

A Brief Analysis of the Risk Control Issues of ChemChina's Overseas M&A of Syngenta

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Abstract: In the past 20 years, overseas M&As have gradually become an important investment channel and have an important position in foreign investment. According to the background information of ChemChina's overseas M&A of Syngenta, the specific circumstances of legal risks, financial risks and cultural risks in the process of ChemChina's overseas M&A of Syngenta are the starting point for analysis to analyze the reasons for the formation of specific risk factors in this case, summarizing the risk prevention and control measures of Chinese enterprises' overseas M&A from both macro and micro perspectives.

Keywords: Overseas M&A risks; Legal risk; Financial risk; Cultural risk

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1. Introduction

The case of ChemChina's acquisition of Syngenta is a typical representative of the case of China's M&A of well-known overseas companies. Analyzing the risks and causes behind M&As is a cornerstone for effectively reducing the risks of overseas M&As in the future.

1.1. Background introduction to both parties

Both ChemChina and Syngenta are Fortune 500 companies. The outstanding industry position and the high price have made this merger attract the attention of the audience.

The strategic goal of ChemChina is to build a world-class, science and technology-led, multi-level, multi-business, and comprehensive chemical enterprise. Syngenta is a world-class agricultural technology company. Its sales have been declining year by year since 2014, but it still needs to spend billions of dollars in R&D expenditure each year. The strong capital pressure and the combination of multiple industry giants have made Syngenta accepted the M&A invitation from ChemChina.

1.2. The merger and acquisition process

On February 3, 2016, Swiss time, ChemChina announced a public tender offer to acquire Syngenta. According to ChemChina's public tender offer document on March 8, 2016, ChemChina's tender offered to acquire 100% of Syngenta's shares, which was priced at US\$465 per share, US\$93 per depositary receipt and a special dividend of US\$5 per share. The total price was 43 billion U.S. dollars. Subsequently, China, the United States, the European Union, and Mexico successively reviewed and approved this merger. On

June 27, 2017, ChemChina announced that it had completed the acquisition of Syngenta. Although the transaction price was 43 billion U.S. dollars, the actual total capital required was 50.4 billion U.S. dollars.

2. Types of risks in ChemChina's overseas M&A of Syngenta

There are many risks in the entire process of ChemChina's acquisition of Syngenta. Introducing legal risks, cultural risks and financial risks in M&As is conducive to detailed analysis of the causes of risks.

2.1. Legal risk

Although China's M&A laws and regulations have been gradually improving, there are still many shortcomings. In contrast, the Western legal system is relatively mature. Therefore, in the cross-border M&As of Chinese-funded enterprises, legal risks still have an impact on the success of M&As. In the process of ChemChina's acquisition of Syngenta, international antitrust laws, international investment laws, and relevant laws and regulations of China, the United States, Mexico and the European Union have affected the legal risks of the merger. Legal risks specifically include the review and approval risks of cross-border M&A transactions and labor laws and regulations risks.

Syngenta is also a high-tech company with many agricultural technologies and a leading company in the agricultural technology industry. If ChemChina acquires Syngenta, there is a possibility that Syngenta's core technology and brand effect would be exported to China. This has led to the European Union, the United States and other obstacles to the review of M&As, for example, the US Federal Trade Commission has reviewed whether the merger has been in compliance with the US antitrust and consumer protection laws ^[1]. Therefore, there has been a risk of review and approval risks of cross-border M&A transactions. Regarding the risks of labor laws and regulations, ChemChina has paid less attention to human resources related issues. Human resources due diligence still has a lot of room for development, which brings potential labor risks to M&As. According to news reports, Swiss labor unions expressed concern about M&As. Concerns about layoffs and organized demonstrations to protest the chemical group's acquisition of Syngenta. If ChemChina is unable to formulate effective countermeasures to solve the labor laws and regulations of Syngenta employees in M&As, the merger may fall into a stalemate, which would seriously cause the merger to fail.

2.2. Cultural risk

As the two sides have different value of the company, management style and so on. M&As are bound to be very difficult to achieve synergies. If cultural risks cannot be dealt with, it may also reduce the value of the company, affect all aspects of business operations, and even failing to achieve complementary benefits and synergies. In terms of culture, the main risks are the employee collaboration risk of both parties to the merger and the corporate culture integration risk.

As for the employee collaboration risk of both parties to the merger, the cultural backgrounds and language backgrounds of Chinese and Swiss employees are very different, and there would be big problems in business cooperation. A well-known consulting company, Mercer Consulting Co., Ltd., has studied failed merger cases and found that 67% of employees experienced delays in work collaboration due to cultural issues. For example, Eastern decision-makers usually did not explain the reasons for their decisions in downstream communications. In the West, decision makers usually explain the decision to help the executor better understand the reasons behind, so more attention needs to pay for this aspect ^[2].

The risk of corporate culture integration is one of the core issues throughout the M&A process. Usually the most obvious phenomenon of the increase in the difficulty of M&As is the internal division and opposition of employees. In fact, it is because the enterprises after M&As do not have common values and it is difficult for employees to develop a sense of identity. And this is the concrete manifestation of the

failure of M&As to integrate successfully. As early as 2010, Deloitte Touche Tohmatsu CPAs has found that 53% of the failures of Chinese companies' overseas M&As were caused by cultural issues.

2.3. Financial risk

Controlling financial risks is one of the keys for companies to complete M&As. Failure to control financial risks within a reasonable range may cause a fatal blow to M&As. Many companies cause financial risks in M&As because of financing and loan repayment problems.

The total amount required for this transaction as a whole is US\$50.4 billion. ChemChina has set up a three-tier structure consisting of six SPV companies. The hierarchical structure of ChemChina's acquisition of Syngenta is in **Figure 1**.

Hierarchical structure	
China National Chemical Corporation	mainland China
China National Agrochemical Corporation	
CNAC (HK) Holdings Company Limited (SPV 1)	Hong Kong, China
(HK) Investment Company Limited (SPV 2)	
CNAC Century (HK) Company Limited (SPV 3)	
CNAC Saturn (HK) Company Limited (SPV 4)	
CNAC Century (LUX) S.ARL (SPV 5)	Europe
CNAC Saturn (NL) BVS (SPV 6)	

Figure 1. The hierarchical structure of ChemChina's acquisition of Syngenta

ChemChina's special fund of 15 billion US dollars was first concentrated on SPV1. Subsequently, 15 billion US dollars of registered capital plus 5 billion US dollars of priority funds from China CITIC Bank, a total of 20 billion US dollars were injected into SPV2. After that, the six SPVs raised a total of 45 billion U.S. dollars. In addition, the two major syndicates, CITIC and HSBC, set aside US\$400 million for working capital loans. After the acquisition, Syngenta also obtained a US\$5 billion loan from HSBC for debt restructuring. The amount of M&As is huge and the design of SPV is complicated. It is necessary to examine the financial strength of potential partners, the background of the actual controller of the company, industrial background, decision-making efficiency, merger experience and many other factors. A little carelessness may lead to merger failure. Therefore, there are financial risks in this case.

From 2012 to 2015, the asset-liability ratio disclosed in the annual report of ChemChina was 84.88% in 2012, 84.63% in 2013, 81.47% in 2014, and 81.03% in 2015. The average asset-liability ratio corresponding to China's chemical industry is about 30%. In comparison, the industry average is much lower than that of ChemChina. In the case of low corporate profitability and high asset-liability ratio, internal financing cannot help ChemChina complete the transaction. Therefore, ChemChina's financing loan of US\$25.4 billion from social institutions in this M&A. Besides, high debt would make enterprises bear large loan costs, which would increase the burden on enterprises and increase the pressure on cash flow. On the other hand, they would also increase the financial risks of enterprises, making them prone to insolvency, bankruptcy and bankruptcy. Obviously, ChemChina has a loan repayment risk.

3. Reasons for the risks of ChemChina's overseas acquisition of Syngenta

In the process of company M&As, strategy is the foundation, and details should be the most important.

Analyze and study the details of mergers acquisitions through the three angles of law, culture and finance, and further explore the methods of prevention and control of M&As risks.

3.1. Reasons for legal risks

In overseas M&As, ChemChina and Syngenta are bound by the legal systems of their respective countries. The regulations on corporate social responsibility, social insurance funds, overtime subsidies, etc. are not the same, which would arise When the rights and obligations of the two parties do not match, the application of the law would also be contradictory. The following discusses the causes of legal risks from two perspectives.

Firstly, there is an Information asymmetry between the M&A parties. ChemChina and Syngenta are geographically far apart, and many times when conducting M&As, they can only be judged on the basis of data on the surface, and it is impossible to conduct on-site inspections. However, it is difficult to judge whether the data itself is true or not. Both parties to the merger may actively or passively hide part of the data for their own benefit.

Another one reason is lacking of detailed human resources due diligence. There is a large gap in the labor-related systems between the two countries, so it is very important to conduct careful human resources due diligence before M&A transactions. The official information released by ChemChina did not mention whether due diligence has been conducted for human resources consulting, nor did it indicate the arrangements for Swiss Syngenta employees after the merger. However, protests against the merger broke out in Switzerland, which shows that ChemChina is still inadequate in handling this issue.

3.2. Reasons for cultural risk

M&A is a combination of capital, raw materials, technology, and management, and the deep inner meaning is the collision, friction, fusion, and absorption of two different cultures. There are two reasons for the emergence of cultural risks.

The first is that the company lacks international talents with integrated experience. After overseas mergers and acquisitions, employees of both parties need to continuously deepen cooperation and work together to build the merged company into a larger and stronger company. However, many disputes and contradictions often arise during the integration process. There are big differences between Chinese and foreigners in terms of daily behavior and work rhythm. International talents with both negotiation experience and integration experience are scarce in companies, so companies would not be able to identify certain important risks before negotiations, or underestimate the difficulty of integration.

Another one reason is that corporate development philosophy is different. ChemChina hopes to develop green environmental protection technology and is committed to environmental protection and greenness to reduce pollution. However, Syngenta has repeatedly been accused of producing and selling products that pollute the environment. It is deeply caught in public opinion, litigation disputes and large amounts of compensation. It can be seen that although Syngenta is deeply engaged in agricultural high-tech products, the development concepts of the two are different and integrated. High difficulty. In addition, ChemChina's leadership approach is to pass orders from top to bottom, and the internal levels of the company are distinct. This corporate culture favors the rule of man rather than the rule of law. Syngenta is more market-oriented. From the above two aspects, it can be seen that the two are quite different. Whether it can be truly integrated, opening up the Chinese market and new opportunities for Syngenta is still unknown.

3.3. Reasons for financial risk

The financial risk of cross-border M&As refers to the circumstances in which the financial situation of the company deteriorates or financial losses occur due to improper financial control in the process of overseas

M&As [3]. The basis of identifying and controlling financial risks is to correctly understand the causes behind financial risks. Two main reasons lead to the financial risks.

M&A price is unreasonable. Due to the sluggish agricultural product market, the international pesticide market has nearly zero growth from 2014 to 2016. As for the seed market, especially the genetically modified seed market, it is difficult to continue to develop and is relatively saturated. But under this circumstance, ChemChina continued to acquire Syngenta, and also offered a consideration offer of US\$43 billion. This price is much higher than the market price. The relationship between the Syngenta’s 2016-2019 sales and EBITDA is in **Figure 2** as follow.

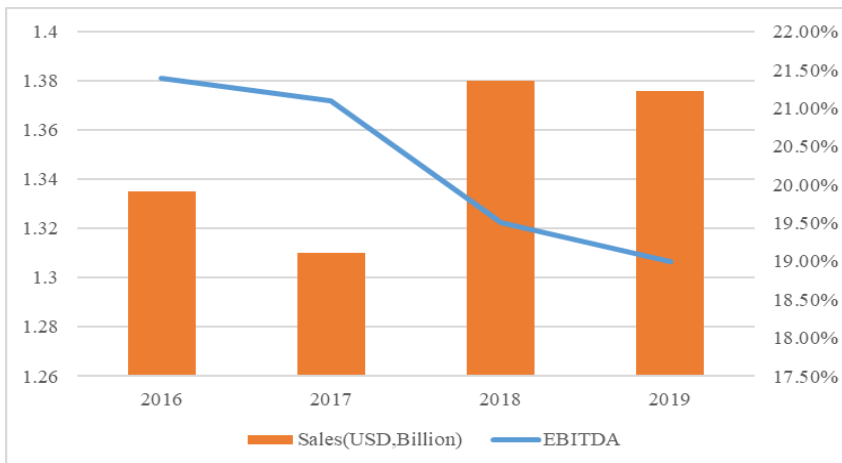


Figure 2. The relationship between the Syngenta’s 2016-2019 sales and EBITDA

According to **Figure 2**, From 2016 to 2019, Syngenta’s sales and EBITDA were relatively stable, without significant changes. Sales remained roughly at the level of 13 billion U.S. dollars, and EBITDA remained at the level of 2.3 billion U.S. dollars. However, EBITDA has been on a downward trend, from 21% in 2016 to 19% in 2019, a drop of two percentage points.

Another factor affecting financial risks is the unstable profitability of the acquirer. According to the consolidated statements of the three years before ChemChina’s merger and acquisition, the net profit attributable to the parent company has been negative for four consecutive years: 2012-2015 net losses reached 1.178 billion yuan, 857 million yuan, 1.146 billion yuan and 828 million yuan. Although losing money for 4 consecutive years, ChemChina still chose to acquire Syngenta with the help of high venture capital investment in 2016 to expand its own body. However, the solvency of ChemChina after the merger is still very unsatisfactory. Although it is still profitable, most of the profit is based on unstable non-operating income rather than the company’s main business income.

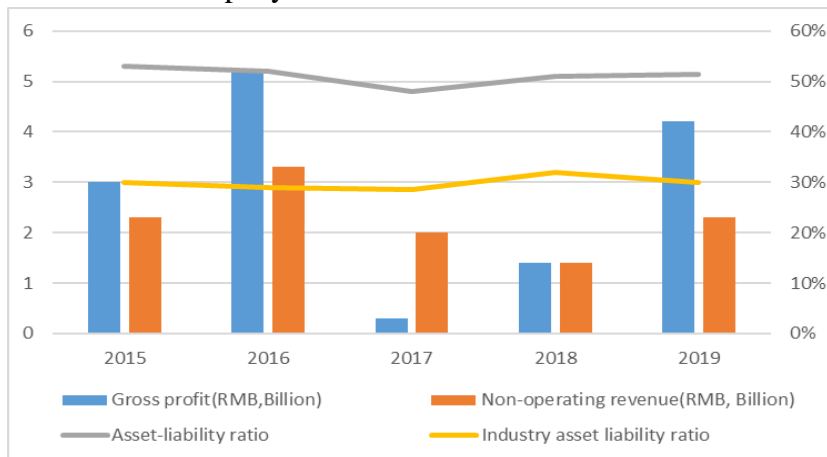


Figure 3. ChemChina’s revenue in 2015-2019

According to **Figure 3**, ChemChina's total profit, non-operating income, and debt-to-asset ratio from 2015 to 2019 can be seen directly from the figure, which is an important indicator of debt solvency-the debt-to-asset ratio has been at a high level. The asset-liability ratio in 2016 was 81%, which corresponds to an industry average of 44%. In 2017, when the merger was completed, it dropped to 73%. In 2017, the industry asset-liability ratio averaged 43%, and it gradually increased to 78% in 2018, And the industry average in 2018 is 48%.

4. Suggestions on strengthening the risk prevention and control measures of Chinese enterprises' overseas M&As

The solution to the risk prevention of Chinese enterprises' overseas M&As requires not only the efforts of the enterprises themselves, but also the strong government forces. The two complement each other on this issue and are indispensable. Only the joint efforts of enterprises and the government can accelerate the development of Chinese enterprises to the outside world.

4.1. Macro level

China's capital market lags behind Western countries, and the international competitiveness of domestic companies still has a lot of room for improvement. If listed companies want to further develop through cross-border M&As, the support of national policies and regulations is indispensable ^[4]. Therefore, the country can improve the laws and regulations on M&As and accelerate the establishment of special laws and regulations for overseas M&As, such as the "Foreign Investment Risk Assessment Modernization Act 2018" passed by the US Congress, and establish special laws to protect the rights and interests of Chinese companies to better promote Chinese enterprises "go out." The state can establish a sound merger review system. Cross-border M&As in developed countries have a history of over 100 years, and long-term operations have left rich and practical management experience. The China Securities Regulatory Commission can start to establish a comprehensive review system for cross-border M&As, regulate M&As operations, and control merger risks. Relevant government departments can strengthen the construction of information platforms for Chinese companies' overseas investment services and establish research centers in different countries, such as the establishment of the Singapore Research Department.

4.2. Micro level

The main body of risk prevention in cross-border M&As is the enterprise, and the government and society can only play an assisting role. Controlling M&A risks is a long and complicated process. Chinese companies should focus on their own development strategies when choosing M&As. Specifically, companies can try from the following three aspects. The first is to establish or hire a professional team to assist in M&As integration. You can hire a well-known human resource consulting company to assist in M&As, and use methods such as global competition to recruit foreign executives or local Chinese, instead of focusing on China ^[5]. The second is to formulate a complete M&A investigation plan. In the early stage of corporate M&As, the merging party should conduct detailed due diligence in taxation, human resources, etc., to understand all the information of the target acquisition company as clearly as possible ^[6]. The third is to respect the background of both parties and strengthen the training of language skills. Business managers should pay attention to explanations during downward communication, and feedback during upward communication. In parallel communication, they should connect empathy. When making decisions, they should not only start from their own cultural background. They need to consider the attitudes of people from different cultural backgrounds.

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