

The Performance and Risk Analysis of M&A Deal: A Case Study of Geely Acquired Volvo

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Abstract. With the development of economic globalization and the deepening of market-oriented reform, enterprises have been exploring how to expand market share, optimize resource allocation, and maximize market value. They finally found that M&A is one of the important ways to achieve this goal. M&A refers to the transaction activities carried out by enterprises in order to obtain the control rights and related resources of other enterprises under the role of market mechanism. It is of great theoretical significance and practical value to choose the right target firm, make reasonable adjustments to enterprise management after M&A, and pay attention to dealing with M&A risks, so as to give full play to the role of M&A. This paper takes the deal of Geely acquired Volvo as an example to conduct an analysis and research on M&A. Combining theory and case study. The paper analyzes the M&A transaction process, the main reasons, and the subsequent risk control. Based on the research, the paper puts forward suggestions and countermeasures on how to carry out M&A effectively and new ideas for enterprise expansion.

Keywords: Merger & Acquisition; Performance Evaluation; Risk Analysis.

1. Introduction

In the early 19th century, Western countries began to carry out M&A deals. M&A is a general term used to describe transactions related to enterprises' purchase, sale, and merger. In fact, according to the full name of M&A, "Mergers and Acquisitions," it contains two meanings, including mergers and acquisitions. There is a difference between mergers and acquisitions: Mergers usually refer to economic behavior in which an enterprise acquires the property rights and decision-making control rights of the target firm in cash, securities, or other forms. Acquisitions usually refer to when one enterprise gains control of another, but the target firm retains its status as a commercial entity. But generally, mergers and acquisitions often have overlapping parts, so they cannot be strictly separated [1]. Mergers and Acquisitions are often combined in related academic fields and capital markets.

How to reveal the real motivation behind a large number of M&A activities from different angles has always been an important topic in the field of M&A research [2]. In the market economy environment, why is M&A often regarded as the method chosen by enterprises to deal with fierce competitive pressure and seek expansion and development? The importance of M&A is mainly reflected in the following three aspects:

Initially, M&A deals create synergies. Synergies generally refer to the cooperative advantage or fit effect after M&A. Based on the theory of Ansoff, this paper puts forward that synergies can be divided into three categories: operating synergies, management synergies, and financial synergies. Operation synergies refer to the efficiency improvement of enterprise production and operation brought by M&A. After the deal, enterprises can reduce production costs through the redistribution of resources, which is conducive to seeking to make full use of complementary resources between the two sides, reduce repeated investment in the field of research and development, and expand the economic scale and other beneficial results for both sides [3]. Management synergies usually occur between two enterprises with a gap in management capabilities. After the deal, the firm with weak management ability will be affected by the enterprise with strong management ability, which can greatly improve the overall operation efficiency. Financial synergies mean that M&A can improve the efficiency of enterprises in financial aspects. Financial synergies are not achieved through

improving operating efficiency or reducing costs but through using more effective financial leverage to make the capital structure more reasonable after M&A.

In addition, mergers and acquisitions can optimize and upgrade the labor structure. After the deal, enterprises usually increase the proportion of highly educated and non-conventional high-skilled labor [4]. It is found that M&A can reduce the financing constraints of enterprises and promote the upgrading of production technology so that the labor structure of enterprises can be optimized and upgraded.

Last but not least, enterprises can explore the international market and obtain overseas resources through cross-border mergers and acquisitions. Due to the diversification of M&A targets, cross-border M&A is also an indispensable part of M&A deals. Cross-border M&A is usually an important way for enterprises to enter the international market and enhance their international competitiveness [5]. Cross-border M&A aimed at acquiring new technologies are also common. The rapid development of science and technology makes the life cycle of products shorter and shorter. Usually, it takes more work for enterprises in a country to acquire all the technologies they need through their independent research and development. As a result, more and more enterprises grasp and absorb other's advanced technology through cross-border mergers and acquisitions to achieve technological catch-up and form a stronger international competitiveness.

2. Introduction of the Case: Geely Acquired Volvo

The two companies involved in the deal are Geely Holding Group Co LTD and Volvo Cars Co LTD. Founded in 1986, Geely Holding Group is a large-scale private enterprise mainly engaged in producing and operating automobiles and auto parts. Geely takes "Let the world be full of Geely" which also means "Let the world be full of lucky" in China as its core value. Since entering the auto market in 1997, Geely has continuously developed new technologies, improved service levels and product quality, and gradually become a leading enterprise in China's auto industry. Founded in 1927, Volvo is Sweden's largest industrial conglomerate and one of the world's 20 largest automobile companies. It was acquired by Ford Motor Company in 1999. With its "quality, safety and environmental protection" core values, Volvo achieved the world-famous brand and is considered synonymous with safe cars.

Understanding the transaction process of the deal is also key to analyzing the case (Table 1).

Table 1. Process of the deal.

Year	Events
2008	Ford Motor Company is rumored to be putting Volvo up for sale. After receiving the news, Shufu Li, chairman of Geely Holding Group, organized a project team to conduct in-depth analysis and officially started to operate the Volvo acquisition project. The project team included Fuld Law Firm, Deloitte Accounting firm and Rothschild Bank.
	In September, as the subprime crisis spiraled into a financial crisis, Shufu Li realized that this was definitely an opportunity for Geely and put acquisitions on the agenda.
	In mid-January, Shufu Li led his team to the United States to discuss the deal with Ford executives. Ford then invited Geely into the Volvo acquisition process, along with SAIC Motor, Guangzhou Automobile Group and Chery Automobile Group.
	On March 12th, Geely submitted its first-round bid to Ford. It also received an exclusive support letter from the National Development and Reform Commission.
2009	In April, Geely began a four-month due diligence process on Volvo.
	On July 30th, Geely submitted a second round of legally binding bid to Ford.
	On October 28th, Ford officially announced that Geely had become the preferred side for Volvo.
	On December 14th, the Ministry of Commerce said it supported Geely's bid for Volvo.
2010	On December 23rd, Ford and Geely reached a framework agreement to sell Volvo.
	On March 28th, Geely signed a takeover agreement with Ford in Gothenburg, Sweden. And formally acquired 100% of the equity of Volvo Car business for \$1.8 billion.

3. Reasons for M&A

The reasons why companies choose and commit to target firm often include various factors. Based on the analysis of this case and other cases, this paper summarizes the main reasons for enterprises to have the idea of M&A into the following three points:

3.1. Technical Factor

Nowadays, the global economic growth has slowed down, and many enterprises are actively looking for breakthrough methods to improve their core competitiveness. As the primary productive force, science and technology have become an important factor for enterprises to gain competitive advantage.

In the M&A announcement, Geely revealed that Volvo has advanced technology is an important motivation for the acquisition. The technological level of China's automotive industry is relatively backward compared to other countries, and Geely's strategic choice at that time can also prove this: low cost, price war is one of its main advantages. With the improvement of national income level, more and more people will choose higher quality cars. Therefore, Geely began a strategic transformation from price competition to technology leadership. However, due to the backward technical level, manufacturing high-end cars is also a big challenge for Geely, and the advanced technology of Volvo is one of the key points Geely values.

Similarly, technology as a driver of M&A is not unique to the automotive industry. Xinjiang Jinfeng Technology is the first wind power equipment manufacturer in China. The wind power equipment manufacturing industry is a major industry belonging to the high-tech field, so the technical level is a key factor supporting the development of this industry and related enterprises. In 2008, Jinfeng Technology decided to introduce foreign advanced technology to make up for its own lack of scientific and technological level. In April of the same year, Jinfeng Technology purchased 70% of the equity of Germany Vensys Energy, and obtained the intellectual property rights of Vensys direct drive permanent magnet technology. Through the introduction of technology, it broke through the bottleneck of the localization of the five major components of the fan, and had the ability of completely independent research [6].

3.2. Current Situation Factor

The economic environment is a significant part of the situation. As an external factor, it also plays an important role in M&A deals.

Ford acquired Volvo as early as the 20th century, but the long-term, large-scale M&A has plunged Ford into huge losses. In 2008, Volvo made a pre-tax loss of \$1.5 billion for the year, Ford management began selling off its business to ensure stability. At the beginning of 2008, Geely began to express its intention to acquire Volvo, but Ford did not take any practical actions, but the financial crisis at the end of 2008 was an important factor for Ford to seriously consider selling Volvo, and Geely seized the opportunity to further negotiate with Ford.

Under the control of national macroeconomic policies, the era of "Internet +" has a great impact on the development of Chinese enterprises. For example, sharing bicycles and takeout can be seen as representatives of "Internet +". With the arrival of the era, M&A is unprecedentedly active. It can provide a new mode of operation for previously independent enterprises, and become a means for enterprises to adapt to the development requirements of the era [7].

3.3. Brand Effect

The brand effect generally occurs in the case of which relatively weak brands acquire strong brands. It will enhance the industry status of enterprises and create brand value-added. Research shows that after the deal, the acquiring company's brand image will improve [8]. Geely's acquisition of Volvo is a classic example of this. One of the reasons why Geely chose Volvo as the target is that Geely values Volvo's worldwide recognition and wants to improve its market position through the deal, so that

Geely's brand can be known widely. Lenovo's acquisition of IBM's PC division was also a major international acquisition at the time. There is a big gap between Lenovo's computer business and IBM's overall strength. Lenovo also wants to increase its brand influence and affect its corporate image through M&A.

4. Measure the Success of M&A

The measure of the performance of the case is also worthy of attention. A successful deal should be able to create value, including technology, brand and management configuration, so as to improve the market competitiveness [9]. Based on the analysis of Geely's acquisition of Volvo, this paper puts forward some methods to measure the performance of M&A.

4.1. The Analysis of Geely Before and After the Deal

Firstly, this paper analyzes profitability from three indexes: earnings per share, gross margin ratio and return on equity. From 2007 to 2013, Geely's EPS showed an upward trend, and the upward trend was strengthened after the deal in 2010 (see Figure 1). Although there were fluctuations after 2013, the EPS in 2017 was 7 times that before the deal in 2009, achieving a significant increase. From 2007 to 2017, Geely's gross margin ratio fluctuated, but the overall trend was upward. From 2008 to 2014, Geely's ROE showed a downward trend, indicating that the company's operating capacity was weak due to the large differences between the two companies. After 2014, the ROE showed an upward trend, and the growth rate also increased year by year, which can be seen as the effect of the deal has been reflected.

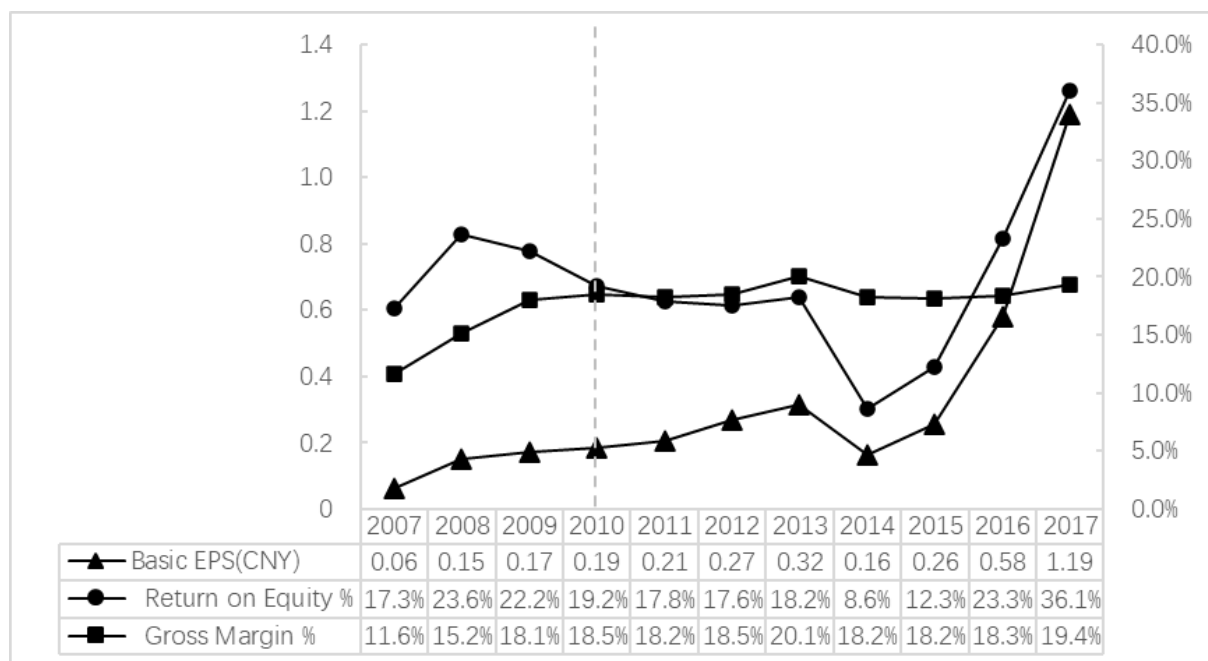


Fig 1. The change in profit indexes of Geely.

Secondly, this paper takes the number of patents applied by enterprises every year as a measure index to analyze the technological innovation ability of enterprises. In 2009 and before, Geely did not have external technical input, and the number of patents applied for each year was concentrated around 150, far less than the average level of other competitors. The number of patents Geely increased exponentially from 2010 to 2013 after the acquisition and quickly matched or even far exceeded the average level of competitors, which was inseparable from the acquisition and the introduction of advanced technology (see Figure 2).

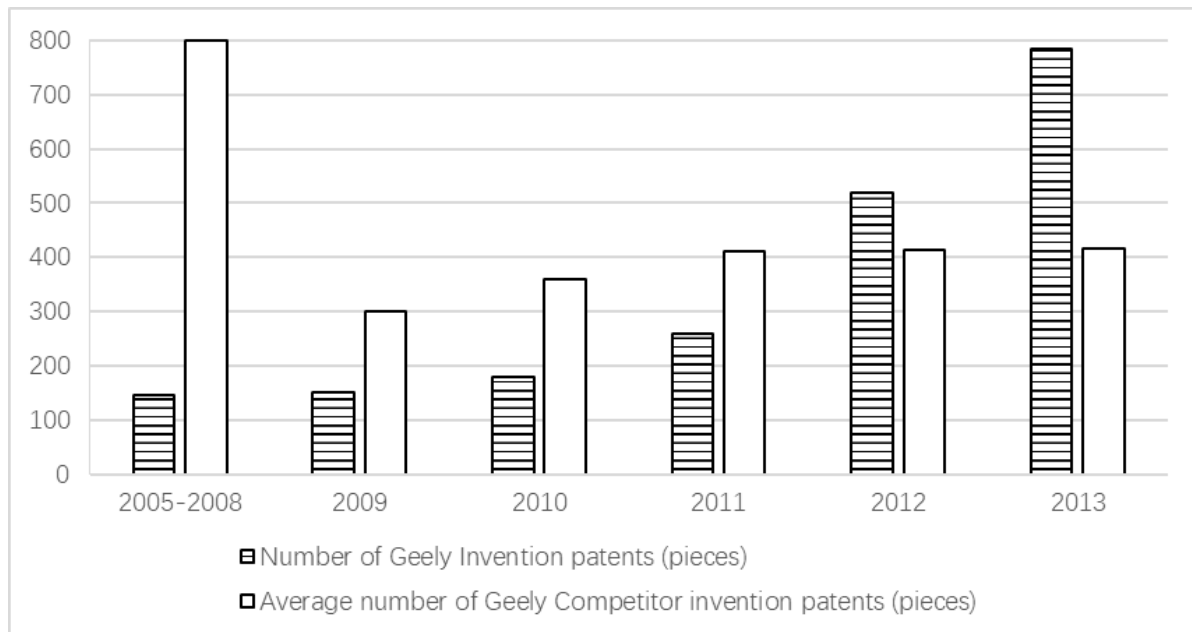


Fig 2. Comparison of the number of patent applications of Geely and the average number of patent applications of its major competitors over the years.

4.2. The Analysis of Volvo Before and After the Deal

The same indexes will be used to analyze Volvo's profitability. Volvo's three indexes have similar fluctuating trends, as Figure 3 shown. After Ford's acquisition of Volvo, Volvo's performance improved little, after the arrival of the financial crisis in 2008, the three indexes fell sharply. After Geely took over Volvo in 2010, the tide of the financial crisis gradually receded, and by 2011 all indicators had recovered. From 2011 to 2014, similar to Geely, there was no timely adjustment at the initial stage of the acquisition, resulting in weak operating capacity and a decline in various indexes. After the adjustment after 2014, Geely has adopted a series of effective strategies and provided sufficient policy and financial support for Volvo. It can be seen that the investment results have been reflected. Although there are small fluctuations, Volvo has successfully achieved a breakthrough in operation on the whole.

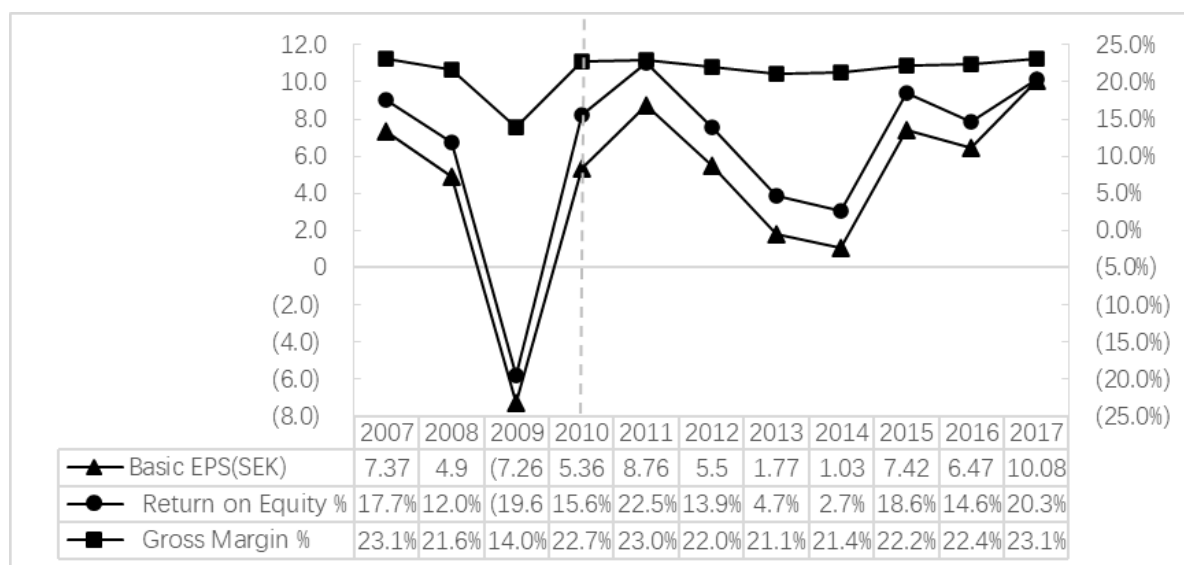


Fig 3. The change in profit indexes of Volvo.

The analysis of the two enterprises shows that the short-term market reaction of the two companies declined after the deal. At the same time, the relevant indicators increased through long-term adaptation and adjustment, indicating that Geely has achieved technological progress and economic

performance through the acquisition. Volvo has also achieved excellent performance through Geely's support in all aspects. Therefore, it can be seen that whether to Geely or Volvo, this is a win-win situation in the true sense.

5. Subsequent Risk Control

Although M&A will have a series of beneficial effects on enterprises, the risks also can't be ignored. Based on Geely's acquisition of Volvo and other cases, this paper will analyze the potential risks of M&A from brand risk, cultural conflict in cross-border M&A, and solvency.

Although brand effect is one of the important factors in promoting enterprises to carry out M&A, improper brand integration will still bring brand risks to enterprises. After the deal, if Geely fails to adjust the positioning of the two brands in a timely manner, the positioning of Volvo as a luxury car brand will be reduced, which will drag down the world recognition of Volvo and accelerate the decline of the Volvo brand.

In addition, companies also need to pay attention to the cultural conflict in cross-border M&A. Cultural conflict will be manifested in product preference and internal personnel management, etc. These problems will directly affect the effect of the deal. Handling these issues well and turning cultural differences into cultural innovations rather than cultural conflicts can create value for both sides [10]. In the case of BenQ's acquisition of Siemens, BenQ ignored the two companies' completely different national and corporate cultures, resulting in cultural conflicts. The layoffs and salary cuts were strongly resisted by the German labor union, and the two sides did not compromise, which eventually led to the failure of the deal.

Solvency is also a potential risk that enterprises need to pay special attention to. This paper will analyze the solvency from three indexes: current ratio, quick ratio, and total liabilities. Due to the acquisition and the assumption of Volvo's own debt, Geely's debt is under obvious pressure. Total liabilities continued to rise. After the deal, Geely's current and quick ratios declined, resulting in certain short-term liquidity pressure. However, the fluctuation range was not large and still within a controllable range (Figure 4).

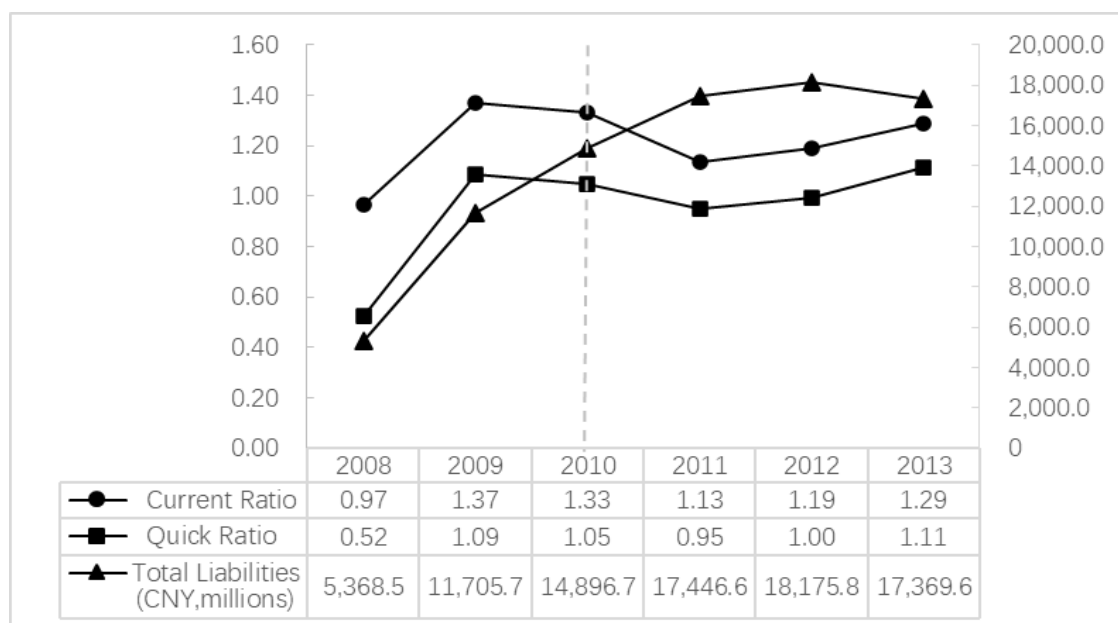


Fig 4. The change in short-term solvency indexes of Geely.

6. Conclusion

Through the case analysis of Geely's acquisition of Volvo, this paper concludes from the perspective of financial and non-financial indicators of both sides. However, the business

performance is not very satisfactory in the short-term. They finally achieved good development results in the long run. The study of risk control found that although it is important for M&A to bring development potential to enterprises, the hidden risks should also be noticed. At the same time, in addition to M&A strategy, enterprises can also scientifically expand other ideas to achieve the goal of long-term development of enterprises. Enterprises can combine internal management integration with external expansion, strengthen internal innovation ability, implement talent strategy, introduce efficient financial system, and realize modernization in the process of informatization. They can also search for externally diversified investment subjects, absorb more funds, and improve international competitiveness. In the era of globalization, enterprises need to conform to the development trend of the industry, clear their own advantages and goals, always pay attention to development opportunities, evaluate the situation, find a suitable development path, and achieve enterprise diversification and globalization.

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