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Cost Theory Analysis of Chinese Enterprises' Cross-Border m & a in One Belt & One Road Countries -- Based on Transaction Cost and Resource Theory

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Abstract: As One Belt and One Road (OBOR)spans 6 economic belts and 65 countries, business will inevitably encounter merger and acquisition (M & A), which are likely different from those of developed countries. Various factors such as national strength, institution, industry, companies, and timing would eventually lead to differences in the cost of merger and acquisition. This study is to establish a differential analysis model about merger cost in the context of One Belt and One Road cross-border acquisition by Chinese enterprises, providing reference for relevant researchers and realistic executors.

1. Introduction

With the development of global economic integration, China has played an increasingly important role. As a cooperation concept of a transnational economic belt, Belt and Road has become an important strategy for China's foreign economy. Currently, 60 countries and international organizations have participated the program.

As the Belt and Road program started to be implemented, increasing number of M & A cases make the issue of M & A cost becomes more noticeable.

Although research on M & A is not scarce, analysis on costs of OBOR cross-border mergers and acquisitions still seems rare. No theoretical consensus has been reached on cost analysis of cross-border M & A of the Belt and Road initiative, especially based on differences of various factors affecting costs. Therefore, establishing a comprehensive structure to explore the influencing factors of cost within the Belt and Road mergers and acquisitions, from the perspective of transaction costs and resource dependence, has become necessary.

As Belt and Road spans 6 economic belts and 65 countries, business mergers will inevitably encounter situations that will be different from those of developed countries. Various factors, such as difference on national strength, governance institution, industry, company business cultures, and timing, may lead to differences in the cost of merger and acquisition.

This study hopes to establish a differential model that may affect merger cost in the context of Belt and Road cross-border acquisitions by Chinese enterprises, and provide reference to more relevant researchers and real-world executives.

2. Literature Review

Following the national strategy, this article reviews the literature related to the cost of cross-border mergers and acquisitions in the “Belt and Road”, policy implementation of national strategies, and the macro factors of investment in countries along the said route. And to combine the research literature basis for the cost analysis of cross-border mergers and acquisitions along the “Belt and Road”.

2.1 Transaction Costs and Cross-Border m & a Costs

2.1.1 Transaction Costs and Costs of Multinational Mergers and Acquisitions

Coase proposed the concept of “transaction costs” in “the nature of the enterprise”, which mentions what we talk about transaction costs today. Coase believes that there is a cost to use the price mechanism when we produce or trade. We can also understand the transaction costs as all expenditure of time, effort and material incurred in order to obtain the economic gains.

Put the above theory in the context of transnational mergers and acquisitions, we find that because of differences between countries, cultures, geographic distance and institution, multinational mergers and acquisitions have to face more difficulties to search for information, negotiate and even signing a contract.

Therefore, transnational mergers and acquisition are so often pay higher prices than local mergers to facilitate transactions, resulting in excessive cost of cross-border mergers and acquisitions.

2.1.2 Williamson's Transaction Costs Versus the Costs of Multinational Mergers and Acquisitions

Williamson (1985) believed that each transaction was affected by three dimensions: asset specificity, uncertainty, and occurred frequency. Among them, specificity of the asset is the most critical.

Because of the distance, many assets are exclusive and hard to be transferred between the target and home country. In order to obtain these resources, the corresponding transaction costs must be paid, and the greater the difference between the home and the target countries, the more exclusive the assets are, and the higher the cost costs to obtain these assets accordingly.

On the other hand, uncertainty is based on transaction environment and behaviors from both sides. Generally speaking, if greater discrepanciesexistin legal & political system, economic development and technology between transaction countries, environmental uncertainty is likely to be greater.In order to overcome such uncertainty, excessive payment is more likely to happen and leads to higher M & A cost.

Occurred frequency is the frequency of transactions happened in a period, relatively speaking. Cost occurred when operating business, same as M & A. To offset costs during these transactions, business entities need to evaluate profits within its own institutional structure, especially how often it can carry out M & A.

2.2 Resources Depend on Theory and Cost of Transnational Mergers and Acquisitions

Pfeffer addressed the theory of resource dependency with Salancik in 1978. They believed that organizations need resources, which organizations can not normally produce themselves, in order to survive; organizations must interact with environmental factors, which often contain other organizations.[1]

Resource dependence theory believes that different degrees of “ability difference” (power imbalance) leads to different degrees of “interdependence” (mutual dependence), the side with more resources undoubtedly has more organizational influence to control other organizations.

To survive in international competition, multinational companies need resources, and mergers and acquisitions are their fast way to access these resources, so they have to interact with the target companies. On the other hand, due to the uneven ability of both sides, the side from developed countries, with larger enterprise scale, higher technical level undoubtedly, have more influence on the other side from developing countries with limited resources .In the process of the transaction, the side in an advantage is easier to ask for a high price. Therefore, the greater the gap between the strength of both sides, the easier it is for the side with limited resources to pay a higher price, resulting in over-payment leading to excessive costs.

2.3 Factors That Affects One Belt and One Road m & a Costs

Since cross-border M & A along the Belt and Road involve 65 countries, across different cultures, some traditional M & A factors can also be applied to analyze cross-border M & A along the Belt and Road.

According to Delios,Gaur and Makino (2008), cross-border mergers and acquisitions are closely related to the environment, industrial , international and company characteristics between organizations.[2]Brouthers (2002) analyzed the pattern of performance, and believes that there are variables that affect the performance of cross-border mergers: institutional background, cultural variables, company scale, international experience and industrial factors.[3]

Zhang and Ebbers (2010)identify the key factors that determine the outcome of M & A, combine macro level factors (such as institutional stability, culture, trade relations), industrial level factors (e. g., density of target industries), micro level factors (e. g., experience of the acquirer) and factors related to the transaction (e. g., industrial cooperation) into a single model.[4]

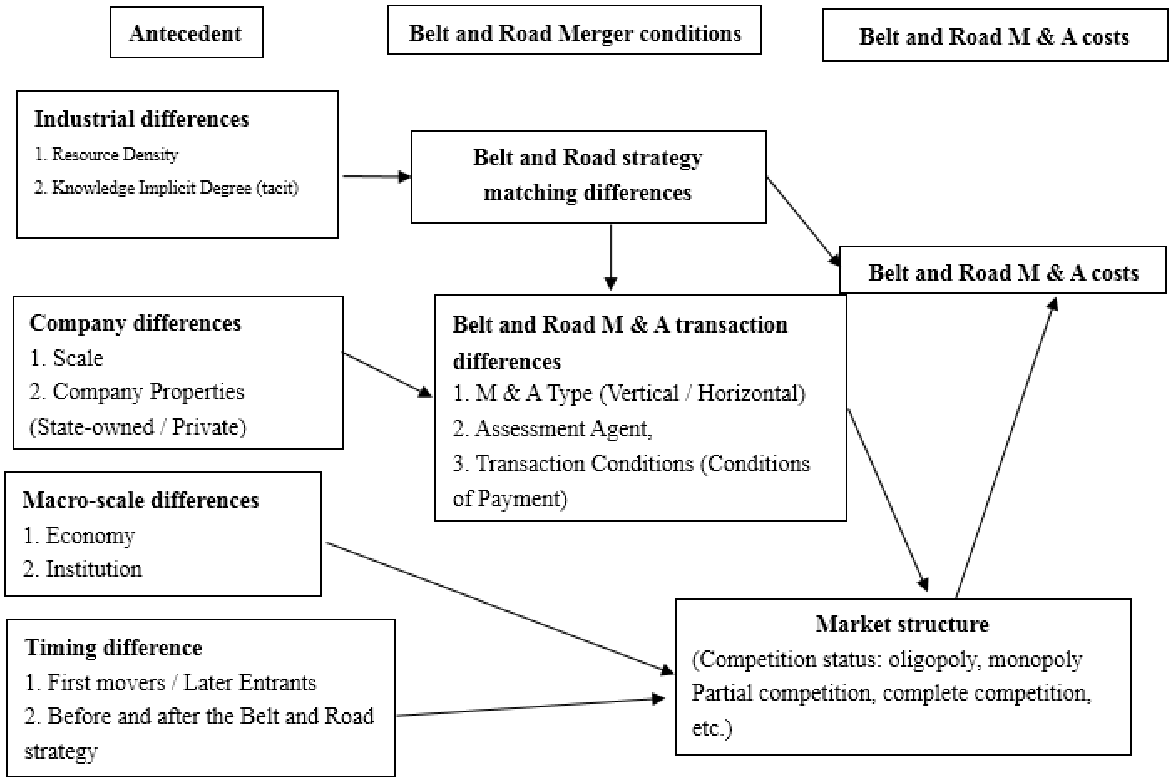
2.4 Correlations and Differences

Homberg etal (2009) applied meta-analysis to study relatedness and performance in acquisition, and found that business and technical relatedness were positively correlated with overall performance, while cultural and scale relatedness were negatively correlated.[5]

It can be seen that difference of related factors is also the reason for the difference in M & A performance.

3. Comprehensive Differential Assessment Framework of m & a Costs

Based on the above analysis, it can be learned that differences in countries, industry, companies will greatly affect the cost of merger and acquisition. In addition, timing is also an indispensable influencing factor. Despite most scholars currently believe that direct impact from macro and micro environmental factors causes the difference in M & A costs, these research results can not be completely agreed. There is increasing evidence shows that those macro and micro economic factors are only functioned as leading factors, but other factors related to M & A acts more directly and critically[6](Castro,1998). Therefore, this paper proposes a new chart that influences Belt and Road cross-border merger cost analysis synthesis, as the figure shown below.



With this new cross-border M & A comprehensive cost analysis model, it provides that: macro-scale differences along the "Belt and Road" countries affects M & A cost thru market structure. Meanwhile, industrial differences can lead to change of strategic matching and then to transaction conditions. It may further affect the market structure. Company difference contributes transactions differences, which eventually, results in market structures as well. Timing difference affects market structure directly. Finally, market structure and matching difference becomes the key factors to decide the M & A costs.

4. Differences of Macro Economics, Timing, Company Business Culture, Technical Issue and Cross-National m & a Costs Along the Belt and Road

4.1 Macro Differences and Belt and Road Cross-Border Merger Costs

During implementation of the Belt and Road strategy, China has also undergone changes in overseas investments, which Chinese team not only participated in the construction of infrastructure, but also in management, instead of transferring to local management.

4.1.1 Economic Level Differences with Cross-Border m & a Costs Along the Belt and Road

Countries along the Belt and Road include multiple Southeast Asia, South Asia, and African countries, who have weaker economic strength, and foundation in infrastructure construction than China. Thus, it is more common for that Chinese acquirers have stronger control and influence during negotiations, so economic level differences can help acquirer side to control cost of M & A.

4.1.2 Institutional Differences and Belt and Road's m & a Cost

To assess the institutional environment of countries along the Belt and Road, one path is to evaluate the level of institutional development[7]. Less developed institutional systems such as poor property rights protectation, ineffective commercial enforcement, opaque judicial and litigation systems, less developed factor markets, and inefficient market intermediaries have increased transaction costs and severely weakened the competitiveness of businesses (North,1990[8]; Peng,2003[9]). Another aspect of the institutional environment is related to institutional instability, referring to the extent to which a country's institution changes rapidly over time (Li,Poppo,&Zhou,2008)[10]. Rapid institutional change creates a high degree of uncertainty, that is, a company may find it is difficult to predict the trajectory of institutional changes and respond in a timely manner (Fulmer,2000)[11].

The protection of investors and the legal system in Southeast Asia, South Asia and West Asia and Africa is not sound compared with China. A typical example is a number of anti-China riots across Vietnam in 2014, which affected Chinese enterprises and other Asian investment with Chinese signs operating in many provinces and cities in Vietnam. Most of these riots caused serious casualties and economic losses. After the incident, the Vietnamese government did not take timely and appropriate measures to prevent the deterioration of the incident.

Thus, the greater the institutional difference among Southeast Asia, South Asia, West Asia countries and China, the higher the environmental uncertainty, which will result in excessive payment to overcome environmental uncertainty.

4.2 Timing Difference and m & a Costs Along Belt and Road

4.2.1 First Movers, Later Entrants, and Belt and Road m & a Costs

Investors who entered the market along the Belt and Road in the early stage, paid higher due to the lack of knowledge and experience of the market; and in the later stage, with the accumulation of knowledge and experience, the entering cost will gradually reduce. Later followers can avoid or reduce the costs to entry Belt and Road market. On the other hand, the first entrants set a higher entry threshold, and the subsequent followers should bear the higher costs from this respect.

4.2.2 M & a Costs Before and after the Belt and Road Strategy

Since the two sides were in the process of playing in a game, the resources of the countries and regions along the Belt and Road were at a reasonable market price level before the announcement of the Belt and Road strategy. With the announcement of the Belt and Road strategy, Chinese companies have invested, and companies from other countries follow up closely, which increases the resource cost of these markets and costs of M & A along the Belt and Road.

4.3 Companies Differ from Cross-Border Merger Costs with Belt and Road

4.3.1 Scale Differences Are Compared with the Cross-Border Merger Costs of Belt and Road

Chinese companies generally have larger business scale than those in Southeast Asia, South Asia and West Asia and Africa. Due to ability differences, Chinese enterprises with more resources undoubtedly have more influence.

Due to the uneven ability of both sides, relatively developed Chinese enterprise with higher technical level, thus less depend on Belt and Road countries , having more influence. Hence, from this point of view, Chinese enterprises are easier to obtain at more satisfactory prices, so as to well control the cost of M & A.

4.3.2 Company Attributes and Belt and Road m & a Costs

Among the enterprises conducting M & A along the Belt and Road, compared with private enterprises, state-owned enterprises have more social resources, easy to obtain low-cost funds, but also easier to obtain government policy support, thus pay excessively to achieve their target, that is, the cost of M & A will be increased accordingly. While private enterprises are hard to obtain low-cost funds, they pay more attention to cost control when conducting cross-border mergers and acquisitions, and it is relatively not likely to make excessive payment of M & A.

4.4 Industry Differences Are Compared with the Cross-Border Merger Costs of Belt and Road

Resource differences

Resources availability between two countries can also have significant effects on M & A costs. For instance, port facilities, oil & gas distribution pipeline are scarce resources to most Chinese business. To invest and acquire Sri Lanka port, Central Asia and Russia oil and gas resources, Chinese acquirer is in a relatively dependent position comparing to their acquiree. It would be more common for the Chinese acquirer to pay a higher cost to facilitate such transaction.

On the other hand, Chinese business has more advantages on industries involved with electrical equipment, communication facilities and other infrastructure construction when comparing to most countries along the Belt and Road. As a result, Chinese acquirer has stronger bargaining ability, which will be less likely to incur excessive payment and higher costs.

4.5 Knowledge Implicitability

Knowledge can be clearly expressed and effectively transferred into explicit knowledge (Explicit Knowledge) and implicit knowledge (Tacit Knowledge).In certain industries, key knowledge can not be clearly expressed through words, language or coding, which will increase uncertainty and complexity in value evaluation of M & A transactions, cost of searching information, negotiation and the difficulty of execution after the transaction. Eventually, all these factors will contribute to a greater impact on the actual cost of merger and acquisition.

M & A conditions and Belt and Road M & A costs

4.6 Strategy Matching Degree

The price of the target, in addition to the value of the target, may also be related to the degree of strategic matching. When the strategic intentions of the merger and acquisition parties match, the target side would rather assume the possibility of undervalued assets, in this case, it is easier for Chinese companies to reach transactions at a lower cost.

In the Belt and Road strategy, countries along the Belt and Road have urgent strategic intentions to build and develop electrical equipment, communication and other infrastructure, while China has a strategic intention to export production capacity. When the strategic intentions are matched, transactions are likely to reached at a lower cost.

4.7 Market Structure

Due to the different institutional systems of countries along the Belt and Road, it may cause differences in the state of competition in the internal market of each country. When facing oligopolies, partial competition and free competition, Chinese enterprises should pay different M & A costs.

5. Conclusion and Suggestions

The “Belt and Road” strategy is among Chinese national levels. Under the guidance of this strategy, Chinese enterprises have gone abroad for investment and mergers and acquisitions of countries along the Belt and Road. This paper builds a comprehensive analysis model of “Belt and Road” based on “four differences” in the system.

As Belt and Road program spans 6 economic belts and 65 countries with national differences, it is inevitable that Belt and Road M & A will encounter various differences: national strength, institution, industry and timing.

In the context of Belt and Road cross-border merger by Chinese enterprises, this study establishes a differential model that analyzes the cost of such international M & A, while in the future, more relevant researchers and realistic executors can do further research to verify and test.

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