulatory approval from China. Although in the literature, the regulatory approval was not addressed as a determinant for an acquirer to complete the deal, in reality,

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[189] For details of Geely' M&A team, see the Reuters report : Rothschild quartet helped China's Geely snare Volvo Cars, http://www.reuters.com/article/2010/03/29/volvo-geely-bankers-idUSLDE62S17C20100329

[190] See Caixin's report: Geely's Volvo Strategy Gets behind Blue Eyes. http://english.caixin.com/2011-11-07/100322917.html

[191] See *Figure 6-10 Geely Annual car production before the deal (in 1000 units)*. Geely's production capacity was 300,000 cars per year in 2010.

[192] See Section 6.3.2.1for the details.

the complicated administrative approval system in China could be a reason an OMA is aborted. For instance, as mentioned before, Tengzhong's attempt to acquire Hummer from GM was withdrawn because Tengzhong did not get positive feedback from MOFCOM when consulting the comments from MOFCOM prior to Tengzhong officially making a bonding agreement with GM. As analysed in Chapter 4, although China has greatly relaxed overseas investment controls, Chinese acquirers often need to present their OMAs, especially big value deals and/or deals in sensitive industries, to NDRC and/or MOFCOM. NDRC and/or MOFCOM's approval is based on the feasibility not only from the acquirers' perspective but also from the industrial level. The 2004 auto industry policy implies that feasible OMAs in the auto sector should be in line with the Chinese auto industry objectives which are to enhance self-reliant production, local brands, R&D capacity and international competitiveness[193]. Knowing the potential harm if the deal was not supported by regulatory authorities, Geely unofficially consulted the MOFCOM with regard to investment approvals and merger-control concerns. Defusing the concerns of MOFCOM and having a greenlight prior to the deal-making eliminated one potential threat to the deal.

6.3.3 Deal Performance

In the agreement of the acquisition, Geely promised three lines of action on production. Firstly, Volvo continued manufacturing Volvo cars in Europe, run by the existing management team. Geely would not interfere in Volvo's day-to-day management. Secondly, Geely would promote the sales of Europe-produced Volvo brand cars, especially in China. Geely and Volvo would form a JV in China with the production capability of 300,000 units yearly. Thirdly, Geely will buy and integrate Volvo's patented technologies and use them in its Chinese domestic car models under the Geely brand.

After the deal was completed, the question was whether these commitments were fulfilled and whether the deal was profitable. As reviewed in the literature (see Chapter 2), there are a number of benchmarks to define an OMA's performance and a number of competing measurements of the performance in the literature (see chapter 2). Here this chapter, will firstly adopt shareholders' values as a benchmark, analysing the stock market performance of Geely Automobile, Secondly, from a long-term perspective, it will analyse whether the post-deal plans are systematically implemented which are the instruments to realize synergy gain. Additionally, it will also adopt both the managers' perceived performance and expert informants' assessment to briefly introduce the assessment of managers and experts.

6.3.3.1 Stock market performance

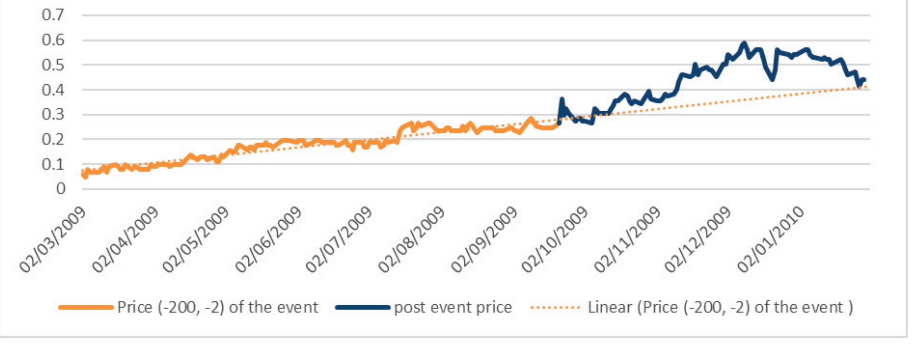
As stated in Chapter 3, it is important to address beforehand the concern that stock market performance as a benchmark has its limitations. First of all, it is on the assumption of an efficient market, meaning the market can efficiently predict the profitability of the deal. Geely is listed in Hong Kong. Although it is a better-developed stock market, it is hard to prove the degree of its efficiency. Secondly, we cannot eliminate other variables contributing to the stock performance. Therefore, in analysing stock market performance, we should be aware of

[193] See Table 6-3 Key points of 2004 Automotive Industry Policy

the fact that a short-term return may be related to market inefficiency. So, it is only used here as a reference to show the market reaction to the deal. And a long-term stock performance may be caused by various reasons; therefore, it is only used to show the confidence of the market with Geely in the post-deal era, but not as a definitive measurement of the post-deal performance.

It is difficult to define the time when the market was informed about the deal. In this deal we see that the market reacted during two periods of the deal. The first period started when Goldman Sachs Group (through its private equity fund) invested \$250 million in Geely Automobile on the 21st of September, 2009. Goldman Sachs' purchase triggered the "market rumour" that its investment was to finance Geely's acquisition of Volvo. The stock price of Geely started to increase. Later in October, Ford announced that Geely was a preferred bidder, and in December, Geely and Ford had agreed the fundamental terms of the acquisition. The figure below shows the overall stock market performance of Geely over the period of March 2009 and January 2010.

Figure 6-11 The Stock performance from March 2009 -Jan2010 (Daily Adjusted close Price)



Source: Yahoo Finance

Using the event study[194] methodology, we study the effect of the event on stock price, the linear line was the prediction (based on 200 days of estimation window) of the stock price had the event not happened. The difference between the dark blue line and the linear line are the abnormal returns from the event. It shows a clear positive gain around and after the event. It implies that the market reacted to the Goldman Sachs' purchase (which was rumoured as an indication of a potential acquisition of Volvo) very positively. We see an obvious price spike around the event, with the anticipation of the deal, and the event effects were captured in a four-month post-event. The stock price of Geely increased by 124% in those four months. With a closer look around the event of the 21 days window (- 10, + 10), as shown in the figure below, we see a clearer image of the event effect. There was a clear price spike around the

[194] See chapter 3 for event study methodology explanation.

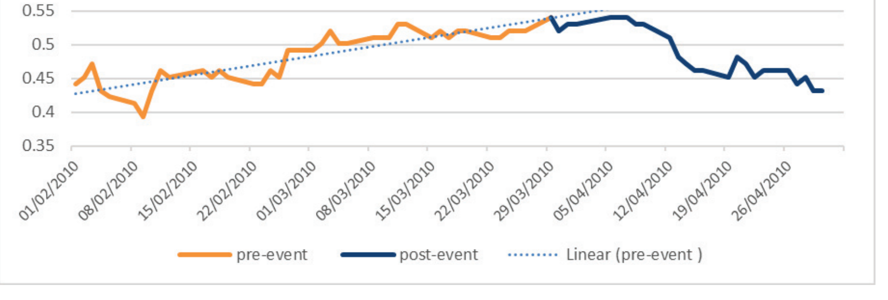
event. The short term event effect was mostly captured in the 3 days window (-1,+1). The adjusted closing price next day after the event had increased by 37%.

Figure 6-12 Price around the event (-10,+10) (Daily Adjusted close Price)

Source: Yahoo Finance

Another event was the official signing day when the official deal was signed in March 28, 2010. As shown in the figure below, we see a growth in the stock price starting from the beginning of March, but based on an event study (100 days of estimation windows[195]) there was no positive return around the event. This result implies two things, firstly, the event effects of the acquisition had been captured when Goldman Sachs invested in Geely, given the fact that in four months after Goldman Sachs invested in Geely, the price of Geely grew in total 124% (see Figure 5-12). Secondly, the event might have been learned about by the market earlier than the official date. Therefore, we see a growth trend way before the event.

Figure 6-13 The Stock performance from Jan 2010- Apr 2010 (Daily Adjusted close Price)



Source: Yahoo Finance

[195] The reason for using the 100 days estimation window is because with a longer window, it will be too close to the first event which may still have an influence on the price.

The long-term performance after the deals was also referred to. The basic logic for long term event study is to extend the event window to a longer period of time after the announcement of a deal. However as stated before, the magnitude of the M&A effect on the share prices strongly depends on the estimation method used to predict the benchmark return; in a longer period, the event effects can be disturbed by many other events of the firm. Therefore, here there is not an event study with a month-long event window, but it rather looks at the overall stock market performance of Geely in a longer period, since it is more interesting to have a broader picture regarding how Geely's performance was perceived by the market before and after it owned Volvo (see below figure).

Figure 6-14 Overview of Geely's Stock Market Performance (Daily Adjusted close Price)

Source: Yahoo Finance

Geely's stock market performance increased dramatically when the market started to learn about the deal; in 2009, we see that Geely enjoyed a continuous and sharp stock price growth throughout 2009. It was especially impressive considering the market was declining sharply. After the deal was completed, Geely's stock price remained at a higher level. The overall growing trend of Geely's stock market performance (compared to the overall declining market) to some extent implies an overall positive view of the market on Geely's post-deal performance.

6.3.3.2 The post-deal plans are seemingly properly implemented

Geely's main motivation was to access Volvo's intangible assets, including the technology, brand and market to grow Geely's competitiveness; it was also motivated by synergy gains of improving Volvo's efficiency. From what has been done by Geely and Volvo, it is clear that some of the plans have been implemented.

Intangible assets synergy

Firstly, Geely's **brand** value was increased almost "overnight" because of its acquisition of Volvo. The international market started to pay attention to Geely, and in the domestic market, Geely's image was upgraded from affordable "cheap-car maker" to a comprehensive car producer which owns high end production lines in Europe. Secondly, as agreed in the deal, Geely started to **access some of Volvo's technology and know-how**, which started to upgrade Geely's domestic production portfolio. In 2012, Geely and Volvo signed another technology transfer deal that will allow Geely to enrich its product portfolio and boost its competitiveness on the domestic and export market. The deal also includes jointly developing electric vehicle and small-car technology, including plug-in vehicles. Thirdly, the **new R&D centre formed** together with Volvo aimed to expand the R&D capability for both brands that has started running in Sweden, working on upgrading the R&D mainly on small-car technology.

Global competitiveness

Firstly, the deal immediately expanded Geely group with the new subsidiary –Volvo's production and sales. Geely was pushing hard with **the sales of Volvo in both China and globally**. For instance, Volvo Car's global sales rose by a healthy 20% total in 2011. Volvo's China sales rose 36%, representing 21,000 vehicles in that period. Although sales from 2012 and 2013 did not see an impressive growth (421,951 and 427,840) from 2011, Volvo walked out of its money-losing trend in 2012. Volvo made 66 million kronor ($7.8 million) operating profit, and in 2013 surged to 1.92 billion kronor ($292 million) as sales in China leapt by 46 percent. In 2014, Volvo reached its historical high sales (465,866) and created an operation profit of 2.25 billion kronor ($271 million). In the long run, the Volvo's Torslanda plant in Sweden and the Ghent plant in Belgium are kept to serve the mature market, such as the US and Europe. And the **new JV** in China will mainly serve the Chinese market, with which the cost of Volvo cars will be dramatically decreased; this should be helpful in increasing Volvo's market shares both in China and globally. Furthermore, with the technology access, **Geely will produce more models** under the brand of "Geely" and increase the sales under Volvo's sales channel. The Chinese government has approved that **Volvo cars will build new plants** in Chengdu, Sichuan province and in Daqing, Heilongjiang province, which covers the western and north-eastern market of China, respectively. In accordance with the 39 Chinese economic development policies to "open up the western area" and "rejuvenate North-eastern China's old industrial base", Geely –Volvo new plants will enjoy favourable policies support.

6.3.3.3 Managers' perceived performance and expert informants' assessment

As mentioned in Chapter 2, in the literature, assessments from managers and experts were a source of indicators implying how in general the deal was performed. Based on the various comments from managers and the experts after the deal, it is largely believed that the deal is "so far, so good".

Li Shufu, the Chairman of Geely, expressed his view of the deal on various occasions. He is generally satisfied with the post-deal performance of the two companies. In the China Business News interview in 2014, he said "…the past four years have proven that we made the right decision. Volvo has been occupying a leading position among the luxurious car brands in terms of technologies in safety, product quality, management and research and application of new technology, which is inseparable from the special environment and unique nature of Northern Europe and Volvo's long-lasting virtuous character"

Xiaolin Yuan, the Director of M&A Department in Geely, serves as head of the chairman's office in Gothenburg after he helped to seal the deal. Yuan, as an expert in cross-border M&A and a manager closely monitoring the post-deal performance, believed the integration went surprisingly well. He said that "I sometimes shake my head at how smoothly Volvo's extraction from 10-year-owner Ford and its 4-year integration into Geely has gone". Yuan said Volvo's renaissance has come under a traditional corporate governance structure, where "Geely board members debate business strategy and make material business decisions. Whereas Volvo management in Sweden carries out those directions and manages day-to-day business"

Volvo's President, Hakan Samuelsson, when presenting the operating profit for the year 2013(close to $ 310 million) said that "We're moving in the right direction and at a slightly faster pace than we anticipated. Things are going particularly well in China and decently in Europe, in light of the current market condition." [196]

6.3.4 Factors Contributing to Geely's Post-deal Performance

Theoretically, "efficient resource allocation by allocating ownership and control of assets to those who value them the most and installing the most able managers" is the key to a successful deal. A successful OMA will achieve synergy gains from "more efficient asset combination, and/or more efficient management, and/or better corporate governance structures" (Macey et al. 1995), at the same time, the investment costs of the deal will be reasonably minimized given the circumstances of the deal.

It is too early to claim the degree of Geely's success, but however as analysed in section 6.3.3, Geely seemingly has a gained a considerable benefit from this acquisition. Based on Chapter Two which identified the most influential factors affecting the performance of cross-border M&A, two sets of factors were identified that contributed to a beneficial acquisition based on their primary function - the benefit-increasing factors and the cost-decreasing factors. The net gain from its acquisition of Volvo was ultimately determined by the fact that benefits from the deal outweighed the costs of the deal.

6.3.4.1 The benefit-related factors

Sweden as well as the EU is highly developed.

On the macro level, a firm's foreign investment benefits from the overall economic growth of the host country. Therefore, acquiring a target in a country that has high economic performance in general is more likely to succeed (Evenett 2004; Evenett and Hoekman 2005). The fact that Volvo is headquartered in Sweden is an advantage for Geely to have a good performance in the deal. As Sweden is an EU Member State, Volvo also has a factory in Belgium and its primary market is the EU. Geely's other products will eventually benefit from the development of Sweden and the EU which has already been coming out of the financial crisis since 2013.

Geely and Volvo are in the same industry.

[196] See Volvo's Annual Report 2013

Some research found that the industrial relatedness between the acquirer and the target has significant effects on the gains, especially as it showed significant effects in long-term performance (Conn and Michie 2001) . As Geely and Volvo are both in the auto industry, and have complimentary assets, this industrial relatedness had contributed to realizing the synergy gains of the deal. With their long–term plans on joint R&D and a new JV in China, long-term gains should be expected.

Geely carried the acquisition at a low-equity market cycle.

During high-equity market cycles (i.e. optimistic market), optimistic managers tend to pursue aggressive cross-border M&A (Gugler, Mueller, and Weichselbaumer 2012). However, during low market cycles the market provides better M&A opportunities; and the M&As conducted during low market cycles tend to perform better (Pangarkar and Lie 2004). Geely started its acquisition when the market was low due to the financial crisis, which gave three advantages to Geely. Firstly, if it were not for the financial crisis, Ford probably would not have put Volvo up for sale at that time. Secondly, during the crisis, there were fewer managers pursuing aggressive cross-border M&As, Geely did not face extensive competition in bidding for Volvo. Thirdly, the stock price of Volvo was affected because of its poor performance during the crisis, Geely managed to get a good deal for acquiring Volvo.

Geely paid cash.

Geely paid Ford $1.8 billion in cash to acquire 100% of Volvo. Jensen and Meckling (1976) found empirical evidence to prove that cash payment has a positive impact on the share prices of the bidder because it shows the confidence of the bidder in post-acquisition performance. A capital ejection via cash payment as big as $1.8bn during an international crisis period was surely a sign to outside investors that Geely has confidence in the deal. Furthermore, Goldman Sachs also invested $250 million in cash in Geely Motors prior to the OMAs deal, which was considered by the market as a positive sign of Geely's bid for Volvo, which gave market confidence to the deal.

Two OMAs experiences prepared Geely.

The "learning by doing" theory is applied to cross-border M&A. Empirical research has also proven that in cross-border M&A, firms which have prior acquisition experience are more likely to make successful acquisitions, and among successful deals, experienced acquirers yield significantly higher returns than non-experienced acquirers (Collins et al. 2009). Furthermore, Hayward (2002) found that firms learn best from prior acquisitions which are not highly similar to, or dissimilar from, the previous experiences. Geely's two prior OMAs were both different from its acquisition of Volvo. The first OMAs in 2006 was a majority-share acquisition of Bronze, the London black taxi producer. It was a horizontal acquisition and the main goal of this OMA was to lower the production cost of the London black taxi. After the acquisition Geely and Bronze set up a JV in China to produce the taxi cabs, with much lower unit costs. The second OMA of Geely was the 100% acquisition of Australian automatic transmission supplier Drivetrain Systems International (DSI) in 2009, it was a vertical acquisition to enhance Geely's capability in automobile parts technologies. These two deals enabled Geely to accumulate extensive experience which later on was applied to the acquisition of Volvo. For instance, Geely's M&A team gained experience in negotiating with targets from advanced countries in terms of valuation of the acquisition, IPR management, overcoming institutional differences; Geely also learnt the post-deal management, in terms of human resource management, localization of the production, technology sharing, etc.

6.3.4.2 Cost-related factors

Geely's bidding strategy and paid premium.

Bidding strategy is proven to have a close link to the final premium paid. As some empirical studies showed, acquirers earn less in the case of revised bids because of a bidding contest. Therefore, the gains of the winning bidder, at some level, depend on how successful the bidding strategy was (Betton, Molson, and Thorburn 2008). Geely's acquisition team had given its initial legally-bonding bid after months of lengthy due diligence and discussions with Ford; therefore, Geely's first bid did not trigger a bidding war or lead to a revised bid, which is essential for winding up the bid at a good paid premium.

Geely only paid one third of the original price when Ford bought Volvo. Needless to say, the less the premium paid, the more profit the investment earns. Empirical evidence shows (John, Liu, and Taffler 2010; Mukherji et al. 2013) the average premium paid in corporate acquisitions according to goodwill has increased in the 21st century. One theory is that the market for M&A of public companies is excessively competitive (Alexandridis, 2010; Alexandridis, Fuller, Terhaar, & Travlos, 2013), as a result, acquirers tend to enter non-profitable deals because they bid more aggressively and offer higher premiums. Sometimes it is also the case that fierce competition for listed targets is likely to enhance managerial hubris-related effects which can lead to reduced gains for acquirers (Billett and Qian 2008).

There is no conclusive evaluation that Geely had the best deal with the premium it paid; however, it is generally believed that Geely negotiated a good price from Ford. Geely paid $1.8bn to Ford, less than one third of what Ford paid ($6.45bn) when it acquired Volvo. One explanation is that Ford put Volvo up for sale during the crisis time and the market was low. Furthermore, auto companies in the US and Europe were heavily affected by the financial crisis, they primarily focussed on surviving the crisis. Volvo was losing $231mn in the second quarter of 2009 and sales of its vehicles had fallen 22% in the US. Geely had bargaining power over premium due to Volvo's poor performance and low bid competition. Geely had a sophisticated acquisition team to consult the bid offer based on the market price, which also minimized the chance of managers' hubris behaviour leading to over-paying for the target.

Geely minimized the liability of foreignness (LOF) and liability of multi-nationality (LOM). The LOF here means the additional costs (compared to domestic companies) the post-deal company incurs when it starts to operate in the host country (Hymer 1960). There are two sources of LOF during the post-deal stage. One is the unfamiliarity of the institutional framework of the host country, especially the regulatory environment, cultural differences in the host country (Doukas and Lang 2003). The other one is the high institutional distance which also suggests a significant deficit of legitimacy in the host country (Kostova and Zaheer 1999; Zaheer 2002), provided the post-deal company remains "foreign". Compared to greenfield investment, cross-border M&A suffers less LOF during the post-deal period because the post-deal company is usually less "foreign" compared to a Greenfield company.

Geely, as a Chinese Company acquiring a Swedish firm, faced a considerable institutional gap. However, Geely managed to minimize the LOF by being "less foreign". Firstly, Geely had studied thoroughly the LOF that might happen because of the lack of cognitive information with a professional M&A team and external experts. From Geely's first idea in 2002 till Geely officially proposed the deal it took 6-7 years. The lengthy study engaged advice from both Chinese and Swedish government officials, business consultants, lawyers and financial analysts. Geely had a fair understanding of the LOF before they conducted the deals.

Secondly, Geely's business strategy was to keep Volvo's operation in Europe, and Geely's operation in China, as if both companies would be operating in their home country. This business strategy essentially avoided the "deficit of legitimacy" greatly because the post-deal company was not "foreign", in many ways, the post-deal company was still perceived as Volvo in Sweden. This model helped to minimize the LOF greatly but it may create a source for LOM. LOM means the additional cost incurred by the MNEs compared to the single-national companies. The main source of LOM is inefficient communication and difficulties of accessing each other's firm specific assets (Ramachandran and Pant 2010). The Geely-Volvo model (remain separated) ensured that Geely did not interfere with the daily management of Volvo in Sweden, but this might make communication between Geely and Volvo less smooth. Geely's strategy was to delegate Xiaolin Yuan, the Director of the M&A Department in Geely, as the head of the chairman's office in Gothenburg after he helped to seal the deal. His main role was to smooth the communication between the Chairman Li Shufu and other board members of Volvo. Geely and Volvo also cross-manage their sales in each other's market of origin, so they can communicate instantly. For instance, Volvo China has both a manager from Volvo and Geely to deal with Volvo cars sales in China. With regard to the access of each other's firm specific assets, Geely and Volvo had already signed a technology transfer agreement (for Geely to access the technology of Volvo) and made a JV plan (for Volvo to access the cheap production cost of Volvo). This agreement and implementation greatly decreased the possible LOM.

Behaviour of Managers

Managers' behaviour may seriously affect the performance of OMAs (Datta, Iskandar-Datta, and Raman 2003), because of its importance during every step of the deal. Gugler et al (2010) developed the managerial theory of mergers; they believe that the psychology of the manager's behaviour often has a significant impact on mergers. Goergen & Renneboog (2004) also found evidence that deals made in an optimistic environment by managers with hubris may lead to poorly performed cross-border deals for acquirers. The Geely vs. Volvo case showed that risks induced by managers' behaviour can be minimized by a well-planned OMA deal (Guo, Li, and Chen 2017).

When Li Shufu firstly presented the ambitious vision of "buying Volvo" to his employees, no one took it seriously and later on when he started to hire a whole team to prepare the proposal, people thought that his expectations were hubristic.[197] It may appear that Li Shufu's acquisition plan was made out of over-confidence and his obsession with Volvo. But as

[197] See The Rise to Market Leadership of a Chinese Automotive Firm: the Case of Geely. Chapter 2 of *The Rise to Market Leadership: New Leading Firms from Emerging Countries, p 20.*

analysed in previous section his obsession with Volvo was backed up by sound economic rationale.

Firstly, Li Shufu and his team had done thorough research on Volvo and the host country institutional constraints. The deal was not a decision led by Li's over-confident behaviour, but a well cultivated corporate strategy made after sufficient feasibility study, due diligence and major negotiations. The acquisition team had studied Volvo and the deal for years even before the first time Geely sent its first unofficial letter of intent to Ford in 2007. Moreover, Li and his team did not just focus on "making the deal", they also had a detailed post-acquisition planning.

Secondly, Li was the founder of Geely, which differentiated him from other professional managers. He did not suffer from the "cross-border M&A" obsession to further his career. His plan to have a "partner Geely can learn from side by side" (S. Li, n.d.) was in line with his interest as the shareholder of Geely. Therefore, instead of opportunistically studying various targets, Geely was only focused on one target – Volvo. This also allowed the management team not to be over-focused on OMAs but to delegate the tasks to the professional managers in the M&A team. Therefore, operational managers were not distracted by the acquisition and could still focus on the performance of Geely itself.

Lastly, Li and his team avoided other common mistakes over-confident managers would make such as to under-estimate other transaction costs. Geely paid extra attention to the other transaction cost. For instance, they had to pay attention to the cultural difference in the bidding strategy and post-acquisition planning. Geely did not send a new management team from Geely but kept Volvo's European management team or hired new managers that best fitted the corporate culture of Volvo. It ensured a decision-making mechanism with smooth communication, which could avoid poor decisions due to the conflicts of culture and management styles.

Geely also had other disadvantages which somehow did not affect the performance of the deal. For instance, the relative small size of Geely (Geely value / Volvo value) did not negatively affect Geely's stock market performance after the deal, although the literature found that the stock market reaction to acquiring firms varies according to the relative size of the acquirer to the target (Asquith, Bruner, and Mullins 1983). Geely had good stock performance in both the short period and during the three years after the deal. A possible explanation is that the literature drew conclusions from advanced stock markets (Shleifer and Vishny 2003) which may not apply to the particular market. As the empirical evidence showed, the Chinese stock market is different (Black et al. 2013), Chinese acquirers that conducted "impressive" OMAs were often rewarded by the market.[198] Firstly, the market did not worry about Geely's capability of financing the deal. Geely had ensured multiple loans from China and Sweden, and Geely already had the first initial investment from Goldman Sachs way before the official bid. Secondly, Geely had shifted the market's focus from its relatively small size to its relatively fast growth and its post-acquisition potential. The process of the acquisition presented the market with a well-planned deal with enormous potential which convinced the market that the deal would be profitable for the shareholders.

[198] See chapter 3, section 3.5.

6.4 Conclusion

This chapter has presented the case of an internationally unknown car maker Geely that successfully “merged up” with a world-famous car maker Volvo. Geely seemingly managed to maintain a fairly good performance after the acquisition. Geely’s acquisition of Volvo is an outstanding case to study. It represented the main peculiarities of a Chinese acquirer in its overseas M&A in terms of motivation, deal-making and performance. More importantly, this case revealed the roles of an acquirers’ Chinese institutional background in Chinese OMAs as described in Chapter 5, both restrictive and facilitative institutions have shown some influences in the process of Geely’s acquisition of Volvo.

Encouraged by a series of facilitative institutions on competitive markets, OMAs and auto industry upgrading, Geely gained advantages in financing, low cost and market shares in China. These advantages motivated Geely to conduct its “merging-up” deal which fits the reversed OLI paradigm. In acquiring Volvo, Geely was able to exchange and enhance its advantages in financing, China’s market channel and low production costs for Volvo’s brand, technology and international market channel.

At the deal making stage, Geely faced most of the risk factors which could have jeopardised the deal; the LOO generated by its Chinese institutional background and its private ownership weakness both could have discouraged Ford and Volvo’s final decision to embrace the acquisition. It took Geely years to prepare its acquisition plan in order to defuse the concerns raised by Ford and Volvo, especially over corporate governance and IPR protection. With a professional M&A team with financial experts and legal experts, Geely, Ford and Volvo arranged a comprehensive tender offer and acquisition agreement as well as IPR related contracts to legally govern the post-deal corporate governance and IP solution.

Furthermore, Geely has minimized the influence of restrictive institutions on OMAs approval regime. It had consulted MOFCOM and gained approval prior to the acquisition and reassured Ford and Volvo that the acquisition would face no regulatory approval problem regarding OMA and anti-trust.

In the 4 years after the acquisition, it seems that Geely has respected and been implementing its acquisition plan as agreed in the acquisition agreement. Besides the positive reaction of the stock market as an indicator, the production and sales increase in both brands also promised a good performance of the post-acquisition ear. This sector did not draw links between specific institutions with the post-acquisition performance of Geely, but rather has backed up the findings from the literature (Gu and Reed 2013) that the current OMAs facilitative IF has two effects on the performance. Firstly, the “deregulation”, “go-out” and 2004 auto industry policy gave the market extra confidence in Geely’s acquisition, so therefore it had a positive effect on the market perception of Geely’s acquisition. Secondly, the evolving market compatible institutional framework of China is facilitative to the post-acquisition Geely which has become a MNE via multiple OMAs.

Chapter 7. Conclusion

A central feature of the world economy in the last decades is the dramatic transformation of the Chinese economy along with the transformation of Chinese companies. For instance, Chinese companies were nowhere to be seen in the international market in the 1980s. Yet there were 10 Chinese companies on the list of global 500 in 2001 and the number grew to 98 in 2015 and Chinese companies ranked second by country [199] . In the late 1980s, Chinese SOEs started to adopt market-driven corporate governance whereas private firms also emerged and they started to catch up with advanced firms at an unprecedented pace. Extremely young and inexperienced, they managed to navigate in a turbulent economic environment domestically and internationally and became important players in the international M&A arena making headline deals globally. This dramatic transformation has drawn a considerable number of scholars from various fields and they found interesting firm level results regarding Chinese OMAs motivation and performance. The literature however did not pay attention to whether the national level institutional factors have explanations for the peculiarities of Chinese OMAs.

This thesis therefore suggested taking the NIE approach and expanding the existing OMAs literature to the home-country level institutional analysis. The NIE approach has previously been employed in national level analysis (Liebowitz and Margolis, 1995; Pierson 2000; Martin and Sunley 2006) to explain the importance of the national level institutions (economic, political, cultural) on the performance of the country statistically and over time. There is also firm-level NIE analysis to emphasize the regulative and cognitive influences on companies' strategic behaviour. This thesis employs the NIE approach to analyse the effects and consequences when national level institutions (e.g., the laws and culture) of China provide regulative and cognitive influence on economic actors' behaviour in Chinese OMAs, and it also emphasizes the "path dependence" due to the unique starting point of Chinese institutions.

This thesis found that it is very likely that the peculiarities of Chinese OMAs are linked to the particular incentive structures of parties and other stakeholders', which is likely to have its origins in the acquirers' particular institutional background. Horizontally, governed by institutions with Chinese characteristics, the incentive structures of, and the dynamic among the acquirers, targets, policy makers and other stakeholders is unique in Chinese OMAs compared to the OMAs of other countries of origin (COO). And vertically, the growth path of Chinese companies has been inter-twined along with the path of institutional transformation in China. The influence of such institutional settings and changes has its marks on Chinese overseas OMAs.

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[199] Companies are ranked by total revenues for their respective fiscal years ended on or before March 31, 2015. See the ranking of Fortune, available at http://fortune.com/global500/retrieved on 31, September,2015.

7.1 Main Findings of the Thesis

This thesis found that during each stage of a Chinese OMA, home country institutional factors have played a role.

During the pre-deal stage, the institutional background of acquirers governs the incentive structure of the acquirers and their managers. Acquirers who have efficient management would take the transaction cost (TC) situation into consideration in making an OMA decision. In estimating the cost of a potential deal, they would include the TC which may be created or increased by restrictive institutions and TC may be decreased due to supportive institutions. The situation of TC will firstly affect the acquirer's decision to "deal or not to deal", and secondly it affects the acquirer's choice on "whom to acquire".

During the deal-making stage, the institutional background of acquirers not only governs the acquirers but also affects the incentive structure of the target and other stakeholders' incentives structures. The LOO may be created due to the target and other stakeholders' perception on the overall quality of the IF in China, such as the rule of law and quality of law enforcement; or some specific institutions such as corporate governance, IPR and overseas investment. How the acquirers address the concerns of targets and other stakeholders and minimize the LOO is the key. Firstly, it may affect the target and other stakeholders' decisions on "deal or no deal". Secondly, it also determines acquirers' governance options, namely "OMAs or contracts".

After an OMA has gone through the process of the Chinese administrative scrutiny, and the questions of the target and other stakeholders, when the deal is finally proved and accepted by the target and other stakeholders, the market usually perceives the OMA as value increasing due to its self-selection feature. It seems that the market believes that, in the event that the acquirer has weak economic rationales or poor management, it would not be able to pull though the deal under the governance of the current IF.

7.1.1 Lobby, Deregulation and Chinese OMAs wave.

The empirical evidence in chapter 3 showed that Chinese OMAs missed the 1990s OMAs wave which happened simultaneously in the developed world (see *Figure 3-3 OMAs yearly number US vs.UK vs. China 1990-2013).* The 1990s wave was fuelled by the host-country deregulation on a global scale (Evenett 2003; Hijzen, Gorg, and Manchin 2005). However, in the 1990s, the overseas investment of China was still heavily regulated although the domestic investment was deregulated and liberalized towards the market economy. The regulatory controls significantly increased the TC (time, uncertainty, monetary cost) and more than often it was just not feasible to conduct any overseas investment. Therefore, in the 1990s, for the majority of Chinese companies, OMAs were not appealing because investment in the domestic market was much less costly and risky. Lobbied by Chinese high performing SOEs, and motivated by preparing for the World Trade Organization (WTO) membership, the "lagged" deregulation on overseas investment finally happened in 2000s. Chinese policy makers on the one hand "agreed" that some Chinese high performing SOEs were ready for international competition, while on the other hand, the obligation of the WTO also called for deregulation on China's investment policy. The Chinese policy makers initiated the "go-out" policy in 2000 and China joined the WTO in late 2001, there was a clear deregulation effect around 2000 and 2001 (see *Figure 3-4 Yearly Deal Number and Completion Rate*).

Furthermore, the institutional arrangements for OMAs have constantly been liberalized thereafter. In 2000s, a number of facilitative policies was pursued by the policy makers, which further encouraged Chinese companies to engage in OMAs. Especially during the financial crisis period, there were a number of directives and suggestive policies "helping" the Chinese acquirers to invest in the advanced market. Therefore, the world saw a strong force from Chinese acquirers to join the 2000s cross-border M&A wave. Moreover, since the financial crisis, Chinese OMAs have grown even faster while the rest of the world started to reduce their OMAs.

7.1.2 The Institutional Background and the "Merge-up" Motivation

The Institutional framework played a double role in this arena; both restrictive and facilitative institutions play a role. On the one hand the drawbacks of the Chinese institutions, for instance the laws and enforcement on corporate governance and IPR, deter the motivations of the potential targets. Compared to advanced companies, strategic assets holders are less willing to enter contractual relationships (License Agreement, Joint Venture and R&D cooperation, etc.,) with Chinese companies granting them access to their strategic assets, unless the Chinese companies have additional value to offer. Therefore, a Chinese company's best chance lies in a target which can benefit from the OLI advantages the Chinese acquirer enjoys, namely advantages in capital, cost and the Chinese market. Therefore, the restrictive institutions inspired Chinese companies to apply a "reversed" OLI paradigm on financially stressed targets that also hold the strategic assets Chinese acquirers lack. Furthermore, the Chinese acquirers should also address the institutional concerns of the targets by well-defined OMAs plans and agreements. The targets would prefer to accept a well-defined acquisition proposal with a clear plan of intangible asset transfer compared to a simple contractual relationship in terms of protecting their IPR (Oxley 1999). This reversed OLI model can also internalize some transaction cost for the Chinese companies. In an IPR contractual relationship, Chinese companies are often not able to share the key updates of the technology due to the incomplete nature of the contract and lack of trust from the foreign party. Plus, to enforce a cross-border contract is often complicated and costly for a Chinese company.

On the other hand, the facilitative institutions which encourage strategic asset OMAs affect the motivation of Chinese acquirers. The stimulus industry policy encourages and supports the R&D and industry innovation on a major scale. With the policy support, companies especially in technology intensive industries can access financial means provided by various policy banks (Deng 2009). Therefore, these companies have added capacity to "merge up" more advanced companies to enhance their competitiveness in both the domestic market and the international market.

7.1.3 Institutional Background and Deal-making

In terms of deal completion, the institutional background of Chinese acquirers mainly played a negative role. The empirical evidence showed that Chinese OMAs had a significantly lower completion rate compared to the Anglo-Saxon OMAs. Moreover, Chinese acquirers also had less chance to complete OMAs compared to other emerging economies' acquirers. (See *Table*

3-8 Deal Completion compared to other countries). Chinese acquirers suffer from the liability of origin (LOO). The international management literature found that LOO plays a role in national companies' internalization (Moeller, Harvey, Griffith, & Richey, 2013). Chinese acquirers suffer from LOO caused by the image of the country, the institutional framework of the country and the image of the country-product. The current country image of China still projects poorly on Chinese corporations (e.g. Chinese political regime, rule of law, human rights). LOO from the institutional framework of China includes poor intellectual property protection, the poor corporate governance (especially for Chinese acquirers that have an SOE background) and poor corporate social responsibility (e.g. environmental protection) in China. The LOO from country-product image is that Chinese products are still perceived as "cheap and bad quality". The LOO greatly decreased the attractiveness of Chinese acquirers in competition with acquirers that have another country of origin. Although the Chinese institutional framework is evolving, it takes time for these institutions to be effective (North 1994) and even longer time for the results to be perceived as effective. LOO can only be reduced over a long period of time. That partially explains why Chinese OMAs even have lower completion rates compared to other emerging economies' OMAs. However, Geely's acquisition of Volvo has proven that, provided there is a calibrated pre-deal plan and a careful implementation of the plan, the LOO can be well-addressed on the deal level.

7.1.4 The IF and the Market Reaction

The event study and case study both showed the positive market reaction on Chinese OMAs. It seems that the market has a general confidence in Chinese OMAs. A possible institutional contributor is that under the current IF, Chinese OMAs are "self-selected".

Firstly, the market recognizes that the current IF only encourages the high-performing SOEs or private companies which are in strategic sectors endorsed by the industry policies to engage in OMAs. Companies which do not fit the profile would not want to face the risks that the deal would not be approved or financially supported. Therefore, the market believes companies which engage in OMAs are the ones which have sound economic rationale and sufficient financial means. Secondly, the market also recognizes that Chinese acquirers suffer LOO induced by the Chinese IF. Therefore, companies that can successfully complete the deal have efficient management and a deal plan and successfully address the target and other stakeholders' concerns over Chinese institutional problems. Therefore, the market in general perceives Chinese OMAs as "game up" and profit-making ones.

That is to say, it is likely that although the current IF may have blocked some high quality OMAs, the ones endorsed by the IF are usually sound ones. The market's perception is from the firm specific characters and deal specific characters which are essential determinants for post-deal performance. For instance, Chinese acquirers are mostly friendly bidders; Chinese acquirers tend to pay the premium entirely or partially in cash, this often enhances the confidence of the market (de La Bruslerie, 2012). From the post-deal management perspective, especially in "merge up" deals, the acquirers tend not to interfere with targets' corporate governance. The target often operates as a separate company, even though the Chinese acquirers gained controlling shares over the target. Therefore, Chinese acquirers appear to the market as having long-term competitiveness and enhancement seeking which gives confidence to the market. The continuous high profiled successful deals such as Geely's acquisition of Volvo are also likely to further endorse the market's confidence.

7.2 The Limitations and Contributions

7.2.1 The Contributions

Theoretically, this thesis uses NIE as a theoretical lens to study the OMAs, which has not been well explored in the literature. Given the theoretical and methodological sophistication of the NIE approach, it helps to address several unnoticed or unexplained aspects related to the Chinese OMAs as addressed in section 7.1. Furthermore, the study goes beyond simply applying the NIE insights to the Chinese OMAs, but also using the context of OMAs to provide a balanced view on the efficiency of the Chinese institutional framework in the economic performance of Chinese companies. The interaction of the Chinese IF and Chinese OMAs yields some implications. The findings point out that the Chinese institutional framework is efficient in some aspects (positive feedback) and inefficient in some others (negative feedback). Sometimes it decreases TC for the Chinese acquirers; sometimes the institutional framework itself is the source of the TC. These positive and negative feedbacks should be factors to encourage institutional changes and policy makers should take these feedbacks as important indicators of building more efficient institutions.

Empirically, this study takes a historical approach by looking at both Chinese OMAs and the Chinese institutional framework over time. It studies the Chinese OMAs over a 24-year period of time, scrutinizes the suppression period and its rise and the pattern of the rise. The Chinese institutional framework was analysed for an even longer period, 65 years of PRC history, 3 stages and 3 IFs. The qualitative analysis provided a clear picture of the overall institutional changes. In the case study, it also studied the Chinese auto industry and industry policy changes from a historical point of view, as well as its impact on automakers' behaviour and OMAs performance. By unbundling the Chinese institutions and institutional changes towards OMAs, this study makes it possible to see more clearly the institutional factors which play a role at the different stages of an OMA.

Practically, this thesis helps to move the public focus away from the rise of Chinese OMAs around the financial crisis period. By combining the theories and empirics of Chinese OMAs, this thesis demonstrates the economic rationale for the emergence of Chinese OMAs under the "state capitalist" governance of China (Coase and Wang 2012). The analysis shows that with or without the financial crisis, the timing for Chinese OMAs to rise was there. Therefore, the comment that "China is buying up the world" when the world is in crisis, is far from accurate. China is neither buying up the world because the size of Chinese OMAs is still relatively small; nor was it an opportunistic move; the analysis proves the Chinese OMAs trend is likely to continue.

7.2.2 Limitations

This thesis focuses on analysing the impact of institutions on the economic performance of Chinese OMAs, and therefore it did not engage in a lengthy analysis of the impact of economic performance on the institutional changes in China. Thus, it is not a full picture of the relationship analysis of the two, because the economic performance as a feedback influences the institution-making. This also limited the possibility for this thesis to propose sophisticated policy recommendations rather than a general direction which is to "economize" the institutions towards the market in both legislation and enforcement.

Furthermore, there are also some data limitations which may compromise the empirical findings. 1) The Thomson One Banker data was not complete on the deal level. Some of the deal specifics could not be found; therefore, the statistical analysis is not 100% precise. For instance, some deals with confidential transaction value may not be captured in the deal value but are captured in the deal numbers. 2) The event study sample of this thesis is rather small and selective. The event number was controlled by only selecting completed deals and transaction values no smaller than $10million. Without a bigger sample and better-quality data, the result should not be overly generalized. 3) There was no investigation of the long-term performance of the deals, due to the difficulty of monitoring and analysing the long term performance of a number of samples.

7.3 The Future

New Institutional Economics tells us that institutions matter and history matters. It is the foundation of "path dependency" at the country level (North 1990), yet it is difficult to test how the institutions matter and how much they matter at country level over time.

China is a good example to study. The economic development of China in the last 35 years is by far the most impressive economic performance of a nation. China was one of the poorest countries when the socialist regime was established after World War II and it remained a chronically under-developed country till the end of the 1970s when China started its economic reform. Since then, China has been a super performer with around 10% average GDP growth for 35 years. China surpassed Japan as the world's second largest economy in 2010. Angus Maddison, a world famous scholar on quantitative macro-economic history, predicted that by 2020, China would displace the U.S. and get back to the top position as the world's largest economy, which China lost 150 years ago (Maddison and Wu 2006). What made this impressive economic performance more special is that China achieved it in a unique institutional setting - a mixture of planning- and market-mechanism. Therefore, the rise of China is a puzzle to many in the world (Nolan 2012). From the economic ideology perspective, capitalism and market economy have been proven to be a successful match during the post-war economic history (Baumol 2002). From the political ideology perspective, the market economy and western democratic political system were believed to go hand in hand; it was well-accepted that a communist political regime is not compatible with the market economy. East Germany vis-à-vis Western Germany and China vis-à-vis Taiwan were natural experiments. In the 40 years history of East Germany and West Germany, the socialist East Germany was always economically behind West Germany. In the first 30 years history (1949-1979) of the People's Republic of China (PRC), it was also always economically behind Taiwan. Yet the transitional China (1978-) provided an alternative example. The economic institutions of transitional China imitated much best practice from the advanced market, the ideology and belief system also evolved as pro-market; however there has been no systematic reform in its political regime. This style of transition was different from any other country and it transformed China from an isolated socialist country which ignored the market to a powerful economy which is equipped both with market compatible institutions and socialist compatible institutions. The astonishing result has attracted a great number of studies in many disciplines trying to explain the relationship between the successful transition of China and its peculiar institutional framework- which is called “socialism with Chinese characteristics” by the communist party of China (CPC).

The rise of Chinese OMAs and their peculiarities is part of the rise of China with its characteristics. This thesis shows that the IF of China plays both positive and negative roles in the process of a Chinese OMA. On the positive side, the market identifies these institutional circumstances as it is on an evolutionary track[200] and Chinese acquirers may therefore become attractive. Therefore, the Chinese companies perceive that their opportunities in the free market are increasing, and the managers are more active in the international expansion. On the negative side, the mix of market institutions and state-capitalist institutions is still rather confusing to most outsiders, as China still has poor country governance compared to advanced economies.[201] With such an IF, the transaction cost for Chinese companies in a global market is still higher than they should be. Based on the size of the Chinese economy and the size of its Trade and IFDI, Chinese OMAs should have much more potential, especially in the advanced economy where Chinese companies can acquire the most needed assets. Therefore, a continuously improving institutional framework should be very much desired in order to further develop the international competitiveness of Chinese companies. It is likely that this thesis is the epitome of learning the role of home-country institutions and firm level efficiency. However, the findings of this thesis are not generalised, nor is there an attempt at analysing the big puzzle- does the special mixture of Chinese IF support Chinese firms to realize their economic potential and can the Chinese firms outgrow their home-country institutional constraints? However, as a social science scholar as well as a corporate lawyer, I offer a small piece of this big puzzle. Under the NIE theoretical framework, many other similar studies can be done to analyse the effects of the home-country institutional factors on the economic performance of firms.

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[200] For instance, the 24-nation survey of *Pew Research Center* in 2008 shows that “China has used a unique blend of free markets and authoritarianism to attract both admiration for and fear of its military and economic prowess”. The survey asked “whether China would replace – or had already replaced – the United States as the world’s leading superpower”. “Majorities in seven countries and pluralities in six more answered yes”. Available at *http://www.pewglobal.org/2008/12/18/global-public-opinion-in-the-bush-years-2001-2008/*.

[201] See Figure 4-6 Overview of ROL and RQ changes under the 3rd IF.

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Summary

This thesis examines the relationship between home-country institutions and the cross-border M&A in the context of the rising number of Chinese overseas mergers and acquisitions (OMA). The rise of China under its peculiar institutional framework is a puzzle to the world. The rise of Chinese OMA, especially during the period of financial crisis, is one piece of the big puzzle. A sudden surge in Chinese OMA has drawn considerable attention in various fields such as economics, business and politics. Though there is only a limited amount of research on Chinese OMA, evidence shows that there are some peculiar characteristics in Chinese acquirers' behaviour and the outcome of Chinese OMA. These findings are quite puzzling to both academics and practitioners. Why do Chinese acquirers only emerge now? Is the booming Chinese OMA an inevitable trend or it is driven by the Chinese government? Why do Chinese acquirers face a high risk of failure in the deal during the deal-making? Furthermore, why does the market reward the new and naïve Chinese acquirers?

The current literature on Chinese OMA has not offered the full picture in answering these questions. This thesis is also not intending to solve the puzzle itself but it aims at giving a clearer picture regarding Chinese OMA and the contribution of the tool of the state - the domestic institutional framework of China.

Based on the theoretical and empirical background laid out by the literature review, this thesis performed a thorough investigation of the Chinese OMA. It investigates the driving forces of the Chinese OMA wave, the motivation of Chinese acquirers, and the performance of Chinese acquirers in completing the deals and managing the post-deal companies. In the investigation, I focus on underpinning the peculiarities of Chinese OMA. Secondly, under the framework of new institutional economics (NIE), this thesis reviewed and analysed the institutional changes of China. Then it analysed the relationship between the Chinese institutional changes, the Chinese companies' behaviour and the characteristics of Chinese OMA to understand to what extent the Chinese institutional framework matters. Thirdly, this thesis tested the main findings with a case study. The case study of Geely's acquisition of Volvo showed how the general institutional framework, the auto industry policy and the auto producers co-evolved in China. By analysing the case in detail, it is clear that the institutional factors played an important role at each stage of Geely's acquisition of Volvo.

This study contributes to the literature on Chinese OMA in several ways. Firstly, it uses NIE as a theoretical lens to study the phenomenon. Given the theoretical and methodological sophistication of the NIE approach, it helps to clarify several unnoticed or unexplained aspects related to the Chinese OMA. Secondly, this study takes a historical approach to look at both the Chinese institutional framework over time and its impact on firms' strategies. In the case study, I also studied the Chinese auto industry and industry policy changes from a historical point of view. This showed the economic rationale for the emergence of Chinese OMA under

the “capitalist” governance of China (R Coase and Wang 2012). Thus it moves the focus away from the spotlight - China is buying up the world when the world is in crisis. Thirdly, by unbundling the Chinese institutions and institutional changes towards OMA, this study makes it possible to see more clearly the institutional determinants at different stages of an OMA. Namely, the impact of institutional framework on corporate behaviour and the performance in the whole process of an OMA. Finally, the study goes beyond simply applying the NIE insights to the Chinese OMA, but in an innovative way also uses the context of OMA to provide a balanced view of the efficiency of Chinese institutional framework in the economic performance of Chinese companies.

Samenvatting

In dit proefschrift wordt de relatie onderzocht tussen binnenlandse instituties en grensoverschrijdende fusies en acquisities gezien het toenemend aantal Grensoverschrijdende Fusies en Acquisities (GFA's) in China. De groei van China stelt, vanwege het bijzondere institutionele kader van dit land, de wereld voor een raadsel. De toename in het aantal Chinese GFA's, vooral ten tijde van de financiële crisis, vormt één aspect van de puzzel. Een plotselinge stijging in het aantal Chinese GFA's heeft op verschillende terreinen veel aandacht getrokken, zowel binnen de economische, business als politieke wetenschappen. Hoewel er slechts beperkt onderzoek is gedaan naar Chinese GFA's is inmiddels wel duidelijk dat er een aantal bijzondere aspecten verbonden is aan de handelwijze van Chinese overnemende partijen en aan het resultaat van Chinese GFA's. Deze bevindingen stellen zowel de wetenschappers als de mensen uit de praktijk voor een raadsel. Waarom komen Chinese overnemende partijen pas nu boven water? Is de hoge vlucht die Chinese GFA's nemen een onvermijdelijke trend of heeft de Chinese overheid een vinger in de pap? Waarom lopen Chinese overnemende partijen tijdens de onderhandelingen een groot risico dat de deal mislukt? En waarom beloont de markt deze nieuwe en naïeve overnemende partijen in China?

De bestaande literatuur over Chinese GFA's geeft geen volledig antwoord op deze vragen. Het doel van dit proefschrift is ook niet om het raadsel zelf op te lossen, maar om een duidelijker beeld te geven van Chinese GFA's en de bijdrage die de Staat daaraan levert: het binnenlandse institutionele kader van China.

Op basis van een theoretische literatuurstudie en empirisch onderzoek wordt in dit proefschrift diepgaand onderzoek gedaan naar de Chinese GFA's. De drijvende kracht achter de golf aan Chinese GFA's wordt onderzocht, de motivatie van Chinese overnemende partijen en de manier waarop deze overnemende partijen de deals afronden en daarna de bedrijven besturen. Bij mijn overzoek heb ik vooral een onderbouwing gezocht voor de typische kenmerken van Chinese GFA's. Ten tweede bekijk en analyseer ik in dit proefschrift de institutionele veranderingen in China gebruikmakend van de Nieuwe Institutionele Economie (NIE). Vervolgens ga ik in op de relatie tussen institutionele veranderingen in China, de handelwijze van Chinese bedrijven en de kenmerken van de Chinese GFA's om zo inzicht te krijgen in de rol die het Chinese institutionele kader hierbij speelt. Ten derde worden de belangrijkste bevindingen in dit proefschrift getest aan de hand van een casestudy. Deze casestudy, de overname van Volvo door Geely, laat zien hoe het algemene institutionele kader, het auto-industriebeleid en de autoproducenten in China zich ontwikkeld hebben. Door deze deal gedetailleerd te analyseren wordt duidelijk dat de institutionele factoren een belangrijke rol speelden in elke fase van de overname van Volvo door Geely.

Dit onderzoek levert op verschillende manieren een bijdrage aan de literatuur over Chinese GFA's. Ten eerste wordt gebruikgemaakt van NIE als theoretisch model voor dit fenomeen. De NIE-aanpak is theoretisch en methodologisch dusdanig geavanceerd dat daarmee verschillende

onopgemerkte of onverklaarde aspecten van Chinese GFA's kunnen worden verduidelijkt. Ten tweede wordt vanuit een historisch perspectief gekeken naar het Chinese institutionele kader in de loop der tijd en de invloed daarvan op de strategie van bedrijven. In de casestudy heb ik tevens de Chinese auto-industrie en de beleidswijzigingen in deze industrie vanuit historisch oogpunt onderzocht. Hieruit kwam de economische rationale naar voren voor de opkomst van Chinese GFA's onder het 'kapitalistische' bestuur van China (R Coase en Wang 2012), waarbij uit het oog wordt verloren waar het daadwerkelijk om gaat - China koopt de wereld op als de wereld in crisis verkeert. Ten derde, door de Chinese instellingen en institutionele veranderingen op het gebied van GFA van elkaar te splitsen wordt het duidelijker wat de doorslaggevende rol is van de instellingen in de verschillende stadia van een GFA, namelijk de invloed van het institutionele kader op de gedragsnormen en de prestaties gedurende het hele GFA-proces. Ten slotte gaat het onderzoek verder dan het simpelweg toepassen van de NIE-inzichten op de Chinese GFA's. Op een innovatieve manier wordt de context van GFA's gebruikt om een evenwichtig inzicht te geven in de doeltreffendheid van het Chinese institutionele kader gezien de economische prestaties van Chinese ondernemingen.

European Doctorate in Law & Economics

Curriculum vitae

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Short bio	
A business oriented corporate lawyer with both Chinese and European education. Have 8+ years working experiences as a lawyer, researcher and policy analyst in both China and Europe in the field of Europe-China direct investment. Before moved to Zurich, I worked as an in-house counsel in the biggest Croatian Food and Drug Company, working on global business development and China-related legal and public affairs. I also worked as a part-time lecture in Free University of Brussels lecturing on Cross-border M&A with EU-China focus. An excellent negotiator, drafter, presenter and researcher; pro-active, team-player, passionate and results-driven.	
Education	
PhD Candidate -European Doctorate in Law and Economics	2011-
LLM -European Master in Law and Economics	2010-2011
Judicial Master – Civil Law and Business Law, East China University of Politics and Law, Shanghai, China	2004-2007
BA - Finance and Accounting, Harbin Commercial University, China	1999-2003
Work experience	
Senior Legal Counsel -Podravka D.D, Zagreb	Sept. 2015-Jan. 2017
Policy Analyst - EU-Asia Centre, Brussels	Sept.2014–Aug. 2015
Lawyer - Greatway Advisory (Shanghai) Ltd, Shanghai	Apri.2007-Sept.2010
Project Analyst - BP (China) Ltd, Shanghai	Nov.2006-April.2007
Prizes and awards	
Member of Chinese Bar Association	2008
Publications	
N/A	N/A
Others	
Lecture at Budapest Business School: Trade and investment between China and the EU-Legal Perspective	2015
Lecture at Vrije Universiteit Brussel: EU-China Economic Relation-Chinese ODI in the EU	2015
Lecture at University of Ljubljana: How to do business with China-the legal perspective	2014

EDLE PhD Portfolio

Name PhD student : Xufeng Jia
PhD-period : 2011-2014
Promoters : Prof. Michael Faure
Prof. Wolfgang Drobetz

PhD training

Bologna courses	*year*
Introduction to the Italian Legal System	2011
Introduction to Statistics	2011
Game Theory and the Law	2011
Economic Analysis of Law	2011
Behavioural L&E Ⅰ – Game Theory	2011
Behavioural L&E Ⅱ-Enforcement Mechanisms	2011
Experimental L&E - Topics	2011
European Securities and Company Law	2011
European competition law and intellectual property rights	2011
Experimental L&E	2011
Specific courses	*year*
Seminar 'How to write a PhD'	2012
Academic Writing Skills for PhD students (Rotterdam)	2012
Seminar Series 'Empirical Legal Studies'	2013
Seminars and workshops	*year*
Bologna November seminar (attendance)	2013
BACT seminar series (attendance)	2012-2014
EGSL lunch seminars (attendance)	2012-2014
Joint Seminar 'The Future of Law and Economics' (attendance)	2012-2014
Rotterdam Fall seminar series (peer feedback)	2013
Rotterdam Winter seminar series (peer feedback)	2014
European School in New Institutional Economics	2014
Presentations	*year*
Bologna March seminar	2012
Hamburg June seminar	2012
Rotterdam Fall seminar series	2012-2014

Rotterdam Winter seminar series	2012-2014
Bologna November seminar	2013
Joint Seminar 'The Future of Law and Economics'	2014
11th M&A International Lawyers Conference, Prague	2015
XVIth April International Academic Conference on Economic and Social Development, Moscow	2015
Attendance (international) conferences	*year*
XVIth April International Academic Conference on Economic and Social Development, Moscow	2015
11th M&A International Lawyers Conference, Prague	2014
10th M&A International Lawyers Conference, Barcelona	2013
Teaching	*year*
Lecture at Budapest Business School: Trade and investment between China and the EU-Legal Perspective	2015
Lecture at Vrije Universiteit Brussel: EU-China Economic Relation-Chinese ODI in the EU	2015
Lecture at University of Ljubljana: How to do business with China-the legal perspective	2014
Others	*year*
n/a	