China Go Abroad (6th Issue)

Strategic collaboration – How inclusive management helps Chinese enterprises win overseas

August 2017
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China’s outward FDI flows reached a new record high in 2016. However, such high growth did not continue in the first half of 2017. Amidst the current complicated and rapidly-changing international environment and under the new policies of the Chinese government, Chinese enterprises have become more rational in making investment decisions when they go abroad. From January to June 2017, China’s outward FDI flows decreased 46% year-on-year to US$48.2 billion¹.

Despite a significant reduction compared to previous years, the overall investment structure has been optimized. China’s outward FDI flows in the real economy increased tremendously, in particular in emerging industrial sectors, while its investment in real estate, cultural, sports and entertainment industries has dropped. This shows that Chinese investors are now focusing more on strategic deployment of their overseas assets to achieve transformation and upgrade of the real economy. After the high momentum of outbound investments in the past few years, Chinese enterprises are beginning to integrate their overseas investments and achieve synergy - a critical moment for them to take the quality of these investments to the next level.

Anti-globalization movements have intensified in recent years and the international environment has become increasingly uncertain and unstable. In the pursuit of inclusive and steady growth of the global economy, China has been advocating worldwide collaboration and promoting the Belt and Road Initiative by strengthening multilateral relations around the world. Since the launch of this national strategy of China in 2013, more than 100 countries and organizations have responded positively and will continue to increase their investments along the Belt and Road over the long term. In May 2017, China successfully hosted the first “Belt and Road Forum for International Cooperation” in Beijing. During the forum, EY co-organized “The First Advanced International Conference on ‘The Belt and Road’ Industry and Finance”, where our guests exchanged insightful ideas on how to improve the quality of Chinese enterprises’ overseas investments. In the future, EY will continue to assist Chinese enterprises along their go abroad journey and make their steady and sustainable development a reality.

As early as 2002, the founders of the China Mergers & Acquisitions Association (CMAA) called for “the year zero of M&A for China”; in 2013, the CMAA claimed that China was entering the “golden age of M&A funds.” In more than a decade, China’s M&A market has grown significantly and has become a major force that drives industry integration in Asia and across the globe. In 2016, the value of Chinese enterprises’ overseas M&A deals (M&As) surpassed that of the U.S. for the first time. During the same year, China also ranked second in terms of outward FDI flows worldwide².

Data also shows that Chinese enterprises’ overseas M&A deals have been changing profoundly for at least the past decade. On the one hand, no matter what the M&As are about - resources, technologies, networks or brand - the purpose of these deals is no longer just about serving China’s needs, but rather about the global allocation of assets. On the other hand, these investments have become smarter. In the past, Chinese enterprises tended to be overly aggressive and irrational when it came to overseas expansion. Now, however, Chinese enterprises are more interested in deals that respect the logic of M&A trades, which typically promote industry integration. The focus of M&As has also shifted to one that emphasizes strategic collaboration, cultural integration and organizational integration after the merger. In addition to the development of the Chinese government’s supply-side reform, its growing strength as a nation, an accelerating process of industry transformation and upgrades, the promotion of the Belt and Road Initiative and the support of buyout funds, the fifth “National Conference on Financial Work” in July 2017 also proposed policies to encourage the finance sector to support the real economy, as well as support for capable Chinese enterprises “going global” and cooperating globally on production capacity. These growing overseas investments will continue to be the lifeblood of China’s efforts to build an open economy.

The CMAA is committed to promoting the maturity of the Chinese M&A market, leading the marketization and standardization of this industry, and helping Chinese companies to globalize. In 2013, the CMAA hosted the 10th China M&A Annual Conference and published the CMAA Hong Kong Declaration, as well as The Best Practices for China’s M&A Industry in Hong Kong; in 2017, as Hong Kong celebrates the 20th anniversary of its handover to China, the CMAA hosted the 14th Annual Conference for China’s M&A Practice titled “20 Years’ Development of Overseas M&A Practices” in Hong Kong. Currently, with the international political environment filled with uncertainty and with protectionism on the rise, we face both great opportunity and challenges. However, with China actively advocating multilateralism, as well as promoting the Belt and Road Initiative, there are reasons to be excited that the age of global industry integration, led by China, may soon arrive.

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¹ Source: MOFCOM
² Source: World Investment Report 2017, UNCTAD, only include data of mainland China

**Foreword**

Albert Ng  
Chairman, China  
Managing Partner, Greater China

Lidong Wei  
Chairman of the China Mergers & Acquisitions Association  
Managing Partner and President, Shang Finance Management Co, Ltd

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In 2016, the value of overseas M&As by Chinese enterprises surpassed that of the US for the first time, amounting to US$92.2 billion; during the same year, China also ranked 2nd in terms of outward FDI flows worldwide.

In 2017, Chinese enterprises are tending to make more rational overseas investment decisions. China’s outbound M&As announced during H1 2017 totaled US$65.7 billion, a YoY decrease of 51%.

EY predicts that China’s outward FDI flows will surpass those of the US in the next decade, in view of China’s potential capital strength.

In H1 2017, China has been steadily boosting its investments along the Belt and Road, with newly signed engineering, procurement and construction (EPC) deals amounting to US$71.4 billion, a YoY increase of 39%.

During this year’s “Belt and Road Forum for International Cooperation”, China signed economic and trade cooperation agreements with more than 30 countries along the Belt and Road, and issued the “Initiative on Promoting Unimpeded Trade Cooperation” with more than 60 countries and international organizations.

72% of respondents consider “raising brand awareness” as the most important contribution that an overseas presence brings to Chinese enterprises.

70% of respondents consider “integration of corporate culture” as the greatest challenge facing Chinese enterprises’ overseas business operations.

Foreign employees only account for 10% of total staff in Chinese multinational companies – a lower proportion than in multinational companies from most developed and developing countries.

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3 Source: Mergermarket, including data for Hong Kong, Macau and Taiwan
4 Source: The official website of the Belt and Road Forum for International Cooperation
5 Source: UNCTAD, EY Analysis
Since the beginning of 2017, China's outward FDI flows have decreased significantly year-on-year: from January to June, China's non-financial outward FDI flows reached US$48.2 billion, down 46% year-on-year. There are a number of reasons for this: firstly, Chinese regulators have issued policies to regulate and guide investment behaviors since late 2016 as Chinese enterprises made some irrational overseas investment decisions; secondly, the global political and economic environment remains unpredictable in 2017, which eclipses Chinese investors' will to conduct overseas investment; thirdly, more and more Chinese enterprises have resorted to innovative financing channels overseas, which has caused a decline in outward FDI flows; and, furthermore, last year's high base also contributes to the large decline in 2017.

We do not agree that the slowdown in statistics indicates that Chinese outbound investment is entering a “glacial period” after the “rapid surge” seen in previous years. We believe that the favorable trend towards Chinese outbound investment cannot be overshadowed by short-term fluctuations. Recent data suggests that Chinese outbound investment has reached a slower and more stable stage after the rapid development seen for more than a decade. In addition, as we can see from the transition of M&A-focused industries, Chinese outbound investment is becoming more rational.

During H1 2017, the global political environment experienced a wave of unrest: the impact of Brexit continued to unfold, the Trump administration kept issuing new policies and several EU countries held crucial and contentious elections. Against the backdrop of such uncertainty in the international political landscape, China has proactively established multilateral organizations and cooperation frameworks. Since its launch in 2013, the Belt and Road Initiative has provided new momentum to help the global economy recover from crisis and continue to develop sustainably. In particular, the “Belt and Road Forum for International Cooperation” that was held in Beijing in this May delivered many achievements. Therefore, a lot of opportunities still exist despite the changing international environment.

No matter how unstable the external environment to be, to stand out among multinational companies, Chinese enterprises need to make extra efforts to strengthen their internal management capabilities, especially when it comes to post-deal overseas business operations. In H1 2017, we conducted a survey among a number of enterprises on post-deal overseas business management. The results showed that the most severe challenges for Chinese enterprises in managing their overseas operations include achieving cultural integration, and aligning strategic targets. Thus, EY suggests that Chinese enterprises enhance communication with their overseas business and establish a diverse and inclusive business environment in which employees from various backgrounds can respect and understand each other’s differences. In this report, we will focus on the importance of diversity and inclusiveness (D&I) on these enterprises’ successful management of overseas business, based on our extensive experience in assisting Chinese enterprises “going global”. We will also analyze some classic case studies of Chinese enterprises that have optimized their overseas business operations.

As 2017 progresses, Chinese enterprises are focusing more on increasing investment returns while expanding the scale of outbound investment. They can deliver successful outbound investment by optimizing their overseas business operations and management, so as to transform China from being simply a large outbound investor to becoming a strong and competitive one. We hope you will find this report useful and insightful for your outbound investment management, as you navigate trends and seek to seize better opportunities.
1.1 Outbound investment becomes more rational, Chinese enterprises continue to accumulate capital strength

As one important part of an open economy, Chinese outbound investment has achieved much after its rapid development over the past decade or so, which has become one of the highlights of China’s economic reform: in 2013, China’s outward Foreign Direct Investment (FDI) flows exceeded US$100 billion for the first time; in 2015, China’s outward FDI flows exceeded inward FDI flows for the first time and realized net capital outflow, making China a net capital exporter; and in 2016, China’s outward FDI flows hit another record high.

In H1 2017, China’s outbound investment slowed down compared with the corresponding period in the previous year. During this period, China’s non-financial outward FDI flows decreased 46% year-on-year to US$48.2 billion. Besides the high base, the main reasons for this slowdown are as follows. Firstly, since late 2016, Chinese regulators have issued policies to guide Chinese enterprises’ outbound investments, which have led these enterprises to focus on strategic outbound investment in a more rational way. Secondly, the uncertainties of the international environment have left Chinese companies hesitant about investing overseas. Thirdly, as Chinese investors have accumulated extensive experience in overseas investments, many of them are exploring innovative financing channels, such as leveraging Hong Kong as a platform or using the offshore assets of an international entity for financing directly, leading to a statistical decrease in outward FDI flows. However, EY believes, the Chinese government will encourage Chinese enterprises to participate in global cooperation and competition, and will boost the investments that can help Chinese companies move up the global value chain. As pressure on capital outflows decreases, we’re seeing a promising long-term increase in China’s outbound investment.

Figure 1: China’s outward FDI flows from 2007 to H1 2017 (US$ billion)

Note: Data of H1 2016 and H1 2017 are non-financial outward FDI flows
Source: MOFCOM’s website
Chinese regulators have implemented stricter measures on Chinese enterprises’ overseas investment, in a bid to persuade them to make more rational and superior outbound investments. At the end of 2016, officials from the Ministry of Commerce (MOFCOM), the National Development and Reform Commission (NDRC), The People’s Bank of China (PBC) and the State Administration of Foreign Exchange (SAFE) jointly clarified that Chinese enterprises will be encouraged to participate in international economic competition and cooperation, integrate into the global industry and value chains, adhere to the principles of “business entity, market principle, international customs and government guide” and continue with reform on “streamline administration and delegate power, strengthen regulation and improve service”.

Figure 2: Regulatory guidance on outbound investment issued by Chinese authorities since late 2016

6 December 2016
**MOFCOM, NDRC, PBC and SAFE**
- Closely monitor the irrational outbound investment tendencies in the real estate, hospitality, film studio, entertainment, and sports club industries;
- Closely monitor the potential risks involved in mega-investment in non-core business, outbound investments by limited partnerships, and outbound investments such as “tiny fish eating big fish” and “fast setup, fast exit”, and encourage relevant enterprises to make prudent decisions.

7 January 2017
**SASAC**
- In principle, central SOEs are not allowed to make non-core business investments overseas (core business refers to that decided by each central state-owned enterprise, confirmed and announced by the State-owned Assets Supervision and Administration Commission of the State Council (SASAC));
- Central SOEs should clarify the decision-making mechanism for investment, and limit the hierarchy of the decision-making process to two tiers to ensure central management of the outbound investment.

29 November 2016
**SAFE**
- Support qualified enterprises in conducting real and compliant outward FDI;
- Coordinate with outbound investment-related authorities to conduct authenticity and compliance reviews, to crack down on fraudulent outbound investment.

27 December 2016
**Department of Outward Investment and Economic Cooperation Division of MOFCOM**
- Further define reliable contents for approval: firstly, enterprises pursuing M&As should provide materials relating to the target enterprise naturally generated from decision-making, such as due diligence and feasibility reports, and details about market share, competitiveness, the level of development, profit and loss, etc.; secondly, enterprises should submit the principles of association of the overseas enterprises they established or acquired; thirdly, enterprises should provide materials about management decision-making from the board of directors, such as original board meeting minutes; and fourthly, enterprises should provide audited financial statements, focusing on the debt ratio, capital sources, etc.;
- Enterprises should make commitments about the authenticity of any materials submitted. If the materials are complete and accurate, they can be filed within three days of their acceptance.

27 April 2017
**SAFE**
- Suspend some outward FDI activities financing through “onshore guarantees for offshore loans” and increase scrutiny of such outward direct investments.

Sources: Xinhua News Agency, MOFCOM, SASAC, SAFE, compiled by EY

*Source: Xinhua News Agency*
In 2017, Chinese enterprises continued to optimize their investment structures to support the transformation and upgrading of the real economy, and meanwhile dramatically reduced “irrational” investments.

In H1 2017, the structure of Chinese outbound investment as a whole became better optimized compared to the corresponding period in 2016: outbound investments towards real industries, especially emerging industries, increased significantly. According to data from MOFCOM, from January to June 2017, Chinese outbound investment mainly flowed to leasing and business services, manufacturing, wholesale and retail, and information transmission, software and IT services, which accounted for 28%, 18%, 13% and 11% respectively. Additionally, investments in the real estate and entertainment sectors (including culture and sports), both dropped significantly (by more than 80% respectively)\(^1\).

In H1 2017, Chinese enterprises announced 302 overseas M&As, amounting to US$65.7 billion, a year-on-year decrease of 51%\(^3\). The decrease is partly due to last year’s high base, including a string of big M&As such as the Syngenta deal. On the other hand, the deal value of the M&As undertaken by Chinese enterprises as a percentage of the total M&A deal value, rose in a number of sectors, including automotive and transportation, power and utilities, life sciences, and mining and metals. Of these, the deal value of the automotive and transportation sector saw the largest increase, accounting for 31% of the total in H1 2017, up 27 percentage points from the corresponding period last year (when this sector accounted for 4% of the total)\(^3\).

In recent years, some Chinese enterprises have invested heavily in the overseas real estate sector. However, doing so has exposed the imprudence and immaturity of many Chinese enterprises in their outbound investments, as they have neither made adequate judgments about fundamental areas, such as the purpose and necessity of overseas M&As, nor carried out sufficient and scientific assessments of their M&A projects. The national regulation and control measures on overseas real estate investment introduced at the end of 2016 have delivered remarkable progress. In H1 2017, the total value of overseas real estate M&As was around US$400 million, only accounting for 6% of that amount in the corresponding period of 2016\(^4\). EY believes that, driven by the regulation and control measures on the scale of overseas real estate investment, Chinese enterprises will continue to adjust the scale of their investments and optimize their strategic roadmaps to choose superior outbound investment targets in H2 2017.

In 2017, Chinese enterprises continued to optimize their investment structures to support the transformation and upgrading of the real economy, and meanwhile dramatically reduced “irrational” investments.
Capital strength is robust in China. In 2016, the value of Chinese overseas M&As outperformed that of the US for the first time, and China ranked in second place worldwide in respect of outward FDI flows. EY predicts that, in the next decade, China’s outward FDI flows are likely to surpass those of the US.

In 2016, the outbound FDI flows of China ranked in second place worldwide, gradually reducing the gap with the top-ranked US. China’s outbound FDI flows grew from 7% of those of the US in 2007 to 61% in 2016. However, by the end of 2016, the outbound investment stock of the US was still five times greater than that of China. Therefore, the global expansion of Chinese enterprises is expected to have higher capacity for growth. EY predicts that, in the next decade, China’s outward FDI flows are likely to surpass those of the US.

In the past five years, the total value of global cross-border M&As has gradually recovered from the financial crisis of 2008. According to data released by UNCTAD, the US, Japan, China, Canada and Ireland were the most active performers during the past five years, by accumulated cross-border M&As.

The value of a country’s outbound investment is not only a key indicator of the progress towards globalization made by the enterprises in that country, but also an important consideration in the global strategic roadmap of a country adhering to its opening-up policies. Such investment can bridge domestic development with global economic systems.

Loletta Chow
Global COIN Leader
1.2 Chinese enterprises are subject to risks and opportunities in overseas investment amid the ever-changing international environment

Since the beginning of 2017, the international environment has become more uncertain and unstable in the context of the uncertainties from Brexit, new policies introduced by the Trump administration in the US and volatility driven by the European elections. In H1 2017, the number of China’s overseas M&As sharply declined. On the one hand, this reflects the recent restrictions imposed by the Chinese government on outbound investment; on the other hand, it also indicates that more Chinese investors are adopting a “wait-and-see” stance in an uncertain environment where many other countries have also introduced similar measures. EY suggests that Chinese enterprises could move after setting their strategies – they should pay close attention to government policies, adjust their overseas investment strategies accordingly and avoid stepping into the “policy minefield”. At the same time, to deal with practical overseas investment demand, enterprises should seek help from professional organizations during the investment process. Through this way, enterprises can improve their investment planning, as well as their risk management.

Figure 7: Top 5 destinations of outbound M&As of Chinese enterprises in H1 2016 vs Top 5 destinations of outbound M&As of Chinese enterprises in H1 2017

1. Switzerland US$48.8 billion* 1. UK US$15.5 billion
2. USA US$34.2 billion 2. Australia US$14.7 billion
3. Germany US$10.4 billion 3. USA US$7.5 billion
4. Finland US$8.9 billion 4. Singapore US$4.1 billion
5. UK US$3.6 billion 5. Germany US$2.7 billion

*Include the deal that ChemChina acquired Swiss Syngenta for US$43 billion
Source: Mergermarket, including data for Hong Kong, Macau and Taiwan
Globally, enterprises often consider overseas M&As as a way to secure supply chains, market access and sustainable growth. According to EY’s recently released 16th edition of the Global Capital Confidence Barometer, 64% of the respondents claimed that they were looking for suitable targets for cross-border M&As because they believed that trading opportunities were expected to significantly increase as a result of various “uncertainties”. The pound has plummeted to a record low level since the Brexit referendum in June last year. A number of Chinese enterprises seized the opportunity to enlarge their investment footprint in the UK and completed several large deals. Chinese investors were particularly keen on investing in the UK’s high-tech sectors, because, for most of them, these deals were focused mainly on acquiring technologies, and the Brexit vote had a limited impact on such deals. For example, as one of the main investors, Jiangsu Shagang Group led a deal to acquire Global Switch, a UK data center company, for GBP£2.4 billion, while Ctrip acquired Skyscanner, a UK travel search giant, for GBP£1.4 billion. What’s more, it is expected that after Brexit, the UK may be more willing to consolidate the bilateral relationship and strengthen economic and trade investment with China to ensure its own stable economic development. Such efforts will create a more favorable investment environment for Chinese enterprises in the UK.

In addition, following his inauguration in January 2017, US President Donald Trump signed an executive order to “Buy American, Hire American”. The order explicitly requires every department and agency of the Federal Government to strictly enforce its rules, creating jobs for the country by taking advantage of federal financial aid incentives, adhering to federal procurement terms and conditions and, as far as possible, leveraging goods and materials produced in the US. The two core principles of the executive order are “to promote the use of American-made goods” and “to help ensure that American labor is hired to do the job”. EY believes that “to promote the use of American-made goods” is a sign of increasing trade protectionism, which will result in trade friction and even “trade wars” between China and the US, and that the increasing cost of trade may impel Chinese investors to build manufactories in the US.

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7 Source: EY’s 16th edition of the Global Capital Confidence Barometer
8 Source: The White House website (www.whitehouse.gov)

Focus on Chinese outbound investment in 2017
1.3 China is proactively “making more friends” as the Belt and Road Initiative begins to play a “new leading role” in globalization

Against a backdrop of rising wave of anti-globalization and weakening international security and economic mechanisms, China is rising and playing an increasingly important role on the international stage in promoting trade and investment globalization, strengthening multilateral cooperation and facilitating regional “win-win” development.

The rise of China directly affects the geopolitical landscape, especially when it comes to the competitive relationships with nearby and other connected countries. For Chinese enterprises that expect to achieve growth and globalization through outbound investment, the focus of future investment will be on seizing opportunities amidst uncertainty, and proactively managing and controlling risks. In recent years, China has actively participated in the establishment of multilateral international organizations and cooperation frameworks and has played a leading role in addressing the increasingly complex geopolitical landscape. To protect the legitimate rights and interests of Chinese enterprises conducting business overseas, China has actively signed bilateral and regional agreements with other countries, including bilateral investment treaties, free trade agreements, regional free trade and investment agreements and economic partnership agreements. By the end of 2016, China had signed 131 bilateral investment agreements with 129 countries, of which 110 had already been validated2.

Figure 8: The collaboration results between China and multilateral organizations from developing countries in recent years

Sources: Ministry of Foreign Affairs, SASAC, the Chinese government website, yidaiyilu.gov.cn, Xinhua News Agency
In addition, China is playing a critical role in global international organizations. In September 2016, the Hangzhou G20 summit agreed on the G20 Guiding Principles for Global Investment Policymaking, the world’s first global multilateral investment guidelines, which establish the overall framework for global investment rules and provide important guidance for countries on coordinating the formulation of domestic investment policies and negotiating foreign investment agreements. These guiding principles are urgently needed as there are more than 3,300 global bilateral and multilateral investment cooperation agreements with inconsistent terms and conditions, protection levels, levels of market openness and strength of protection toward foreign investors. China’s leading role in this achievement not only shows its increased international influence and empowered voice following the rise of its economy, but creates greater outbound investment opportunities for Chinese enterprises seeking to “go global” and integrate with the world.

The world economy has been through weak recovery and demand growth, while the Belt and Road Initiative has become a new engine for the revival of the global economy and sustainable development. In H1 2017, China has made US$6.6 billion non-financial outward FDI in 47 countries along the Belt and Road, accounting for 13.7% of the total investment in that period, up six percentage points compared to the corresponding period last year. In addition, the newly-signed contract value of EPC projects amounted to US$71.4 billion, a year-on-year growth of 39%. The Belt and Road Initiative focuses on the fundamental issue of development, and is designed to help realize the potentials of the countries involved, seeking economic integration, development cooperation and results sharing. In May 2017, China held the “Belt and Road Forum for International Cooperation” in Beijing and put together a list of deliverables, which includes 76 items comprising more than 270 concrete results in five key areas – namely policy coordination, facilities connectivity, unimpeded trade, financial integration and people-to-people bond. During the period, EY co-organized “The First Advanced International Conference on “The Belt and Road Industry and Finance”, at which the “Silk Road Industry and Finance International Cooperation Alliance” was established. The Alliance will integrate the resources of Chinese and foreign entities and financial institutions to realize industry information-sharing, finance-sharing and service-sharing along the Belt and Road.

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<th>Figure 9: G20 Guiding Principles for Global Investment Policymaking</th>
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<td><strong>1</strong> Recognizing the critical role of investment as an engine of economic growth in the global economy, governments should avoid protectionism in relation to cross-border investment.</td>
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<td><strong>2</strong> Investment policies should establish open, nondiscriminatory, transparent and predictable conditions for investment.</td>
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<td><strong>3</strong> Investment policies should provide legal certainty and strong protection to investors and investments, tangible and intangible, including access to effective mechanisms for the prevention and settlement of disputes, as well as to enforcement procedures. Dispute settlement procedures should be fair, open and transparent, with appropriate safeguards to prevent abuse.</td>
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<td><strong>4</strong> Regulation relating to investment should be developed in a transparent manner with the opportunity for all stakeholders to participate, and embedded in an institutional framework based on the rule of law.</td>
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<td><strong>5</strong> Investment policies and other policies that impact on investment should be coherent at both the national and international levels and aimed at fostering investment consistent with the objectives of sustainable development and inclusive growth.</td>
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<td><strong>6</strong> Governments reaffirm the right to regulate investment for legitimate public policy purposes.</td>
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<td><strong>7</strong> Policies for investment promotion should maximize economic benefit, be effective and efficient, aimed at attracting and retaining investment, and matched by facilitation efforts that promote transparency and are conducive to investors to establish, conduct and expand their business.</td>
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<td><strong>8</strong> Investment policies should promote and facilitate the observance by investors of international best practices and applicable instruments of responsible business conduct and corporate governance.</td>
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<td><strong>9</strong> The international community should continue to cooperate and engage in dialogue with a view to maintaining an open, conducive policy environment for investment, and to address shared investment policy challenges.</td>
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The Chinese government signed cooperation agreements on the economy and trade with the governments of more than 30 countries along the Belt and Road, and signed more than 20 cooperation agreements on infrastructure-related projects. A total of RMB100 billion has been added to the Silk Road Fund, and has realized financing about RMB350 billion for investment along the Belt and Road through domestic and foreign financial institutions.

In the next three years, China will provide no less than RMB430 billion in assistance to the developing countries and international organizations joining in the Belt and Road construction.

China has also signed Belt and Road Financing Guidelines, proposed by the Ministry of Finance, with 27 countries along the Belt and Road.

The Belt and Road Initiative contributes to realizing the potentials of developing countries to promote economic globalization in a more general, inclusive and impartial way, by strengthening cooperation and connectivity among these countries. This will bring great business opportunities, achieve “win-win” results, and enhance the stability and far-reaching development of the world. The Belt and Road Initiative will play a “new leading role” in globalization.
1.4 Buyout funds – Boosting Chinese enterprises’ overseas M&As*

Nowadays, buyout funds play an important role in overseas M&As and have become a major driver in promoting these deals.

The evolution process in which buyout funds assist Chinese enterprises in overseas M&As

As early as 2005, when Lenovo acquired IBM’s PC business, it brought in TPG Capital Management, General Atlantic Service Company and Newbridge Capital as joint investors. In 2008, when acquiring Awilco Offshore ASA, a Norwegian-listed company and international offshore drilling contractor, China Oilfield Services Limited also had in-depth discussions on the potential for a joint acquisition with Goldman Sachs and First Reserve, a professional investment fund in the energy field. Since then, Chinese enterprises have increasingly begun to use buyout funds in overseas M&As.

In recent years, buyout funds have been expanding rapidly in China. In 2016, the value of M&A deals in which financial investors such as private equity funds and asset management company funds participated exceeded US$ 38.1 billion, more than twice the figure of 2015. We discovered that buyout funds have played an important role in overseas M&As and have become a major driver in promoting such deals.

For example, in 2016, Leo Group signed the Framework Agreement on Co-sponsorship and Establishment of the Buyout Fund with Shanghai Dinghui Bai Fu Fortune Management Co., Ltd. and Ningbo Meishan Bonded Port Area Leo Digital Entertainment Industry Investment Partnership (Limited Partnership) to co-invest in Leo Dinghui Buyout Fund Partnership (Limited Partnership). Based on the agreement, the amount of the buyout fund shall not exceed RMB 8 billion, of which Leo Group’s own capital contribution will be no more than RMB 800 million as a limited partner, the general partners (Dinghui Baifu and/or Ningbo Leo Digital Entertainment, or a new entity jointly established by both parties) are set to contribute RMB 500,000, and the rest of the fund will be raised from other investors. The buyout fund is a special investment fund, used only for the M&As of Internet technology-based companies with stable growth, which are top-ranked in the US and other overseas markets.

For the divestment of the project, the buyout fund will complete the investment in the underlying assets and standardize the cultivation. Under equivalent conditions, selling to Leo Group is prioritized. Leo Group agrees to give priority to an investment when the underlying assets of the buyout fund meet the company’s acquisition terms. If Leo Group abandons this acquisition priority, upon the approval of the investment decision-making committee, the buyout fund can also divest by means of listing on the stock exchange, separate IPOs in domestic and foreign markets, M&As, or transfer to other third parties.

Buyout funds provide an important financing channel for Chinese enterprises to carry out and achieve a greater chance of success in overseas M&As

In the past, when Chinese enterprises conducted overseas M&As, domestic bank lending was usually considered as the main financing method. Banks were inclined to allocate more financial resources to SOEs. In contrast, some private enterprises and smaller companies found it difficult to access financing for overseas expansion. In recent years, with the gradual diversification of Chinese enterprises’ overseas investments, financing channels are becoming increasingly broader, and the role of buyout funds in overseas M&As is growing in importance.

Based on international experience, leveraged financing is the most common financing channel for cross-border M&As. However, private enterprises involved in cross-border M&As for the first time prefer to rely on cash payment. In fact, the cash method largely increases the acquisition cost, often resulting in high pressure on cash flow. As early as the last century, some foreign companies resorted to leveraged buyouts (LBO). Through this method, the acquirer can acquire the whole target by only paying a percentage of the total price, which largely reduces the acquisition cost and cash flow pressure of the acquirer.

* Source: Beijing Chamber of International Commerce
10 Source: stcn.com
11 Source: cnstock.com
12 Source: Sina Financials

*Note: This part is developed by China Mergers & Acquisitions Association (CMAA)
The LBO model has been accepted by more and more Chinese enterprises for their cross-border M&As in recent years: Lenovo’s acquisition of IBM’s personal computer business, Geely’s acquisition of Volvo, Sany Heavy Industry’s acquisition of Germany’s Putzmeister and Alibaba’s repurchase of shares held by Yahoo. In addition, Bright Food Group acquired Weetabix by means of leveraged financing and “club loan”, not only mitigating the M&A risks, but also enabling the group to reduce the financing costs to between 3% and 3.2%, well below the 4% target cap. During the subsequent three years, Bright Food Group also completed the acquisitions of 50% equity in New Zealand’s Synlait Milk, 75% equity in Australia’s Manassen Foods and 70% equity in the French DIVA Bordeaux Wine Company. Bright Food Group also helped with Synlait Milk’s successful IPO in New Zealand in 2013.

Professional overseas buyout funds generally have a strong industry background and resources, a better understanding of the local market, legal and policy environment in the country where the target is located, and can ease communications with local government and other related parties. Buyout funds can also improve the investment target’s governance and operations to create and enhance the value of the acquired company by means of project screening, due diligence, participation in management and other market-oriented resource allocation methods. This approach helps Chinese enterprises reduce the risks of overseas M&As and achieve a greater chance of success in these deals. By working jointly with the buyout funds, Chinese enterprises develop an alliance for overseas M&As, which is helpful in allowing them to play to their respective strengths and achieve “win-win” results for both sides.

Challenges facing buyout funds in Chinese enterprises’ overseas M&As

At the same time, while looking at the establishment of overseas buyout funds, it is necessary to study how to strengthen the management and mitigate the risks of M&As, and thus make overseas M&As a truly effective way for Chinese enterprises’ internationalization. The success of a M&A depends not only on post-M&A integration and management, but also on M&A program design and pre-M&A due diligence. Meanwhile, it is also important to continue to improve negotiation and bargaining skills for overseas M&As, enhance capacity for cross-border business, and respond to cultural differences and political, economic and other challenges.

Finally, buyout funds are also challenged by standardized operation issues. Therefore, it is important for buyout funds to vigorously enhance the investment and financing capacity, improve internal control systems, and prevent operational risks. For example, buyout funds could clarify the basic principles of their outbound investment decision-making, such as: avoid investing in unfamiliar countries and making imprudent decisions without a comprehensive understanding of the investment destination; avoid investing in disadvantaged areas due to a lack of experience, and carrying out large-scale investments in products or industries that the fund has not previously been involved in; and strive to realize mutual complementation between foreign investment and domestic production -- wherein invested foreign projects shall be helpful for domestic production, to strengthen enterprises' own advantages and make up for their disadvantages.

CMAA’s recommendations

1. A combination of international and domestic training
   Buyout funds shall use both international and domestic resources to actively carry out all-round training for M&A talent;

2. A combination of management and technical talent development
   In accordance with the deployment and requirements of the internationalization strategy of the buyout funds, management and technical talent of different layers and with different specialties should be cultivated;

3. A combination of “going global” and “bringing in”
   The buyout funds should actively implement overseas talent development programs, assign talent to study overseas, and constantly enhance the introduction of M&A talent from foreign investment banking industries;

4. A combination of talent development and practical exercises
   The buyout funds should improve domestic and foreign M&A talent development and exchange, by means of dispatching people to study, visit and work abroad.

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Source: PEdaily.cn
The “gains” and “losses” of Chinese enterprises in overseas business management

To better understand and analyze the gains and losses of Chinese enterprises in overseas business operations and management, EY issued questionnaires to Chinese enterprises that have invested abroad or intend to do so. The respondents were executives or department heads who were directly involved in overseas investment. We analyzed and summarized valid feedback to make corresponding recommendations. The survey interviewed enterprises from various sectors that were active in outbound investment and are headquartered in China’s 17 provinces, municipalities and the Hong Kong SAR. For those enterprises, Europe and the US were the most popular investment destinations.

**Figure 10: Distribution of the respondent types**

- State-controlled or shareholding enterprises: 45%
- Private enterprises: 50%

**Figure 12: Listed or non-listed respondents**

- Listed companies: 41%
- Non-listed companies: 59%

**Figure 11: Distribution of respondents’ industry sectors**

- Financial services: 6.5%
- Energy (including oil and gas): 7.5%
- Others: 9%
- Health and medical: 10%
- TMT: 10%
- RE, Hotel & Construction: 12%
- Consumer products: 14%
- Power & Utility: 14%
- Other industrial products: 16%
- Automobile & high-end assembling manufacture: 16%
- Agriculture: 17%

**Figure 13: Respondents’ target destination distribution**

- Europe: 30%
- North America: 14%
- Southeast Asia: 9%
- Oceania: 7%
- Japan & Korea: 7%
- Latin America: 8%
- India: 7%
- Africa: 7%
- Middle East: 7%
- Russia and CIS countries: 7%

- Respondents’ industries are highly diversified to cover almost all sectors.

- Listed companies and non-listed companies accounted for about 41% and 59% respectively.

- The target destinations of the respondents are mainly concentrated in Europe and the US, but they also cover other developed and developing markets around the world. This distribution is also consistent with the overall regional distribution for Chinese enterprises’ outbound M&A deals.
2.1 Strategic objectives and main contributions of Chinese enterprises’ overseas business

Chinese enterprises are now at a critical stage of strategic transformation, in which overseas M&As have become a major method for them to realize transformation and upgrade their performance. The objectives of Chinese enterprises’ overseas M&As have evolved from just providing access to resources such as energy and minerals. Many enterprises are now focusing on global expansion to make all-round progress in market share, technology and other areas.

What are the strategic objectives of your outbound investment?

73% chose “Strategic roadmap for globalization”

50% chose “Access to new markets”

34% chose “Access to new technologies or products”

The survey shows that as the development of many Chinese enterprises has encountered a bottleneck in the domestic market, it is hard to meet their needs for further development and transformation by relying solely on the domestic market. In order to discover new opportunities for future development, enhance international competitiveness and improve brand and corporate awareness overseas, Chinese enterprises not only need to pursue overseas investment and M&As, but also should seek to fulfill the core strategic objectives of outbound investment, such as globalization and access to new markets and more advanced technologies.
These are the three main strategic objectives of outbound investment for many Chinese enterprises. However, enterprises who vary in industries and natures (state-owned enterprises/private enterprises) will have different overseas strategic objectives. In addition, as their experience, ability and resources in overseas business operations and management are not the same, the contributions of their overseas business will also differ. The survey shows that, generally, the contributions of overseas business to Chinese enterprises are as follows:

**In which area do you believe overseas business will make the most significant contributions to the parent company after M&As?**

- **72%** chose “Expansion of brand awareness”
- **52%** chose “Increase in market share”
- **50%** chose “Improvements in technology and productivity”

The findings prove that, in recent years, Chinese enterprises’ objectives for outbound investment have shifted from accessing resources to the upstream of the value chain, such as brand value, markets, advanced technologies, etc. The findings also reflect that when operating business overseas, Chinese enterprises have accumulated experience in post-deal integration, allowing them to effectively integrate their existing resources in those areas with the tangible and intangible assets, and prominent advantages of the acquirees (such as brand awareness, market share, talent and technical reserves), and consequently generate synergies in the short-term - something that has become the driving force behind Chinese enterprises’ global expansion.

Given the high correlation between Chinese enterprises’ strategic objectives for outbound investment and the contributions of their overseas business, the survey demonstrates that the benefits and outcomes contributed by overseas business are basically in line with Chinese enterprises’ established strategic objectives and planning. It also reflects that Chinese enterprises’ strategic roadmap for globalization has gained considerably from their expanded brand awareness, access to advanced technologies, increase in market share and other improvements.
The survey results also show that respondents from most industries believe that overseas business has little impact on Chinese enterprises when it comes to “cross-industry diversified operation”. In light of the fact that the outbound investments made by different respondents mainly focus on their primary business, these results demonstrate that most Chinese enterprises are “conservative” and focus on developing core business and investing in their own industry or highly correlated sectors. At the same time, the results also reflect that more and more Chinese enterprises have realized the difficulty involved in cross-industry operations overseas: it is hard for them to generate synergies. With the expansion in business size and an insufficient understanding of the sectors involved, investors will have trouble in coordinating with investees’ governance structure, corporate culture, existing business, regulations, and other aspects, not only disordering their own strategic objectives, but also imposing a heavy burden on corporate development.

**EY’s recommendations:**

In the future, while benefiting from acquired brands, markets and technologies, Chinese companies could regularly examine whether their overseas strategies are well carried out in the operations of their overseas business.

In order to promote industrial transformation and diversified management worldwide, and strengthen the operational foundation of overseas business to meet various challenges, Chinese enterprises should attach equal importance to the expansion of overseas business and the development of a diverse and inclusive business environment, so as to mitigate the differences between Chinese and foreign enterprises in terms of corporate culture and governance philosophy, as well as the legal, tax, talent management and other differences across a range of countries and industries.
China Great Wall Asset Management Co., Ltd. (GW Asset) is a comprehensive financial management company directly affiliated with China’s central government. The company coordinates and manages the banking, securities, funds and other business under GW Asset to achieve network coordination. The two major focuses of its asset management business are non-performing assets management and M&A and reorganization in capital markets. The company works actively with listed companies and state-owned large- and medium-sized groups to establish buyout funds as a way to engage in domestic and foreign M&As. It is committed to becoming an integrated financial services provider in cross-border M&As. Through years of exploration and practice, GW Asset has provided M&A and reorganization sevices to more than 200 listed companies.

GW Asset’s core investment logic and outbound investment model

GW Asset believes that as China’s economy has moved into a medium-speed development stage, the key challenges before Chinese companies, especially listed companies, will be to explore high-quality and internally-transferable inorganic growth models in the next five years. As Chinese enterprises speed up “going global”, GW Asset, by investing in the following nine sectors: new energy, new materials, healthcare, information technology, environmental technology, new energy vehicles, high-end machinery manufacturing, modern service industry, rail transportation, and space technology, is also accelerating its internationalization strategy, so as to help listed companies develop overseas M&As and improve their core competitive edge.

Overseas strategy of GW Asset
- Leveraging Hong Kong as a platform
- Expanding to Asia-Pacific, Europe and the US
- Introducing foreign strategic investors
- Committing to becoming a global influential investment bank

GW Asset assists Chinese enterprises “going global”
GW Asset assists an environmental protection enterprise achieving business transformation and upgrade to expand its global impact via an overseas M&A

Background:
A Chinese integrated solution provider specializing in environmental protection wished to transform and upgrade its business via overseas M&As.

GW Asset’s assistance:
GW Asset, as one of the major investors of the company, was deeply engaged in developing the consortium’s transaction framework and the negotiation process, and helped to lock the target assets—the resource regeneration and environmental services business of a well-known German environmental management service provider. GW Asset provided EUR170 million (RMB1.3 billion) in funding to the Chinese buyer through its overseas subsidiary Great Wall Pan Asia, which played a decisive role in the successful transaction of the overseas acquisition.

What is GW Asset’s role in assisting Chinese enterprises “going global”?

1. As a professional institutional investor, GW Asset is equipped with a deep understanding of the trends and prospects of related industries, and is strongly capitalized. These advantages in industry knowledge and capital can be used to help Chinese enterprises “go global” and upgrade their businesses to the higher end of the value chain.

2. As a fund provider, GW Asset is able to provide adequate financial support for enterprises “going global” and help them raise funds for M&As through M&A loans, buyout funds and a variety of innovative investment models, including diversified investment vehicles - domestic, overseas, debt, and equity financing, as well as mezzanine financing.

3. GW Asset, with its extensive experience in financial sectors such as banking, funds, and securities, provides enterprises with “one-stop” investment advisory services.

How does GW Asset help enterprises promote corporate value?

1. Through acquisition: Chinese companies can upgrade their business and gain branding, technological and marketing advantages by acquiring these resources from overseas targets. GW Asset can also provide general financial services, including direct funding support, to the privatization of Chinese companies listed overseas, and help domestic companies to fully achieve their value in the capital markets.

2. From investment to integration, GW Asset can provide solutions for each stage of the investment process. It helps facilitate corporate integration and collaboration over core technologies, products, markets and channels, in order to promote corporate value.

3. Through strategic shareholding, GW Asset can build a close and effective partnership with the client company, continuing to provide financial, asset and capital support to help the client succeed.

Source: China Great Wall Asset Management Co., Ltd., compiled by EY
2.2 What is hindering Chinese enterprises' overseas business: culture, strategy or talent?

Chinese enterprises have recognized the major challenges involved in the long-term operation and management of overseas business – from corporate cultural integration to the alignment of strategic objectives and the challenges of attracting talent and avoiding talent drain. Chinese enterprises should develop and implement detailed integration plans and introduce the principle of diversity and inclusiveness (D&I) to help navigate the challenges arising from deepening globalization.

On the path towards becoming multinational enterprises, Chinese enterprises must learn to manage their globalized businesses. When it comes to overseas business operations and management, they should never simply apply their old management ideas and approaches to overseas teams. Under a successful overseas business management, the business of the investor and investee are aligned; resources are allocated reasonably; and corporate and social value are maximized by introducing the principle of D&I. However, Chinese enterprises face various challenges in their overseas operations, such as difficulties in integrating corporate cultures, inconsistencies between the strategic objectives of the overseas subsidiary and those of its parent company, local talent attraction and retention, and failure to meet expected performance. If the enterprises cannot properly address these challenges, their overseas strategic objectives are likely to be hampered, and the current contributions of their overseas business will be damaged as well.

Top three major challenges in overseas business operations:

- 70% chose “Corporate cultural integration”
- 58% chose “Alignment of strategic objectives”
- 35% chose “Local talent attraction and retention”

“What is the biggest post-deal challenge in your overseas business management?”
According to the survey, “corporate cultural integration” is the biggest challenge in overseas business management for Chinese enterprises. Given that enterprises must be internally consistent in corporate culture and business strategy as a prerequisite for becoming more global and obtaining all the overseas benefits mentioned earlier, if they fail to synergize different corporate cultures before operating overseas, the resulting cultural conflicts will affect the effectiveness of overseas business operations and hinder the enterprise’s ambitions to “go global”.

Further exploring the obstacles for Chinese enterprises in integrating their cultures with those of their overseas businesses, EY found that 87% of the respondents who chose “corporate cultural integration” as the biggest challenge in overseas business management identified the largest obstacle as being “investor and investee/acquiree would not change or have trouble changing their existing cultures”. EY believes that corporate culture (especially western corporate culture) is a unique kind of value that is formed and evolved during an enterprise’s long-term development. It is deeply influenced by the local culture, history, economic development and social transitions, and is widely recognized and observed by corporate members as an organizational principle. Therefore, specific corporate culture, once formed, can hardly be changed or duplicated by other enterprises.

**Figure 17: The biggest challenges in cultural integration facing the respondents in their overseas business management**

- Investor and investee/acquiree would not change or have trouble changing their existing cultures: 87%
- Lack of communication and support from senior management: 72%
- Lack of training and support received by middle project management: 56%
- No effective available communication channel: 49%
- Integrated culture does not meet the investor’s expectation: 36%

**Corporate cultural integration**

The “gains” and “losses” of Chinese enterprises in overseas business management...
Differences in corporate culture can be challenging when Chinese enterprises operate overseas

EY has observed that in western culture, the enterprise emphasizes employee-friendly management and a flexible working environment, and its employees value work-life balance; in Chinese culture, the enterprise places greater value on diligence and dedication, and its employees are accustomed to working overtime. The two opposite corporate cultures can easily lead to friction. For example, an executive of a Chinese enterprise was unhappy that the company’s foreign colleagues rejected calls at weekends, while his foreign colleagues complained about Chinese employees’ excessive working hours. The differences in corporate culture thus affected cooperation and business operations on both sides.

The survey shows that respondents chose “lack of communication and support from senior management” and “lack of training and support received by middle project management” as two of the largest obstacles for corporate cultural integration, accounting for 72% and 56% respectively. This indicates that the attitude and ability of middle and senior management is crucial for cultural integration. Therefore, it is undoubtedly of great practical significance for enterprises with overseas business operations to cultivate leaders with an inclusive attitude.

EY also notes that 49% of the respondents identified “no effective available communication channel” as one of the largest obstacles for corporate cultural integration. EY believes that enterprises should establish effective internal and external communication mechanisms and coordinate different stakeholders once an investment is completed. We also suggest that enterprises specify a lead department responsible for internal communication. In Section 4, we elaborate on the cultural integration issues faced by Chinese enterprises at the integration stage of overseas M&As.

EY’s recommendations:

Prior to investing, Chinese enterprises should strengthen their risk assessment of local and corporate culture and geopolitical situations, conduct due diligence and assessment with the help of professional organizations like EY, design management models for different stages of investment (e.g. Chinese enterprises could delegate more to their acquiree in the early stages, and gradually retrieve the power later), and develop a more inclusive corporate culture, in order to create a diverse business environment in which colleagues with different backgrounds are mutually respected and understood. Through such management, relationships between investors and investees should be allowed to gradually develop into more reasonable and balanced ones.
Alignment of strategic objectives

In this survey, 58% of respondents viewed “failure to align strategies between the investor and investee” as the greatest challenge for Chinese enterprises when it comes to overseas operations and management. Further questioning on “alignment of strategic objectives” showed that:

<table>
<thead>
<tr>
<th>Cause</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investor does not agree on strategy and development objectives with the overseas investee/acquiree</td>
<td>77%</td>
</tr>
<tr>
<td>Lack of professional analysis on the investee/acquiree’s development strategy</td>
<td>58%</td>
</tr>
<tr>
<td>Failure to consider changes in economic environment</td>
<td>58%</td>
</tr>
</tbody>
</table>

77% of the respondents believed that “investor does not agree on strategy and development objectives with the overseas investee/acquiree” was a key factor affecting the alignment of strategic objectives, while those who chose “lack of professional analysis on the investee/acquiree’s development strategy” and “failure to consider changes in economic environment” as the obstacles to aligning strategic objectives in overseas operations both accounted for 58%. Therefore, enterprises need to take precautions to develop clear M&A strategies based on specific industry trends prior to investing, and eliminate differences in corporate strategy, such as: entering into new markets, acquiring brands, expanding brand recognition, accessing resources, new technologies and products, cutting costs, and “going global” via their upstream and downstream industry chains.

After establishing the development vision and strategy for going global, enterprises should effectively screen target companies by thoroughly understanding the target companies’ business and development strategies, and conducting professional analysis and comprehensive assessment of the target companies, in order to identify the most suitable target and minimize the risk of strategy inconsistency in long-term operations at an early stage.

In addition, Chinese enterprises should thoroughly understand the target market’s macro economy, in terms of economic growth prospects, finance (credit, interest rate, and foreign exchange), and price and tax policy stability. This understanding of the macro economy is helpful for allowing enterprises to make rational judgments when selecting the right investment destinations.

During the post-deal integration process, enterprises should develop a comprehensive coordination plan and identify the opportunities for coordination in sales, purchasing, production, operations and other areas, and achieve synergies by integrating the brand, marketing, customer channels, sales channels, purchasing models, and research and development systems.

**EY’s recommendations:**

EY’s recommendations: Chinese enterprises should specify their M&A strategies prior to investment, analyze the target companies’ development vision and strategies from a professional perspective, and screen them effectively. During the integration stage, Chinese enterprises should try to realize synergies and maximize their return on investment. At the same time, facing a changing market environment, they should also seek an exit as early as possible once they confirm the deal doesn’t fit their strategies well.
Local talent attraction and retention

The survey indicates that about 35% of respondents believe that the problem of local talent attraction and retention is a severe challenge for overseas business management. After further investigation, we find that changes in the target’s corporate culture and management style, and the reluctance of foreign employees to be managed by Chinese enterprises, are key factors leading to the problem of local talent attraction and retention. EY finds that successful enterprises will conduct in-depth investigations into the target’s personnel structure, personnel status, compensation and benefits, and fully assess the risk of losing core team members during the human resources due diligence stage prior to investment. In the initial stage of post-deal integration, investors should fully communicate with core staff members to ensure they understand the purpose of the investment, the company’s future development strategies, job allocation and other key information and have any concerns about the new company relieved; at the same time, the acquirer should also have an in-depth understanding of core staff members’ retention factors and develop a targeted employee retention program.

EY’s recommendations:

Chinese enterprises should conduct sufficient human resources due diligence work before investment, adjust corporate strategies based on their strategic M&A objectives, and implement active “talent management”, which aims at maximizing talent efficiency on the prerequisite of legal compliance.

“What are the biggest challenges faced by your company concerning talent management of overseas business?”

83% chose “Changes in corporate culture result in talent drain”

72% chose “Changes in the company’s management style lead to talent drain”

64% chose “Reluctant to be managed by Chinese enterprises”
The talent retention issue is affected by a number of factors. When developing a specific retention program, enterprises should not only consider how to achieve short-term talent retention, but also consider how to align with employees’ long-term development plans and then adopt incentives possible to support employees’ long-term stability. EY’s experience indicates that the retention bonus program is a popular one in existing employee retention plans. In order to deal with the local talent retention problem in overseas operations, Chinese enterprises should not only cultivate internationalized local staff members who are familiar with overseas business, but also avoid “cultural migration” – simply migrating headquarters’ culture and management principles into acquired entities overseas. We recommend that the C-suite executives of Chinese enterprises adopt a diverse and inclusive management principle, and establish a business environment that promotes D&I and “win-win” ideas, in order to address talent retention problems caused by changes in corporate culture in their overseas investment.

**Other factors affecting overseas business management**

In addition to the above three difficulties in overseas business operations, 34% of respondents believe that worse-than-expected financial performance is also a predicament for Chinese enterprises’ overseas business operations. Based on our additional questioning, we find that lack of effective KPI (Key Performance Indicator) systems and competitive analysis systems, and failing to optimize operating costs and achieve necessary synergies in sales and services are all reasons behind weak overseas business performance.

We recommend that enterprises optimize KPI setting and the incentive packages of the management team of their acquiree, while improving the restraint mechanism. In addition, they should customize talent retention programs to include necessary provisions such as attractive compensation and incentive plans.

**Figure 19: Customize a local talent retention program**

<table>
<thead>
<tr>
<th>Employee category</th>
<th>Retention factors</th>
<th>Employee retention program</th>
</tr>
</thead>
<tbody>
<tr>
<td>C-suite executive</td>
<td>▶ Long-term development opportunities across companies and industries</td>
<td>▶ Make necessary adjustments to compensation based on the new job responsibilities</td>
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<tr>
<td></td>
<td>▶ Stakeholders’ input and attention to the company</td>
<td>▶ Performance incentive plan</td>
</tr>
<tr>
<td></td>
<td>▶ Management authority</td>
<td>▶ Retention bonus plan</td>
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<tr>
<td></td>
<td>▶ Terms of reference</td>
<td>▶ Option incentive plan</td>
</tr>
<tr>
<td>Managers</td>
<td>▶ Interesting and challenging work</td>
<td>▶ Make necessary adjustments to compensation based on the new job responsibilities</td>
</tr>
<tr>
<td></td>
<td>▶ Career development/further promotion opportunities</td>
<td>▶ Performance incentive plan</td>
</tr>
<tr>
<td></td>
<td>▶ Corporate culture and management atmosphere</td>
<td>▶ Retention bonus plan</td>
</tr>
<tr>
<td></td>
<td>▶ Sound relationship with immediate supervisor</td>
<td>▶ Option incentive plan</td>
</tr>
<tr>
<td>General employees</td>
<td>▶ Opportunity for permanent job</td>
<td>▶ Make necessary adjustments to compensation based on the original compensation structure</td>
</tr>
<tr>
<td></td>
<td>▶ Recognition of personal contribution</td>
<td>▶ Performance incentive plan</td>
</tr>
<tr>
<td></td>
<td>▶ Sound relationship with immediate supervisor</td>
<td></td>
</tr>
<tr>
<td></td>
<td>▶ Attractive compensation</td>
<td></td>
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</tbody>
</table>

Source: Shanghai Outbound Investment Report 2016
Analysis of the overseas business management challenges facing Chinese enterprises with regard to investment destinations and sectors

To further explore the overseas business management challenges facing Chinese enterprises, we conducted an in-depth analysis with regard to their investment destinations, sectors and investor type (SOE or private enterprise).

Our survey finds that the challenges faced by respondents are slightly different according to different destinations for overseas operations. For example, 50% of respondents in Africa believe the performance of overseas operations there is unsatisfactory, a much higher proportion than for other regions, suggesting that Africa’s macroeconomic instability can lead to an increase in operational risks. In Japan, South Korea and India, the difficulty in integrating corporate culture is relatively higher, which reflects that the local culture is more powerful, and results in large differences between the inherent cultures of local enterprises and Chinese enterprises, making it more difficult to integrate. Compared with other regions, more respondents believe that communication with regulators and the public in the Middle East is a major challenge. The region has significant differences with China when it comes to language, culture, and social customs, causing obstacles in communication and cooperation.

Figure 20: Respondents’ perception of challenges in the operations and management of overseas business, by geography

14 Source: Economic Insight: Africa, The Institute of Chartered Accountants in England and Wales (ICAEW)
According to the survey, respondents from various sectors are challenged mainly by cultural integration, strategic target alignment, and local talent attraction and retention problems in their overseas business management. However, there are some differences between sectors. For example, pressure from the performance of overseas business stands out in the automotive and high-end equipment manufacturing sector and TMT sector. This reflects that some sectors are under greater pressure when it comes to post-deal consolidation due to the specificity of their sectors, so these enterprises will focus more on the challenge of achieving performance synergies in their overseas business.

Enterprises from the energy sector and real estate, hospitality and construction sector have to communicate smoothly with regulators and the public, which can be a problem when it comes to overseas business. This reflects that, if external communication is ineffective in these industries, overseas business will not be conducted successfully. In addition, for infrastructure and TMT sectors, compliance and tax declaration are a critical challenge. Given that infrastructure enterprises are the major participants in Chinese outbound investments and TMT is a core sector in China's industrial transformation and upgrade, the challenge faced by enterprises in these two sectors reflects their lack of experience in handling overseas legal and tax issues, and the complexity of legal and tax issues in corresponding areas overseas.
Figure 22: Various perceptions of SOEs and private enterprises for challenges in the management and operations of overseas business

According to our findings, compared with SOEs, private enterprises find it is more difficult to achieve cultural integration with overseas companies. Private enterprises tend not to be so able to cope well with cultural integration in their overseas operations due to a limited pool of international talents. In addition, private enterprises’ overseas investments are more diverse, resulting in greater difficulties for corporate cultural integration. Furthermore, the scale of Chinese private enterprises’ overseas investment in recent years has continued to increase and is now almost equivalent to that of SOEs, yet private enterprises still lack international experience in the short term and are inclined to simply apply experience from their domestic business operations to overseas business operations. As a result, cultural conflict is prone to occurring.

In terms of talent attraction, EY’s survey showed that some SOEs were less likely to make a success of overseas positions because they were more likely to dispatch domestic employees to take charge of management and operations in their investment destinations, while private enterprises performed better by localizing overseas employees (see the 5th issue of China Go Abroad for details). Therefore, SOEs faced greater challenges in attracting local talents or retaining their core talents from overseas.

In addition, the survey results show that private enterprises face smaller challenges than SOEs when it comes to issues like compliance and tax declaration, and communication with regulators and the public. The results partly indicate that domestic regulatory authorities remain cautious about SOEs’ outbound investments and impose increasingly rigorous reviews on these investments. On the other hand, it seems more likely for domestic private enterprises to overlook or underestimate the potential risks and challenges involved in outbound investments and business operations, due to a relatively tolerant and loose domestic regulatory environment.

With regard to the setup of internal control systems, it seems to be less of an issue for SOEs than it is for private enterprises, according to the survey results. SOEs, as pillars of the national economy, are required to regulate internal control systems to promote their healthy development, while due to a reliance on their own rules and a lack of experience in overseas management during the start-up stages, private enterprises need to improve their internal control systems during overseas expansion.

EY’s recommendations

Lack of experience in overseas business management sometimes limits Chinese enterprises’ target selection, which results in fewer qualified targets overseas, while at higher prices. This leads to a vicious cycle. Therefore, Chinese enterprises should enhance their overseas business management capabilities. We suggest that Chinese investors aim at “seeking battle after the victory has been won”, rather than “fighting first and looking for victory afterwards”.

Private enterprise State-controlled/state-shareholding enterprise

Corporate cultural integration
Strategic targets alignment
Performance of overseas assets
Local talent attraction and retention
Internal control system setup
Compliance and tax declaration
Communication with regulators and the public
IT system setup and integration
Accounting system and report integration
Management of external stakeholders (e.g. customer relations, supplier management)
Cash flow management and profit distribution

0% 20% 40% 60% 80% 100%
Figure 23: Aspects that affect overseas business management during the whole investment process

<table>
<thead>
<tr>
<th>Challenges</th>
<th>Measures</th>
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<tr>
<td></td>
<td>Planning and market entry</td>
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<tr>
<td></td>
<td>Planning and market entry</td>
</tr>
<tr>
<td></td>
<td>Deal execution</td>
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<tr>
<td></td>
<td>Integration and closing</td>
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<tr>
<td></td>
<td>Define investment strategy, carefully screen and assess the target</td>
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<td></td>
<td>Conduct detailed and comprehensive due diligence</td>
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<td></td>
<td>Communicate effectively with stakeholders</td>
</tr>
<tr>
<td></td>
<td>Develop and implement integration plan</td>
</tr>
<tr>
<td>Corporate cultural integration</td>
<td>√</td>
</tr>
<tr>
<td>Strategic targets alignment</td>
<td>√</td>
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<tr>
<td>Performance of overseas business</td>
<td>√</td>
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<tr>
<td>Local talent attraction and retention</td>
<td>√</td>
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<tr>
<td>Compliance and tax declaration</td>
<td>√</td>
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<tr>
<td>Communication with regulators and the public</td>
<td>√</td>
</tr>
<tr>
<td>IT system setup and integration</td>
<td>√</td>
</tr>
<tr>
<td>Internal control system setup</td>
<td>√</td>
</tr>
<tr>
<td>Accounting system and report integration</td>
<td>√</td>
</tr>
<tr>
<td>Management of external stakeholders</td>
<td>√</td>
</tr>
<tr>
<td>Cash flow management and profit distribution</td>
<td>√</td>
</tr>
</tbody>
</table>

Based on the above analysis of those challenges, we summarize below areas which can result in problems in Chinese enterprises’ overseas business operations and management, and propose suggestions to help Chinese enterprises steadily implement overseas investment and business operations in the coming days.

Figure 24: Overseas business management going wrong – reasons and recommendations

<table>
<thead>
<tr>
<th>Reasons which cause overseas business to fall into trouble</th>
<th>Planning and market entry</th>
<th>Deal execution</th>
<th>Integration and closing</th>
</tr>
</thead>
<tbody>
<tr>
<td>The enterprise lacks clear investment strategy planning and a full understanding and careful screening of the local factors affecting the target enterprise. For example, the enterprise neither conducts detailed and careful due diligence for the target, nor understands the target’s market environment, legal environment and tax environment, as well as its real business model and financial position.</td>
<td>As the enterprise does not establish an effective communication mechanism with stakeholders in the host country, it can only communicate with government agencies, suppliers, clients and internal employees in a relatively restricted way.</td>
<td>The enterprise fails to: prepare a detailed and comprehensive integration plan; understand the target’s operations and legal and regulatory requirements as soon as possible; fully understand the target’s corporate culture; develop a plan for retaining key talent and clients.</td>
<td></td>
</tr>
</tbody>
</table>

**EY’s recommendations**

- The enterprise should conduct careful screening, seek to fully understand and assess the target, further analyze whether the two companies have significant business alignment, and define its own development strategy.
- The enterprise should engage a professional third party to conduct due diligence, cultivate an internal due diligence team that is familiar with process and international practice, and grant it the authority to effectively control the long-term risks in post-deal overseas business operations.
- The enterprise should establish an effective communication mechanism with stakeholders, covering government, shareholders, clients, internal employees, local community, media, trade associations, etc.
- The enterprise should develop a restructuring plan, establish a clear management structure, fully understand business models and marketing channels of both sides, adjust strategies, and integrate resources in order to achieve synergies.
- The enterprise should fully communicate with the target’s employees and promote corporate cultural integration to ensure stable post-deal development.
Managing your global operations in a diverse business environment

3.1 What is diversity and inclusiveness (D&I)?

 Enterprises that invest extensively in D&I are more likely to coordinate better as a team, retain more people, gain a greater market share and win in new markets.

**Diversity is about all differences.** Each of us is different. For individuals, diversity may refer to having different educational, gender, ethnic, national, generational, and religious backgrounds. Diversity may also mean being of different ages, having different sexual orientations as well as working and thinking styles, or working for different departments and possessing different abilities and skills, etc. Each enterprise is also different. For enterprises, diversity may refer to engaging in different industries, geographical areas, and developmental stages, etc.

**Inclusiveness is about leveraging these differences to achieve better business results.** It refers to creating an environment where all people feel recognized and valued. When leading enterprises inclusively, you can:

- Retain key talent and improve attrition
- Minimize unanticipated costs & business disruption
- Increase productivity and level of innovation so to shorten payback period
- Gain in external brand value with increased stakeholders’ confidence

\[ \text{Diversity is about all differences} \quad + \quad \text{Inclusiveness is about leveraging them} \quad = \quad \text{Growth for the business} \]
It has been proved that a lack of inclusiveness and effective communication has hindered cross-cultural integration between Chinese and foreign companies in today’s pluralistic and diverse international environment. Companies can bridge this gap by investing in D&I.

D&I principle should be embedded into all the stages from planning to integration during an overseas investment, and be reflected in areas such as risk and return, legal and compliance, financial and control, and people and culture that enterprises pay special attention to in the investment.

Figure 25: D&I considerations in outbound investments

- **Better Team collaboration** +57%
- **Greater Retention** +19%
- **More likely** Improve market share +45%
- **More likely** Success in new markets +70%

---

+ Source: CEB, Driving Retention and Performance Through Employee Engagement, Arlington, VA, 2008
+ Source: Sylvia Ann Hewlett, Melinda Marshall and Laura Sherbin with Tara Gonsalves; Innovation; Diversity & Market Growth (Center for Talent Innovation; 2013)
3.2 Build a diverse and inclusive team

As a diverse perspective can drive innovation, promote collaboration and enhance interpersonal relationships, a diverse and inclusive team will outperform others.

Talent is undoubtedly one of the most important assets for enterprises. Almost all Chinese enterprises pay attention to attracting, retaining and cultivating talent in their outbound investments because it is critical for them to hire better talent as they expand. Innovative and superior products will count for nothing if enterprises do not establish efficient teams to carry out their strategies.

In recent years, as Chinese enterprises have sped up their pace of “going global”, China’s outward FDI stock has increased every year. As of 2016, China’s outward FDI stock ranked in fifth globally. At the same time, the number of foreign citizens employed by Chinese companies has also grown significantly. By the end of 2016, the number of foreign citizens employed by Chinese companies overseas reached 1.5 million, increasing 4 times since 2007.

However, according to the research, foreign employees only account for 10% of those working in Chinese multinational enterprises, a much lower proportion than that in developed and other BRICs countries, including South Africa, Brazil and India. We believe Chinese enterprises should accelerate the implementation of talent localization strategies to maximize the benefits of post-deal integration. Because local employees are not only more familiar with the characteristics, policies and culture of investment destinations, but also able to quickly respond to the changes in local markets, this talent is critical for Chinese enterprises at the integration stage of outbound investment.

According to our research, talent internationalization and talent localization are two key challenges faced by Chinese enterprises when it comes to outbound investment. EY recommends that, at each stage of outbound investment, Chinese enterprises should seek to balance the two strategies based on industrial characteristics and economic strength, and make full use of the professional advisory team from a third-party intermediary to optimize their talent structure, so as to achieve better business results.

Sources: MOFCOM, WIND

**Figure 26: Foreign employees that Chinese enterprises hired abroad, 2007-2016 (million)**

**Figure 27: Outward FDI stock (US$ billion) in 2016 and proportion of foreign employees in multinational enterprises of major countries**

* The data from Hong Kong, Macau and Taiwan are excluded
** Data are selected for foreign employees of major multinational companies in different countries in 2015

Sources: UNCTAD, EY analysis

**Figure 26**

**Figure 27**

Sources: MOFCOM, WIND

17 Sources: MOFCOM, WIND
As many European countries have introduced gender quotas for boards of directors, Chinese enterprises must not only respect cultural differences between country and country, but also consider how to achieve greater gender diversity when actively expanding overseas.

In addition, we have noticed that many enterprises are establishing gender-diverse teams and an increasing number of companies are appointing females as senior executives. For example, the number of female directors has increased, in part due to the implementation of “gender quota systems for boards of directors”, led and advocated for by developed European countries. Meanwhile, industry research indicates that female leadership has a positive influence on performance. According to the research, companies with strong female leadership (where the board of directors includes three or more females; the proportion of female directors is higher than the country’s average level; or the CEO is female and the board of directors includes at least one other female) enjoyed a 36% higher return on equity than companies lacking female leadership. The research also finds that a lack of gender diversity at board level results in more disputes in corporate governance.

Figure 28: Overview of countries mandatorily introducing a gender quota system for the boards of directors of listed companies

<table>
<thead>
<tr>
<th>Country</th>
<th>Proportion</th>
<th>Effective year</th>
<th>Penalties</th>
</tr>
</thead>
<tbody>
<tr>
<td>Israel</td>
<td>At least one female</td>
<td>1999</td>
<td>N</td>
</tr>
<tr>
<td>Norway</td>
<td>Females account for 40%</td>
<td>2008</td>
<td>Y</td>
</tr>
<tr>
<td>Iceland</td>
<td>At least 40% for both males and females</td>
<td>2013</td>
<td>N</td>
</tr>
<tr>
<td>Italy</td>
<td>At least 33% for underrepresented gender</td>
<td>2015</td>
<td>Y</td>
</tr>
<tr>
<td>India</td>
<td>At least one female</td>
<td>2015</td>
<td>Y</td>
</tr>
<tr>
<td>Germany</td>
<td>Females account for 30%</td>
<td>2016</td>
<td>N</td>
</tr>
<tr>
<td>France</td>
<td>Females account for 40%</td>
<td>2017</td>
<td>Y</td>
</tr>
<tr>
<td>Belgium</td>
<td>Females account for 33%</td>
<td>2017-2020</td>
<td>Y</td>
</tr>
</tbody>
</table>

Sources: Catalyst.org, MSCI.com, EY analysis

18Source: MSCI ESG Research, the research covered companies in the MSCI World Index as of Sep 2015, measured on an equal-weighted basis.
EY believes that, as employees’ gender, nationality and other diversity indicators are not set as development targets for enterprises, Chinese enterprises should focus on how to drive collaboration and innovation by leveraging the differences offered by diverse groups of employees and establishing high-performing teams. By doing so, they can seek to achieve better business results, while also being compliant with the indicators mentioned above as they implement the “going global” strategy.

Figure 29: EY corporate culture evolution roadmap: build high-performance teams

In the heart of our strategy is high-performance teams. That means having the very best people, and then having them team across the world better than anyone else. That team has to be diverse and it has to be inclusive."

Mark Weinberger
EY’s Global Chairman and CEO
In recent years, D&I has become increasingly important for Chinese enterprises’ overseas investment. These enterprises can take the opportunity to better overcome the obstacles caused by different cultures in their overseas investments, optimize their overseas business management, and fully realize better collaboration and strategic cooperation between the parent company and the overseas business. Credit China FinTech Holdings Limited (Credit China FinTech) adopts a similar approach to effectively manage the differences between the parent company and its overseas business and partners, helping to achieve a “win-win” situation. Credit China FinTech is a leading integrated FinTech group that provides online financial services to SMEs, merchants and individuals in China and Asia. In recent years, Credit China FinTech has carried out several investments and M&As at home and abroad. For the development of its FinTech business, the company has established a clear corporate strategy and deployed the right professionals to support this strategy. The firm has also introduced a large number of senior professionals to its board of directors and built a diverse board structure in order to implement D&I ideas from top to bottom.

In addition to corporate governance, Credit China FinTech also pays attention to D&I in its outbound investments. Before investment, the company focuses on whether the acquired team’s enthusiasm, work attitude, ideas and business objectives are consistent with its own, and pays attention to targets with similar corporate culture, and whose direction of development is aligned. Undoubtedly, it is easier for the parent company to carry out its ideas with targets that are truly aligned.

From corporate governance to overseas investment operations, Credit China FinTech has learnt from others’ successful experience and fully developed the idea of diversity:

► For corporate governance, it introduces professionals to the board of directors to build a diverse board structure;
► For outbound investments, it focuses on the pursuit of targets with a highly consistent corporate culture;
► For overseas business management in the post-deal stage, it absorbs and leverages the international background of the acquired enterprise, and helps the acquired enterprise to develop technologically.

Through the application of D&I, Credit China FinTech has persisted in adapting to differences in an inclusive way, smoothly coordinating and cooperating with partners/investees from diverse cultural backgrounds, and better resolving any difficulties in bilateral cooperation due to different cultures. At the beginning of 2017, Credit China FinTech invested in and took control of Amigo Technologies, a financial and IT services provider in Vietnam, and made full use of the Amigo team’s international background and experience to effectively eliminate any cultural obstructions to cooperation between the two enterprises. Most of Amigo’s executives are native Vietnamese with experience studying abroad, who are fluent in English and have been introducing overseas technical experience to Amigo for the last 10 years. This international background and experience helped Amigo quickly adapt to overseas cooperation, and thus bilateral cooperation progressed smoothly. During the integration period, Credit China FinTech also assisted Amigo’s executives learning about the development experience and technical advantages of the FinTech industry in China, in order to help narrow the FinTech gap between China and Vietnam.

Case study: how Credit China FinTech’s overseas investment stands out in diverse cultures

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EY’s observations:

Facing the tide of diverse cultures, Credit China FinTech is constantly seeking greater consensus, improving the quality of its talent and cooperating with overseas enterprises with a higher level of internationalization as the result. By doing so, the company upholds the principle of “investment is to help investees grow rapidly”, and thus coordinates smoothly with external partners and achieves a “win-win” situation.
EY overseas investment growth navigator – Key analysis on corporate culture

Driven by globalization, more and more multinational companies are now being required to reshape their corporate culture to make it more inclusive in a diverse global environment. EY believes that only when enterprises take advantages of different views, perspectives and cultural considerations to cultivate the highest-performing teams, can they win in the global marketplace.

EY’s experience shows that the difficulty in integrating corporate cultures also lies in the fact that “cultural integration” is sometimes misinterpreted as “cultural migration” – despite some Chinese enterprises knowing that cultural integration is the key to success in overseas acquisitions, they simply implanted the domestic corporate culture and management approach into the acquired enterprise in practice, with the original culture of the overseas enterprise sometimes even being destroyed.
Figure 30: EY recommends that Chinese enterprises take four steps in the cultural integration of overseas business

1. Understand differences:
   Establish a department to lead the construction of the new culture; conduct employee investigations and interviews at multiple levels (management and core departments) to understand the differences between the investee and the management of the Chinese enterprise in terms of work style and habits, cognitive perspectives, management style, values and corporate strategy and vision.

2. Evaluate differences:
   Assess the cultural gaps one by one, identify potential cultural conflicts, and determine the objectives and key initiatives for building cultural integration, etc.

3. Enhance communication:
   Assess the cultural gaps one by one, identify potential cultural conflicts, and determine the objectives and key initiatives for building cultural integration, etc.

4. Create a diverse and inclusive environment:
   Respect cultural differences; achieve better business results by leveraging differences; create an environment with mutual awareness and mutual respect; and cultivate leaders with an inclusive mindset.

Sources: Shanghai Outbound Investment Report 2016, EY analysis
Case study:

an enterprise’s internal cross-cultural communication and collaboration project

**Project background:** A Chinese equipment manufacturing enterprise carried out a series of acquisitive activities in Europe and America in recent years.

**Challenges:** Lacking understanding of the different cultural backgrounds in overseas business, the enterprise had difficulties in realizing the cultural integration of different overseas subsidiaries.

**How EY helped:** The enterprise arranged a two-day “Global CEO Summit” with EY’s assistance. During the summit, the enterprise invited the executives from all its recently acquired overseas enterprises to its China headquarters, and held a series of exchanges to discuss the topics of corporate cultural integration and talent integration.

**Project process:** During the summit, the executives were required to form temporary teams with delegates from other overseas enterprises and consider their team as a new business. One of the tasks required of these teams was to fully integrate the views of members from different enterprises, in order to create a global strategy for the “new business”. Another task required team members to share their knowledge and understanding of a team member’s country, with that member then commenting on those perceptions.

**Project achievements:** The event provided a platform for overseas subsidiaries to deepen their understanding and awareness of each other’s countries, corporate cultures and business philosophies, as well as laying a solid foundation for future cooperation.

**EY’s comments:**

EY believes that the Chinese enterprise has made an exceptional effort, through intra-group integration, to achieve mutual understanding and inclusion among subsidiaries from different countries in areas such as business, talent and culture. It has also set a good example for other Chinese enterprises seeking to achieve successful overseas M&As and efficient overseas business operations.
However, without strict implementation standards and evaluation systems, many managers often overlook this topic during the M&A process. As a result, they may fail to realize the final value of such transactions. EY’s corporate cultural integration framework is designed to facilitate cultural integration from four concrete perspectives: incentives, leadership, decision frameworks and organization.

**Figure 31: EY’s corporate cultural integration framework**

- **Incentives:** providing the right motivations
  - Rewards: including compensation and promotions, are risk and behavior adjusted
  - Employee life cycle: including recruiting, onboarding, and exiting process, promotes desired behaviors and effective decision management
  - Risk appetite: is clearly articulated, well understood, consistent with business strategy and embedded into decision making throughout the organization
  - Transparency: is enabled by clear and comprehensive reporting and inclusive communication

- **Leadership:** communicating the right message
  - Tone from the top: clearly establishes desired behaviors, with middle management approaches and behaviors in alignment
  - Behavior standards: are established, assessed and embedded into performance management process
  - Roles and responsibilities: are clearly articulated and well-understood, and accountability is well-defined and established
  - Governance: is effective and facilitates open communication and challenge

- **Decision framework:** taking the right risks
  - Winning Culture

- **Organization:** establishing the right environment
  - EY overseas investment growth navigator
  - Key analysis on corporate culture

**EY’s recommendations:**

In order to better serve Chinese enterprises in their overseas ventures, we obtained a number of key recommendations from interviews with EY’s global professionals:

1. Learn to delegate: Replace your management team if you cannot trust them completely, or let them make independent decisions, especially on those vital decisions related to local issues.
2. Respect cross-cultural differences: For example, many European countries adhere strictly to the cultural concept of balancing work and leisure. Local staff in these countries will often prefer to pursue a work-life balance.
3. Communication is key: A bilingual, or even trilingual team (especially in the Middle East and North Africa) is the key to effective communication. Of course, how you communicate is also important.
4. Form robust teams for both domestic and overseas transactions.
5. Do not avoid risks overly: In many cases opportunities always come with challenges.
6. Prepare as early as possible. Do not wait until a problem emerges in any section.
Case study:

D&I in M&As, by Heaven-Sent Capital Management Group

Heaven-Sent Capital Management Group (HSC) describes itself as a comprehensive capital management group that specializes in professional services for M&As. HSC’s overseas M&A business started in 2011. It has focused on high-quality assets, such as technologies, resources, and brands (channels), as well as low-value overseas assets, with a view to various areas such as diversified management, asset allocation optimization and risk decentralization. The business is designed to facilitate domestic technology upgrades and economic restructuring, and to help Chinese enterprises – especially listed companies – to allocate assets globally.

HSC points out that overseas M&As bring special risks. The target’s own culture and management systems, as well as the religious, cultural, legal, regulatory and other differences found in the countries or regions where the target operates, add additional challenges to M&As. Based on its experience in overseas investment, HSC believes that enterprises should take the following measures in response to the risks listed below:

**Overseas investment decision-making assessment:**

On the one hand, HSC considers the target’s financial quality, growth potential, and valuation rationale; on the other hand, it considers whether the target’s size and sector fit HSC’s own needs, corporate culture, development strategies and capabilities, plus whether there will be clear synergies.

**At the planning stage**

As early as possible, HSC evaluates the integration risks involved after the transaction completes, to facilitate the target’s integration and the delivery of expected value. For example, prior to the acquisition, HSC starts the integration planning and preparation for the investee, looking at corporate governance, business processes, business models, etc. HSC believes that early integration planning can be beneficial for both sides, by preventing the transaction from falling into the trap of “acquisition without integration”, and by laying the foundations for successful business integration.

**At the execution stage**

HSC focuses on the assessment of the differences in accounting standards and tax policies, and seeks to maximize its interests by leveraging these differences, while minimizing risks. HSC works proactively with professional institutions to create financial and tax due diligence reports that provide a clear understanding of the target’s financial position and a reasonable valuation.

**During the integration stage**

HSC, as a Chinese entity conducting cross-border investment, is well aware of the significance of having a team with international vision and deep knowledge about Chinese and Western culture in place, to support effective operation of the integrated company post-transaction. Therefore, HSC assesses specific due diligence situations and the different stages of integration to decide whether to retain existing talent or hire local talent, improving management localization and talent retention.

**Talent strategy for overseas M&As:**

- Where the target has stable operating conditions and growth momentum, HSC retains the existing staffing structure for a long period, taking talent retention as one of its objectives for the operational transition stage. As mutual understanding and integration deepens between the two parties, HSC builds a comprehensive dynamic talent assessment system for existing staff. The assessment refers to a management member’s background, expertise, recognition of HSC, integration with the team and many other factors, and the assessment result is used to review existing talent. HSC then considers whether to replace some of the existing team members with local talent, based on actual operational conditions.

- Where the target is experiencing strategic transformation or a decline in performance, or there are signs of instability in the management team during the acquisition, HSC considers the possibility of appointing new management members during the negotiation and implementation process, and makes corresponding arrangements. HSC employs D&I in the design of the team and organizational structure. Additionally, building effective incentive mechanisms is key to attracting and retaining talent. HSC uses a combination of short-, mid- and long-term incentive mechanisms to improve the team-building process.
In recent years, some countries appear to be against globalization and to be advocating for nationalism. This has not directly affected HSC’s overseas business, but HSC will put a greater focus on risk assessment when it comes to D&I. HSC takes into full consideration the diversity in operations when conducting target identification and screening, project establishment and due diligence; gaining access to resources; optimizing asset allocation; and decentralizing business risks. HSC also considers the target’s culture and management systems and the religious, cultural, legal, regulatory and other differences in the country or region in which it operates. HSC fully assesses the potential risks arising from these differences at the later implementation and post-investment management stages, and tries to make rational and inclusive investment decisions. During the negotiation and execution stage, these differences are addressed in an inclusive and harmonious manner so that the transaction can be completed smoothly. In the post-investment management and operation stage, the focus should be placed on building an inclusive company atmosphere under the new governance structure. This structure has been given full consideration and carefully designed before the investment was made, to ensure a successful integration in terms of corporate management and operations between the two parties, achieving a “win-win” situation and maximizing investment benefit.

In addition to helping Chinese enterprises “go global”, HSC also lays emphasis on its own overseas expansion. It has completed the successive establishment of platforms in Hong Kong, South Africa, and Canada (for North America operations), making it well prepared for future overseas business. HSC has to consider things from different perspectives when expanding its overseas network. For example, with respect to the overall strategy at group level, HSC needs to consider whether the new platforms are conducive to the development of future overseas business (in terms of the identification and reservation of quality targets, transaction facilitation and acceleration, and the exploration of overseas financing channels); from an operational perspective, HSC needs to consider the target country’s or region’s political and social stability, consistency in legal policies and the benefits they provide (e.g., tax incentives that help reduce the overall tax burden of the group), attitudes towards foreign investment enterprises, and the operating costs of enterprises (e.g., rent and labor costs), as well as the impacts of religious and cultural differences on corporate operations and management.

Source: Heaven-Sent Capital Management Group Co., LTD., compiled by EY
Looking forward, Chinese outbound investment will continue its steady development.
In H1 2017, China’s outbound investments scale decreased due to regulatory policies and overseas economic and political uncertainties, and Chinese investors, with a tendency towards rationality, turned to optimize investment structure rather than investment quantity. Outbound investment cooperation will continue to drive the establishment of a new, open economic landscape as China deepens its reform, strengthens its comprehensive national power and accelerates its industrial transformation and upgrade. At the same time, supported by the Belt and Road Initiative, China’s outbound investment momentum remains unchanged in the future. In H2 2017, we remain optimistic about the prospect of Chinese enterprises “going global”. Firstly, Chinese and US leaders reached consensus that mutually beneficial cooperation is the only direction for development when meeting this April; secondly, China and the EU have continued to develop practical cooperation while maintaining a stable relationship; thirdly, as some achievements such as cooperation projects in the energy and infrastructure industries are implemented after the “Belt and Road Forum for International Cooperation”, investment in the countries along the Belt and Road can be expected to increase gradually.

From our survey, we understand that Chinese enterprises have faced the same challenges in terms of corporate culture, strategy and talent under different backgrounds during their long-term post-deal overseas business operations and management. Therefore, EY and the CMAA suggest that enterprises should seek to establish a diverse and inclusive business environment and manage multinational companies in a more flexible way, in order to enhance their capability for deploying and controlling resources and to boost their competitiveness in the global market.

We believe that as Chinese enterprises gain experience on their internationalization journey, they can better manage their overseas business, and realize strategic collaboration and “win-win” outcomes in an inclusive way.
The current wave of globalization continues to transform the business landscape and impact companies around the world. With China’s “One Belt, One Road” initiative and “manufacturing power” policy set out in the 13th Five Year Plan, China will undoubtedly play an increasingly mature and globalized role in the global economy. The global economic situation is still uncertain and challenges may arise due to cultural differences, language barriers, financing difficulties and regulatory issues. Chinese companies need to respond in a timely manner to these challenges while navigating a complex and dynamic outbound transaction environment.

The China Overseas Investment Network (COIN) links EY professionals around the globe, facilitates collaboration, and provides consistent and coordinated services to our Chinese clients making outbound investments. Building on the existing China Business Group in the Americas, EMEIA, Asia-Pacific and Japan areas, COIN has expanded our network into 66 countries and territories around the world.

China Overseas Investment Network helps Chinese business navigate through global markets

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## Our global COIN network

For more information on our China Overseas Investment Network, please visit our website at www.ey.com/cn/coin or contact:

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About CMAA

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