

Economic Consequences of Acquisition between HNA Technology and Dangdang Network

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Abstract: With the development of China's market economy, mergers and acquisitions (M&A) have become an inexhaustible driving force for the growth of modern enterprises. But most M&A have failed, the economic consequences of M&A have not been consistent. This paper uses a single case study, analyzing the economic consequences of acquisition between HNA Technology and Dangdang Network. Starting from the theoretical basis, we analyze the causes of M&A and the reasons for failure, confirming the decision-making mechanism of enterprise integration. Then analyze the economic consequences of M&A in terms of financial aspects, manage aspects and market aspects. Finally, we take the lead and give advice. Appropriate leverage should be paid attention to in M&A, preparing well before the merger; abandoning short-sighted behavior, focusing on reasonable valuation and integration issues after M&A. The study contributes to the selection and implementation of M&A strategies for Chinese enterprises.

1. Introduction

Under the influence of the fifth wave of global mergers and acquisitions, with the development of China's economy, mergers and acquisitions of domestic enterprises are also in full swing. M&A is the inexhaustible power to promote the growth of modern enterprises. In recent years, domestic M&A investment has grown rapidly. Corporate M&A is an important research focus in the field of strategic management (Haleblian et al. 2009).

However, there are many risks and uncertainties in M&A, most of which end in failure. Previous studies have shown that M&A is difficult to create value, only 20% to 30% of them can create value, most of the listed companies have not significantly improved their business performance within two years, and even a few of them have damaged the interests of shareholders. The economic consequences of M&A are not completely consistent.

Therefore, this paper focuses on the case of acquisition between HNA Technology and Dangdang Network, which confirms the decision-making mechanism and economic consequences of enterprise merger. This paper finds out the experiences and lessons in the process of M&A, puts forward corresponding countermeasures and suggestions, and provides warnings and references for the selection and implementation of M&A strategies of Chinese enterprises.

Regarding the research of corporate M&A, there is already wealth of research results at home and abroad. To explore the economic consequences of corporate mergers and acquisitions, we must first clarify the purpose of corporate mergers and acquisitions. The existing literature will be summarized from the motivations and economic consequences of mergers and acquisitions.

In the literature on the causes of mergers and acquisitions at home and abroad, a large number of studies believe that the implementation of mergers and acquisitions is a rational behavior and a cautious choice under rational goals (Devers et al. 2013). However, some literatures have found that the motivation of M&A may also be due to irrational motivation. The first is technology and resources motivation. Nason and Wiklund (2018) shows that core resources are more conducive to the development of start-up enterprises, and diverse resources can help companies achieve higher levels of growth. The second is strategy and market motivation. Corporate M&A can increase market

power, have a smaller number of companies in the market, increase the power of prices at the enterprise level, reduce competition within the industry, and thereby gain monopoly profits (Colling et al. 2009). Finally, there are increasing management interests and irrational perspectives. Increased management interest is also an important motivation for companies to make decisions.

At present, domestic and foreign research methods for M&A performance mainly include event research method and accounting research method. However, there are also many risks in corporate mergers and acquisitions, including financial risk, impairment of goodwill, risk of stock price crash, and so on. Mergers and acquisitions of listed companies have significantly increased corporate financial risks, increased debt pressure caused by huge financing, and reduced solvency and profitability.

The remainder of this paper is structured as follows. Section 2 reviews the theoretical basis. Section 3 describes the acquisition, and analyzes the economic consequences of the financial, management and market aspects. Finally, Section 4 concludes with the discussion and the lessons learned from this case.

2. Theoretical basis

M&A is a collective term for mergers and acquisitions. Under market economic conditions, mergers and acquisitions are an important way to achieve company expansion. Companies acquire control of other companies through mergers and acquisitions to enhance their economic strength and ultimately achieve the company's development goals. M&A activities can be divided into different types according to different standards. According to the industry interrelationships between the main and target enterprises, mergers and acquisitions are divided into horizontal mergers, vertical mergers, and hybrid mergers. The acquisition between Dangdang and HNA Technology is a hybrid merger. The purpose is to synergize existing businesses with retail, logistics, and big data through acquisitions, expand its competitive position, and carry out a strategic transformation to its infiltrated areas.

Regarding the research on the causes of mergers and acquisitions, there are different views in the theoretical world. At present, the theoretical world is mainly divided into three aspects: efficiency theory, agency theory, and tax preference theory. Efficiency theory believes that merger and acquisition decisions have potential economic benefits, mainly to improve the company's operating performance or to obtain some form of synergy, that is, to achieve the effect of "1 + 1 > 2". The strategic restructuring hypothesis refers to the company's strategic planning through mergers and acquisitions to obtain competitive advantages. HNA Technology is optimistic about the position of Dangdang and core competitiveness in domestic e-commerce. It acquired Dangdang for strategic transformation and sought a "retail + cloud computing" business model.

Fama and Jensen (1983) believe that due to the separation of powers in modern enterprises, there is a conflict of interest between shareholders, creditors and managers, which will generate agency costs and affect company value. Due to the existence of agency costs, shareholders will take measures to restrain the manager's rights internally to avoid harming their own interests. As for external supervision, the stock market plays a supervisory role. When these mechanisms are insufficient to control agency problems, the M&A market becomes the last control. Through mergers and acquisitions, external managers can replace existing shareholders and managers and gain control of the company.

There is no unified view and conclusion on the economic consequences of mergers and acquisitions in both academia and practice. M&A performance can be divided into financial performance and non-financial performance according to whether it can be accurately measured. Financial performance refers to the financial benefits brought by mergers and acquisitions, such as increased revenue and net profit, reduced costs, and increased return on assets. Non-financial performance refers to improvements that are difficult to measure, including capital structure, corporate culture, goodwill, and strategic transformation.

3. Analysis of the acquisition

3.1 Basic situation

HNA Technology Co., Ltd. was listed in China in 1996 and belongs to the HNA Group. In December 2016, it paid \$ 6 billion in cash to successfully acquire 100% of Ingram Micro, the world's leading technology and supply chain service provider. In order to achieve Ingram Micro's landing in China, in 2017, it gradually divested its shipping business and continued its strategic transformation. In 2018, HNA Technology explored transformation and development, comprehensively transformed to the technology industry. The acquisition of Ingram Micro has significantly increased HNA's technology assets and liabilities, with its assets soaring from 12.8 billion to 118 billion. At the same time, as 70% of the acquisition funds are bank loans, the asset-liability ratio has surged from 4.35% to 85.53%. Once the profitability of the company declines, the debts that need to be repaid will affect the survival of the company, which is a knife hanging on the head of HNA Technology.

Dangdang is a well-known comprehensive online shopping mall. Dangdang was listed on the New York Stock Exchange in 2010. It is the first B2C online mall in China that is completely based on online business and is listed in the United States. Dangdang became the largest online bookstore in China and is called "China's Amazon". However, since 2014, the domestic book e-commerce market has changed, and JD.com, Amazon, and other merchants have developed strongly. In the B2C book trading market in 2017, JD.com surpassed Dangdang with a 36.2% market share. Dangdang is no longer the giant of domestic online bookstores.

3.2 Motivation of M&A and Failure Reasons

Table.1. Whole process of acquisition between HNA Technology and Dangdang Network

Time	Acquisition matters
January 2018	HNA Technology starts restructuring
April 12, 2018	The reorganization plan was disclosed. It is planned to issue ¥ 4.06 billion shares and pay ¥ 3.44 billion in cash to purchase 100% equity of Beijing Dangdang Information Technology Co., Ltd. and 100% equity of Beijing Dangdang Kewen E-commerce Co., Ltd.
June 2018	HNA Technology delayed the reply of the "Second Inquiry Letter" on the Shanghai Stock Exchange for merger
August 2018	Differences between the two sides continue to intensify
September 20, 2018	HNA Technology announces termination of the merger

Table 1 shows the entire acquisition process. The reasons for the acquisition of Dangdang by HNA Technology are as follows:

In terms of business operation, it can play a synergistic effect of "1 + 1 > 2"; from a strategic perspective, mergers and acquisitions can promote the strategic transformation of HNA Technology. In terms of operations, after the acquisition of Ingram Micro by HNA Technology in 2016, its main business gradually transformed from transportation to integrated services for IT product distribution and supply chain. Dangdang can cooperate with HNA's existing business in depth to promote the business model of "retail + cloud computing". In terms of strategy, in the current era of the digital economy, artificial intelligence, big data, and cloud computing is developing rapidly. The acquisition of HNA is to promote the development of the cloud market business, enable cross-selling of products and user information sharing. Dangdang collaborates to develop education and media services and new retail businesses. This acquisition is to enhance the company's cloud service capabilities and to seize the opportunity to realize the company's technological transformation.

However, the acquisition failed, what caused the acquisition failure? First of all, the risk of debt service is too high. After the acquisition of Ingram Micro by HNA Technology, it has nearly \$ 4 billion in long-term loans. Second is the high risk of goodwill impairment. If the successful acquisition of Dangdang, the goodwill will exceed 20 billion, accounting for 97.27% of net assets. Once the impairment is accrued, it will have a significant impact on corporate profits. From the

perspective of the company's management, there is a problem of management's arrogance in this merger. In 2018, HNA Technology planned to acquire Dangdang for 7.5 billion. At this time, the book value of Dangdang was only 31.79 million, and the value-added rate reached 235%.

3.3 Analysis of economic consequences

The economic consequences of mergers and acquisitions will be analyzed from the financial, management, and market perspectives. The relevant financial indicators of HNA Technology from 2015 to 2018 are shown in Figure 1. The failure of mergers and acquisitions has exposed the financial problems of enterprises.

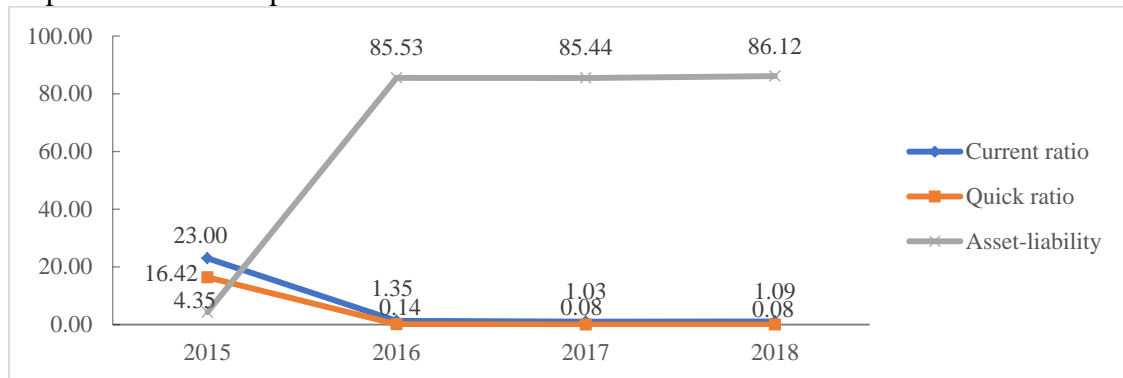


Figure 1. Trend chart of some financial indicators of HNA Technology from 2015 to 2018

As shown in Figure 1, after the successful acquisition of Ingram Micro by HNA Technology at the end of 2016, the company's current ratio and cash ratio decreased significantly, and the current ratio showed a downward trend. Generally speaking, a liquidity ratio of about 2 is more appropriate, but HNA Technology has obvious poor liquidity, short-term debt solvency and strong liquidity risk. Once the company is short of cash, payment difficulties may occur and face a financial crisis. In 2016, HNA's asset-liability ratio jumped from 4% to 85.53%, and maintained an upward trend, which indicates that under a high asset-liability ratio, enterprises have not properly controlled the capital structure, and their long-term debt repayment ability is weak. The financial expenses in 2018 were 3.7 billion, and the money made by enterprises was basically used to repay the debts due. The profit growth rate in 2018 was -82.53%, which decreased from 1.1 billion to 200 million last year. It indicates that the growth of the company is not good. Such development capabilities will be questioned by investors and creditors.

Second, the failure of this acquisition has exposed serious management problems. Management did not do a good job of risk control, including debt risk control and goodwill risk control. The company has 15 billion of goodwill, accounting for 89% of net assets. Under such a high level of goodwill, he does not think about how to improve profitability, but instead pursues higher-risk acquisitions. Once the acquisition is successful, the goodwill exceeding 20 billion yuan will further increase the risk. Management did not effectively integrate Ingram Micro, which has successfully acquired. In the case that the previous merger and acquisition did not integrate well, it blindly diversified and expanded, exposing serious management problems. In addition, the failure of mergers and acquisitions has also affected corporate reputation. Dangdang publicly stated that the failure of the merger was due to a problem with the liquidity of HNA Technology. This may affect investor confidence and damage corporate reputation.

Finally, on the market side, the first consequence is to hurt stock prices. At the end of 2017, HNA Technology had a net asset of 4.63 yuan per share, a stock price of 6.11 yuan, and a P / B ratio of 1.32. At this time, the P / B ratio is greater than 1, indicating that the market is optimistic about the development prospects of HNA Technology. With the failure of mergers and acquisitions, at the end of 2018, HNA Technology's stock price fell by nearly 60%, and its price-to-book ratio fell to 0.59. Second is the frustration of core competitiveness. In today's economic globalization, global competition is intensifying, and almost all companies are striving to build their core competitiveness. Only companies with core competitiveness and market share can obtain good profitability and

development capabilities. However, with the failure of mergers and acquisitions, cloud platforms are no longer the core competitiveness of HNA Technology. In the end, the failure of M&A was also a missed opportunity for Dangdang while the market share of Dangdang continues to decline. As a veteran e-commerce company, its future development prospects are not optimistic.

4. Conclusion

By analyzing the case of acquisition between HNA Technology and Dangdang Network, the following points can be concluded.

First of all, not being fully prepared is one of the important reasons for the failure of mergers and acquisitions, and the risk control of finance is not well done. For HNA Technology, almost all of the profits in 2018 are used to repay due debts. In this case, mergers and acquisitions and reorganizations are still being initiated. This approach may cause huge losses or even insolvency at any time. The delayed reply to the "Second Inquiry Letter" of the Shanghai Stock Exchange indicates that the company is not ready for M&A and cannot explain the questions raised by investors. Secondly, management's arrogance directly led to the failure of mergers and acquisitions. Management is too short-sighted, neglecting mergers and acquisitions integration, and failing to formulate strategies from the perspective of long-term development. Finally, the failure of the merger and acquisition caused HNA Technology to miss important investment opportunities.

Therefore, enterprises should pay attention to making adequate preparations when formulating merger and acquisition plans, including controlling financial risks, a) do a feasibility study, and b) do a capacity preparation and capital budget. In the strategic planning of mergers and acquisitions, we must fully consider the operating conditions and development of the target enterprise. Reasonable valuations, such as the P / B ratio method, the P / S ratio method, and the P / E ratio method, can be used to prevent underestimation of M&A risks and increase the probability of successful M&A. Finally, companies need to focus on integration issues after mergers and acquisitions, including cultural integration, strategic integration, organizational integration, and human resource integration. The success or failure of M&A does not depend on whether the M&A transaction is completed, but whether the operating performance has improved after the M&A.

This article focuses on the case of acquisition between HNA technology and Dangdang Network, which contributes to the literature confirming the decision-making mechanism and economic consequences of enterprise integration. This paper also finds out the experiences and lessons in the process of M&A, contributes to the selection and the implementation of M&A strategies for Chinese enterprises.

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