

Taking Geely's Acquisition of Volvo as an Example to Analyze the Development of Automotive Industry in China

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Abstract. The research background of this paper is the global growth of foreign direct investment and the potential of the Chinese automotive market, with a focus on Geely's acquisition of Volvo. The paper analyzes the acquisition motives, financing methods, market risks, and competitive prospects. The research aims to explore the reasons, impacts, and future development prospects of Geely's acquisition of Volvo. Geely's acquisition of Volvo is mainly aimed at increasing market share and compensating for the shortcomings of its own independent brands. After the acquisition, Geely can enter the ranks of second-tier luxury brands and upgrade its own brand with the help of Volvo's technology and brand advantages. Geely has adopted various financing methods, including domestic bank loans and equity financing, but still faces debt repayment pressure and market volatility risks. However, with Volvo's inclusion, Geely can gain stronger competitiveness in the high-end luxury car market. The addition of Volvo could help Geely expand its market share in the luxury brand segment. Geely will further enhance its brand influence and market performance through the development of the new Lynk & Co joint venture with Volvo and the high-end electric vehicle brand Polestar.

Keywords: Volvo Cars, Geely Auto, Car Acquisition.

1. Introduction

Since 2004, global foreign direct investment (FDI) has been rapidly increasing. In 2007, the total FDI reached \$1,833 billion, showing a 30% year-on-year growth. Developing countries and regions also reached a historical high in FDI inflows, amounting to \$500 billion in the same year. Despite the subsequent global financial crisis slowing down the world economy, China's non-financial FDI continued to grow steadily, accumulating \$43.3 billion [1].

In February 2009, China surpassed the United States in automobile sales and, on October 20th of the same year, became the world's largest automobile market after producing its 10 millionth vehicle. In the same year, sales of domestic brands in China surpassed those of joint-venture brands for the first time. This not only demonstrated the immense potential of the Chinese automotive market but also indicated the gradual emergence of Chinese domestic brands in the international market.

During the negative impact of the financial crisis and the flourishing development of the Chinese automotive industry, Ford's management became chaotic due to prolonged and large-scale acquisitions, leading the company to quickly incur a massive \$15 billion loss. To stabilize the company, the newly appointed CEO, Alan Mulally, started selling off some of its brands. In 2008, Volvo, which had been acquired by Ford in 1999, suffered a full-year pre-tax loss of \$1.5 billion, prompting Ford to put its automotive business up for sale in December 2008.

In 2010, Geely successfully acquired Volvo for \$1.8 billion, which Ford had purchased in 1999. The acquisition included 100% ownership, nine product series, three cutting-edge platforms, over 2,400 global networks, talents, brands, and a crucial supplier system [2].

The remaining sections of this paper are organized as follows: The second section analyzes Geely's motives and objectives in acquiring Volvo from the perspectives of market share, industrial weaknesses, and operating models. The third section examines the financing methods used by Geely for the acquisition and the potential risks after the financing. Finally, the fourth section discusses the development prospects of Geely-owned Volvo after the acquisition.

2. Motivations and Target Strategy

2.1. Filling the Gap in the Luxury Segment of Independent Brands

The most immediate benefit Geely Automobile gained from acquiring Volvo was an increase in market share, leading to a qualitative leap in annual sales post-acquisition. Developed countries have their own globally renowned first or second-tier luxury automobile brands, each with a substantial market share, such as Germany's Mercedes-Benz, BMW, Audi, Japan's Lexus, South Korea's Hyundai, and the United States' Lincoln. However, China lacked a luxury automotive brand with a similar stature. Prior to the acquisition of Volvo, Geely's market positioning in China was focused on everyday family vehicles. The acquisition of Volvo provided Geely with the opportunity to enter the ranks of second-tier luxury brands.

2.2. Addressing Industry Weaknesses

Under the support of national policies, Chinese domestic brands developed rapidly and began expanding globally. However, many domestic automobiles lacked matching technology, networks, and product competitiveness. Geely needed Volvo's technological, networking, product, and branding advantages to compensate for the slow development and immature products of Chinese domestic brands during their early stages. Volvo is renowned for its safety features, which contribute to its large customer base. Since the 1970s, Volvo has collaborated with the Insurance Institute for Highway Safety (IIHS) in the United States, leading safety standards for over 40 years. The first-generation XC90 earned the "Top Safety Pick+" award in 2014. Volvo V40 has maintained the highest overall score in Euro NCAP testing in Europe to date. According to Folksam, a Swedish insurance company's analysis of ten years of real insurance data from 2003 to 2013, all Volvo products surpassed the industry average in safety by over 40%, with some products exceeding 60% above the average level [3]. After the acquisition, Geely can utilize this safety reputation to expand the "Geely Automobile" brand into broader markets and gain wider recognition for its own vehicles' infotainment and chassis through Volvo's core safety technologies. Furthermore, after being acquired by Geely, Volvo shifted its focus to the promising field of new energy vehicles and planned to introduce a full range of new energy-powered models in the future. To achieve this goal, Volvo independently developed and manufactured the strongest powertrain system, "Drive-E Powertrains," which includes eight engines in two series (gasoline/diesel) and an 8-speed automatic transmission, as well as a 6-speed manual transmission. This powertrain system not only features small displacement, high efficiency, and low emissions, achieving a perfect balance between power and environmental protection, but also incorporates innovative elements of intelligence and electrification [4]. In pursuit of its grand vision of "zero emissions, zero casualties" by 2020, Volvo has not only proposed the Drive-E powertrain for sustainable development but also introduced two technology innovation sub-brands, Sensus and IntelliSafe, focusing on mobility connectivity and road safety, respectively.

2.3. Need for Changes in Volvo's Operating Model

Since Ford's acquisition of Volvo for \$6.45 billion in 1999, Ford invested heavily in management efforts to restore the former glory of this esteemed luxury car manufacturer. However, the influx of a large number of middle and senior management personnel from Ford gradually deprived Volvo of its autonomy and disrupted its rhythm. Under Ford's cost-cutting requirements, Volvo's research and development investments declined year after year, making its operations increasingly challenging and leading to declining sales.

Asia

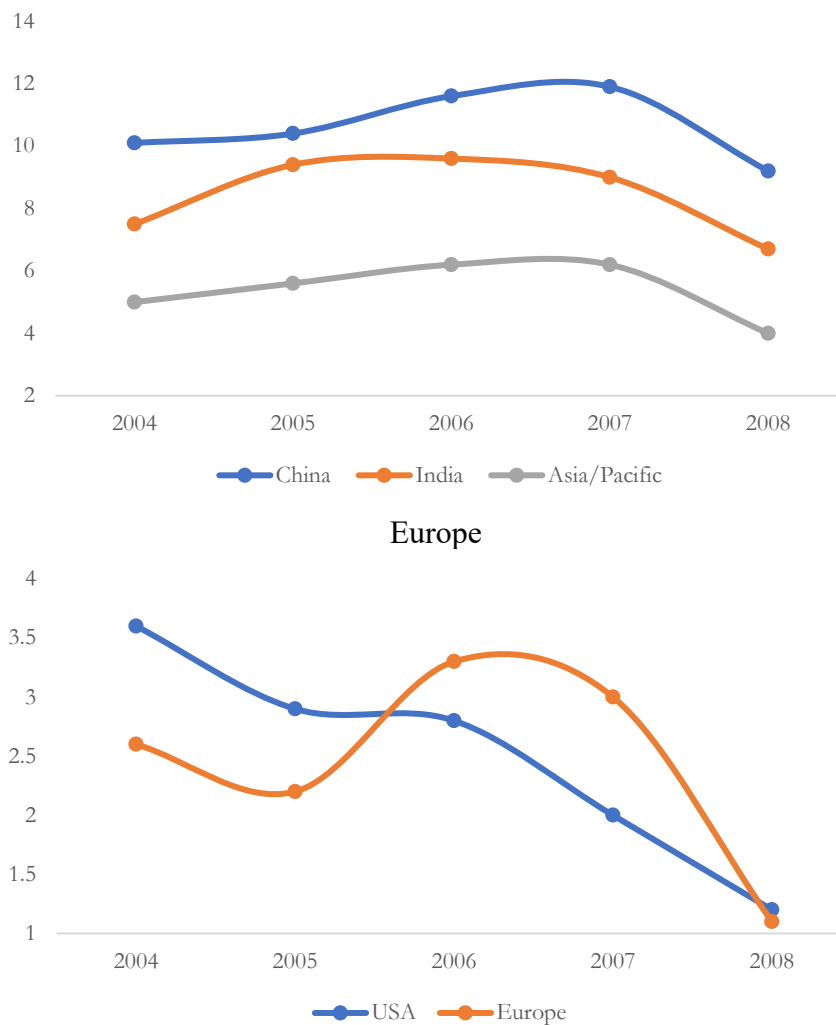


Figure 1 Growth in Asia and Europe (%)

Data source: The Volvo Group 2008

Photo credit: Original

As shown in Figure 1, starting from 2004, Volvo Group's total operating income began to decline in the United States and Europe, and in 2007, it experienced a sharp drop in China, India, and the Asia-Pacific region. At this moment, Volvo is in urgent need of a new management approach and substantial financial support to stabilize its company's condition. Geely Automobile, at this juncture, comes with a fresh management approach and the backing of China's national policies, providing Volvo Group with a new and promising path through its acquisition.

3. Financing Sources and Market Risks

3.1. Financing Methods

Before acquiring Volvo, Geely Holding Group had only been in the automotive market for about ten years. However, it acquired Volvo, which had been established for nearly ninety years. Volvo was Sweden's largest car company and maintained \$14.7 billion (approximately 100 billion RMB) in sales revenue even in the severe financial crisis of 2008. On the other hand, Geely Group had only entered the automotive industry in 1997 and began independent research and development of core automotive components in 2002. At that time, Geely's brand core was to maintain good quality based on low prices. Before the acquisition of Volvo, Geely Automobile sold around 320,000 vehicles in 2009, with revenue of 14.2 billion RMB and a profit of 1.3 billion RMB [5]. Volvo was founded in 1927 and is a long-standing internationally renowned car manufacturing company, ranking among the top three

luxury car brands globally. Before the acquisition, from 2005 to 2009, Volvo's operating income and profits showed a continuous decline, and operating profit began to sustain losses in 2006. However, even in such circumstances, its sales volume was nearly on par with Geely Automobile. To acquire a company of this scale, Geely Group needed significant and stable funds to ensure the successful completion of the acquisition.

The total cost of Geely's acquisition of Volvo amounted to about 2.7 billion US dollars, including 1.8 billion US dollars to acquire 100% of Volvo's equity and an additional 900 million RMB for subsequent operation funds. Geely Group had cash reserves of only 600 million RMB, so financing was crucial for Geely Automobile. Geely used three main financing methods: domestic bank loans, low-interest loans from relevant banks within the European Union guaranteed by the Swedish local government, and equity financing to attract foreign investors. Negotiations with Chinese banks were not smooth for Geely, so they turned to foreign banks for loans. However, when Chinese banks found out that Geely had given up on getting loans from them, they lowered their own standards significantly and reduced the loan interest rates, helping Geely lower the financing cost. In the end, Geely obtained a \$1.5 billion loan from two Chinese banks. China Bank provided a five-year loan of \$1 billion, and the rest was provided by China Export-Import Bank, which was crucial for the successful merger [6]. Additionally, to prevent potential risks in case of significant losses at Volvo after the acquisition, Geely created a risk isolation barrier. It used the earnings of the acquired party as collateral and established Geely Wanyuan as the operating company for the merger. Geely Wanyuan is a wholly owned limited liability company with registered capital of 20 million RMB, and its legal representative is "Tong Zhiyuan" (the person in charge of Geely Holding's Volvo China project operations). It was established on December 22, 2009, with an operating period from December 22, 2009, to December 21, 2039. Its business scope includes "investment, investment management, asset management, and automobile information consulting" [6]. On September 23, 2009, Geely's Hong Kong-listed subsidiary, Geely Automobile Holdings Limited, signed an agreement with Goldman Sachs Capital Partners (GSCP), allowing GSCP to invest in Geely Automobile through convertible bonds and warrants. After the issuance of the convertible bonds and warrants was completed, Geely Automobile would obtain 2.586 billion Hong Kong dollars (approximately \$330 million) in funds [6]. As a significant amount of the loans came from subsidiaries, Geely Automobile faced significantly reduced risks.

3.2. Potential Risks

After the acquisition, the operation still faced considerable uncertainty. Typically, the leverage of an acquiring party, whether from macro-environment, industry environment, or product strategy, tends to be weaker. On the one hand, due to Volvo's large assets and high operating costs, fluctuations in Volvo's sales performance would have a huge impact on Geely. On the other hand, Geely's own product sales performance would directly affect Volvo's future development. Such risks have already surfaced. In 2010, Geely's total sales growth rate was 7 percentage points lower than the average growth rate of China's passenger car market. Geely Automobile could not outperform the market [7]. Since the acquisition of Volvo, Geely Group's debt pressure has also become apparent. According to statistics, as Volvo was already burdened with \$3.5 billion in debt, Geely took over this debt during the acquisition, increasing Geely Group's total debt from 16.05 billion RMB in 2009 to 71.07 billion RMB in 2010. In 2010, Geely Group's capital debt ratio reached 73.47%, compared to the industry's highest at only 60%, indicating that Geely Group would face long-term debt pressure [7].

Apart from financial risks, how Geely Automobile maintains the integration and mutual coexistence of the two brands will also affect the profitability of Geely after the acquisition. Low-end products are still Geely's main selling products. After the acquisition, Volvo alone cannot solve Geely's overall brand positioning issue. If Geely Automobile fails to address its own brand positioning issue after the acquisition, Volvo's position as a second-tier luxury brand will inevitably be affected.

4. Competitive Prospects

After acquiring Volvo, Geely's entry into the high-end automotive market and the market for second-tier luxury car brands undoubtedly strengthened its competitiveness. The three major first-tier luxury car brands are still Mercedes-Benz, BMW, and Audi, with market shares of 21.5%, 21.9%, and 19.6% respectively, as of the first half of 2021 [8]. However, in the market for second-tier luxury cars, according to insurance data for different brands' vehicles purchased, Volvo, Lexus, Cadillac, Jaguar Land Rover, and Lincoln had sales volumes of 10,857, 10,153, 8,835, 8,024, and 3,949 vehicles, respectively, in February 2023. The year-on-year changes in sales volume were 37.9%, -21.48%, -7.93%, 59.11%, and -6.22% respectively [9]. The data shows that most second-tier luxury car brands had negative growth, but Volvo's sales continued to rise steadily. One of the reasons behind this is that Geely European Research Center (CEVT) started its operations in September 2013 after the acquisition of Volvo, relying on Gothenburg's excellent research resources to develop a new mid-level car module architecture and related components. The CMA mid-level car basic module architecture developed by CEVT fully leverages the advantages of both Volvo and Geely automobiles. Based on this architecture, the two companies jointly created the high-end brand Lynk & Co for the global market. Lynk & Co was first launched in Berlin and gained over 570,000 users in just five years. Geely's Lynk & Co also attracted many young users in China. The launch of Lynk & Co satisfied the aspirations of Chinese youth for performance cars. Additionally, Geely Holding Group's premium electric car brand, Polestar, jointly established with Volvo, has announced its intention to be listed on the NASDAQ stock market through a SPAC [10].

5. Conclusion

The acquisition of Volvo by Geely Automobile is one of the significant events in the Chinese automotive industry. The background of this acquisition includes the global trend of increasing foreign direct investment and the potential of the Chinese automotive market. Geely's motives and strategic goals for acquiring Volvo primarily involve increasing market share and addressing industry shortcomings. After the acquisition, Geely gained the capital to enter the second-tier luxury brand market and can leverage Volvo's technology, network, products, and brand advantages to address the shortcomings of its own independent brands. Furthermore, the operating model of Volvo has changed after being acquired by Geely. Geely has stabilized and developed the brand through new management approaches and financial support.

In terms of financing, Geely employed various methods to raise funds, including domestic bank loans, low-interest loans from relevant EU banks, and equity financing. However, after the acquisition, there are still some market risks to be dealt with. Geely needs to cope with the impact of fluctuations in Volvo's sales performance on the company and maintain the integration and mutual coexistence of the brands. Additionally, Geely faces increased debt pressure after the acquisition, necessitating measures to address long-term debt obligations. Nevertheless, the acquisition of Volvo has endowed Geely with increased competitiveness in the high-end automotive market and the second-tier luxury car market. Volvo's inclusion has helped Geely expand its market share in the luxury brand segment. Through the development of the joint venture brand Lynk & Co and the premium electric car brand Polestar, Geely has further enhanced its brand influence and market performance.

In conclusion, the acquisition of Volvo by Geely Automobile is an essential case in the Chinese automotive industry. This transaction has enabled Geely to increase market share, address industry shortcomings, but also entails financing and market risks. With proper management and brand integration, Geely has the potential to gain a greater competitive advantage in the global market.

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