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# Solving China's M&A Haze

Multinationals creating partnerships with Chinese companies can adopt eight best practices to help manage the unique complexities they often encounter.

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**By John Jullens**

It used to be that the only way for multinational corporations (MNCs) to enter China was through a joint venture with a local Chinese partner—typically a government-appointed, hopelessly backward state-owned enterprise (SOE). Foreign ownership was capped at 50 percent, and MNCs faced numerous hurdles, such as local supplier requirements and mandatory technology transfer agreements.

Today's MNCs have more options, including majority joint ventures, wholly owned foreign enterprises, and, in most sectors, outright acquisitions of local Chinese companies. At the same time, many of the old restrictions have been lifted or modified. But despite this progress, creating successful Sino–foreign partnerships remains as challenging as ever. I've seen even well-known MNCs with extensive M&A experience stumble—sometimes badly.

What's causing their missteps? All too often, Western executives simply lack the in-depth knowledge required to navigate the countless pitfalls unique to China's business environment that they are sure to encounter, from the pre-deal phase through the post-merger integration. Here are eight battle-tested best practices that can help.

**1. Focus on filling capability gaps.** Western executives often find China complicated or downright incomprehensible, egged on, of course, by business book writers (and management consultants) with a vested interest in perpetuating that view. This perception may inadvertently lead executives to select Chinese partners on the basis of which company they're most comfortable with personally. Instead, MNCs should clearly identify up front what capabilities and assets they'll actually need to succeed, and choose potential partners with a solid business rationale.

**2. Don't be fooled by *guanxi.*** Relationships are still an important part of gaining access and doing business in China. However, MNCs must be aware that the transactional nature of these relationships goes far beyond Western notions of networking. The Chinese concept of *guanxi* is based on mutually reinforcing cycles of reciprocity and influence, often involving gifts and favors. Although certainly not synonymous with corruption, *guanxi* can easily lead to activities that would be illegal elsewhere. MNCs should be wary of entering into partnerships primarily to leverage perceived *guanxi,* as the strength and relevance of such relationships are difficult to measure and often exaggerated. In fact, the importance of *guanxi* has been declining in recent years, especially in less-regulated sectors, where success is increasingly a function of firm strategy and performance.

**3. Drop the marriage metaphor.** Western companies tend to view a partnership as a marriage: long term and monogamous. But China is a large and diverse country,

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where most industries are still in the early stages of development and highly fragmented. Rather than a single partnership, many MNCs need a portfolio of ventures. They'll be helped by China's lax antitrust regulation, which is much friendlier to such arrangements than is regulation in the United States and Western Europe. For example, it is not at all unusual (or illegal) for an MNC to form joint ventures with two Chinese firms that directly compete with each other in the same industry sector.

**4. Keep on triangulating.** The absence of high-quality data can make it difficult for MNCs to identify target companies (and their value). The trouble is, a lot of important data simply isn't publicly available. But MNCs can sometimes still gain access to this information with the right government connections or through relationships within the Chinese business community. Although these methods can be successful, executives also need to become unusually adept at triangulating information from many different sources—which, in China, requires a bit of science and a lot of art.

**5. Conduct a thorough stakeholder analysis.** Like the lack of good data, the lack of transparency can be baffling even to seasoned China hands. For example, it is notoriously difficult to determine the true ownership structure of Chinese companies, including well-known ones such as Haier and Huawei. MNCs need to conduct a thorough stakeholder analysis to identify the key decision makers, and to understand their interests and objectives. Moreover, it is important to recognize that the Chinese government is almost always involved—especially when the company is an important source of local tax revenues and employment—even when it's nowhere to be found on any official org chart. This is true for privately held companies, too (many of which were, of course, SOEs not long ago).

**6. Clarify decision rights up front.** It's common practice in the West to negotiate the important parts of a deal up front and work out the details later, but this can be problematic in China. A key example involves decision rights. It's crucial that companies define decision-making processes, roles, and responsibilities at the outset, to avoid unpleasant surprises. One MNC learned this the hard way when the management team of its Chinese partner was suddenly exchanged with that of its direct competitor.

**7. Go easy on the integration.** Because even the best Chinese companies remain somewhat unsophisticated compared with their Western counterparts, it is often tempting for MNCs to immediately impose their own way of working on their Chinese partner. The danger, however, is that the very qualities that made the Chinese partner attractive in the first place will be destroyed as costs rise and business operations become overly complex and bureaucratic. Although most Chinese firms could certainly benefit from some support, MNCs have to be deliberate about what to change and what to leave alone, and not make too many changes too soon.

**8. Find ways to earn trust.** Chinese businesspeople and regulators can be highly suspicious of Western motives, an attitude stemming from repeated humiliations at the hands of the West in the 19th and early 20th centuries—the memory of which is still very much alive in China today. Their concerns are only exacerbated by most MNCs' market-based, short-term profit orientation, which can easily be misinterpreted as exploitation. As a result, it is important for MNCs to stress their long-term commitment to their Chinese partner. They also need to empower the deal team—having to check with headquarters for every important decision doesn't exactly promote trust, especially because Chinese managers tend to make decisions quickly—and make sure their most senior executives are actively involved in discussions.

M&A remains essential to virtually all MNCs' China strategies. This includes the hapless latecomers searching for a suitable partner among the few remaining high-potential candidates; companies that didn't get it right the first time and that are now saddled with underperforming partnerships; and those that have been successful but are discovering that China's rapidly changing business and regulatory climate demands entirely new arrangements. These eight best practices won't solve every problem, but they'll go a long way toward ensuring that deals run smoothly—and end in successful partnerships. +

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