Financial Risk Control and Avoidance Measures in Enterprises Mergers and Acquisitions

Fenfang Liu*
School of Management,
Wuhan Technology and Business University,
Wuhan, China

Abstract—there has been a wave of mergers and acquisitions in all industries as a result of the continuous development of the market economy, the fiercer competition among countries and industries as well as the constant increase of concentration of industries. Mergers and acquisitions can reduce transaction costs for the implementing subjects, bring scale benefits to the mergers and acquisitions subjects to quickly enter into emerging industries, improve their competitive advantages through the integration of assets and their operating performance after mergers and acquisitions together with financial risks. Based on the current research background and relevant theories, this paper analyzes the motivation, financial risks and other relevant theories of mergers and acquisitions, summarizes the financial risks of mergers and acquisitions, specifically analyzes the financing risks, payment risks, financial integration risks and influencing factors of mergers and acquisitions, and takes GEELY’s acquisition of Volvo group as an example to analyze the financial risks of mergers and acquisitions, and finally puts forward corresponding suggestions on the prevention and control of financial risks of mergers and acquisitions.

Keywords—mergers and acquisitions motivation; financial risk; GEELY

I. INTRODUCTION

Enterprises are continuously expanding their economic scope with the development of economy, many of them have implemented overseas economic strategies and set up subsidiaries all over the world, which has very positive significance for improvement of their economic benefits. With the expansion of the business scope, many enterprises have begun to implement the strategy of overseas mergers and acquisitions to reduce the cost of their outward expansion, improve its operating efficiency and provide a reliable channel for enterprises’ better development [1]. At the same time, in the process of overseas mergers and acquisitions there have been financial risks which have become a major consideration for many enterprises’ mergers and acquisitions. So, enterprises need to pay more attention to financial risks in overseas mergers and acquisitions and take active measures to effectively control them.

First, this paper introduces the research background, significance and methods. Then it discusses the relevant theories, financial risks and its causes in enterprise mergers and acquisitions. Next, it analyzes the financial risks based on GEELY’s mergers and acquisitions of Volvo group. Finally, it puts forward the prevention strategies of financial risks of enterprise mergers and acquisitions.

II. INTRODUCTION OF RELEVANT THEORIES

In fact, merger and acquisition is a disguised form of financing behavior [2]. During the process of mergers and acquisitions, capital needs to be continuously invested and exchanged with the units to be acquired and much financial support is needed. This is bound to increase the financial risk of the enterprise, affect its normal capital flow, and cause bad effects on its daily financial management. Financial risks mainly refer to various risks brought about by capital flow and occupation in the process of enterprise mergers and acquisitions. The financial risks for enterprises are different under different M & A modes and they are fatal in mergers and acquisitions. We should pay more attention to financial risks for the smooth development of mergers and acquisitions.

A. Pricing Risk of Mergers and Acquisitions

The pricing risk is mainly reflected in the accuracy of the enterprise’s evaluation of the value of the object of the mergers and acquisitions [3]. The enterprise needs to determine the price of the mergers and acquisitions. After they have finalized it, the two sides cannot change the price of the mergers and acquisitions through business negotiation [4]. After mergers and acquisitions, many enterprises’ increased economic benefits are far lower than the price of mergers and acquisitions, which leads to the failure of mergers and acquisitions with a very adverse impact on enterprises. Pricing risks are divided into value assessment and financial statement risks according to the reasons for their formation. The value evaluation risks are mainly caused by inaccurate evaluation results of the overall value of the acquired units. The high cost of mergers and acquisitions leads to the failure of the economic benefits and the positive significance of mergers and acquisitions, which has adverse effects on the development of enterprises. In the process of mergers and acquisitions, many enterprises do not have the necessary understanding of the target in a timely manner, resulting in misjudgment of the enterprise’s operation and future development prospects, the merger and acquisition price significantly higher than the real value of the merged enterprise, causing the continuous rise of the merger and acquisition cost. In addition, the pricing risk may be caused by
the financial statement risk. In mergers and acquisitions, due to the lack of in-depth understanding of the financial situation of the merged enterprise, the value of the enterprise is determined only by the financial statement of the enterprise, which ultimately leads to a very large difference between the value of the determined financial statement and the real value and the pricing risk of mergers and acquisitions and affects the full play of the role of mergers and acquisitions [5].

B. Financing Risks of Mergers and Acquisitions

Financing risk is the most important financial risk that Chinese enterprises need to face in mergers and acquisitions at present. It mainly comes from the acquirer. Due to insufficient funds, many enterprises begin to borrow a great deal of money. Once due to financing failure or the huge demand for funds for mergers and acquisitions, enterprises cannot bear the necessary financial costs, cannot repay the loans in time and constantly increase their financial costs. At the same time, enterprises cannot complete mergers and acquisitions smoothly and have to face repayment pressure, which has extremely adverse effects on their normal operation and development [6]. Many enterprises adopt internal financing in order to avoid financing risks, but they cannot obtain a large amount of funds by this financing method in a short period of time, thus increasing the probability of failure of mergers and acquisitions, which is not conducive to the operation and development of enterprises [7]. At the same time, there are also many financial risks in internal financing because an increase in the amount of internal financing can lead to a decrease in the rapid response capacity of the enterprise, which is bad for the improvement of the economic benefits of the enterprise and is likely to affect its daily operation.

C. Payment Risk of Mergers and Acquisitions

The existing merger and acquisition payment methods mainly include cash payment, share payment, asset payment. As the target of M & A is often overvalued, there is the risk of unclear development prospects. Cash, which has the strongest liquidity, is often required to pay for mergers and acquisitions. However, the acquirer may not have so much cash, which will bring about the payment risk of short-term fund shortage to the acquirer. But for the acquiree, the cash method is not welcomed because it cannot postpone the confirmation of capital gains and the capital gains realized by the transfer, fail in enjoying tax incentives and owning the shareholders' rights and interests of the new company. This will affect the chances of successful mergers and acquisitions with related risks.

D. Financial Integration Risk of Mergers and Acquisitions

After the mergers and acquisitions, there are certain differences between the acquirer and the acquiree in financial management methods and contents. After the merger and acquisition activities are completed, their finance needs to be integrated so as to enhance the financial management ability as a whole [8]. However, due to the differences in corporate culture, management system, business types, internal control, human resources in the initial stage of the merger, various problems occur in the process of their financial integration, which will affect the improvement of the overall management level after the mergers and acquisitions and is not conducive to the development of the M & A enterprise. Managers must pay high attention to the risk of financial integration in the process of mergers and acquisitions [9]. If there are problems in the integration process, it is difficult for the synergy effect of mergers and acquisitions to play its positive role. Moreover, due to the financial integration risks, it is easy to lead to a decline in the operating performance of new enterprise groups after mergers and acquisitions.

III. CASE ANALYSIS

Under the background of the international financial crisis, the global economy grows very slowly, but China still maintains a strong economic growth momentum. Thanks to this, there have been a more and more active trend in the overseas M & A activities of Chinese auto industry enterprises in recent years with a new historical record of the number and amount of the overseas M & A transactions. In March 2010, GEELY and Ford Motor Company cooperated and successfully acquired 100% of Volvo group's shares for 1.8 billion US dollars. Volvo group's price is US $2 billion to US $3 billion. The acquisition price is 1.5 to 2 billion US dollars, and the cost is 500 million to 1 billion US dollars. According to the estimation results, GEELY proposed to acquire Volvo group and spent 1.8 billion US dollars on it, which accounted for only one third of Ford's acquisition. This is the unexpected harvest of restructure in the financial crisis. From Volvo group's brand, suppliers, network and technology, the acquisition price is considerable. GEELY seizes opportunity to become a successful model of global acquisition of Chinese auto.

A. Analysis of Financial Situation before Mergers and Acquisitions

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total assets</td>
<td>195996.2</td>
<td>292035.1</td>
<td>1013096.9</td>
<td>1880218.9</td>
<td>2430359.9</td>
</tr>
<tr>
<td>Post-tax profits</td>
<td>20875.2</td>
<td>30252.7</td>
<td>87905.3</td>
<td>118274.9</td>
<td>190323.3</td>
</tr>
<tr>
<td>Sales volume</td>
<td>12700.6</td>
<td>13172</td>
<td>428903.7</td>
<td>1406922.5</td>
<td>2009398.8</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>87487</td>
<td>33528.1</td>
<td>107328.8</td>
<td>426978.8</td>
<td>1628172</td>
</tr>
<tr>
<td>Currency funds</td>
<td>2097.2</td>
<td>79342.1</td>
<td>100852.4</td>
<td>510855.4</td>
<td>439307.5</td>
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</tbody>
</table>

Data from: GEELY’s Annual Report

From the data, it can be seen that GEELY’s development changed in 2008 before the mergers and acquisitions. GEELY began to enter a period of rapid development. The major financial data had a growth trend with the most significant growth in 2008. In 2008 to 2010, GEELY’s revenue was 4.289 billion yuan, 14.069 billion yuan and 20.099 billion yuan. Excluding merger factors, the actual revenue increased by about 20% in 2010. GEELY’s liabilities rose. Its payment pressure increased due to short-term debt rise from acquisition. However, GEELY has more money at its disposal, easing short-term liabilities service pressure. Through GEELY’s
acquisition of Volvo, its overall image was promoted by high-end brand. It is the direct reason for the acquisition for it to open up high-end market.

B. Financial Performance Analysis after Mergers and Acquisitions

From the data, it can be seen that after the successful merger of GEELY, its total assets rose rapidly, which was from 188,029 million yuan to 67,582.84 million yuan, an increase of 3.6 times. The net margin also rose to 9.52% in 2016 from 8.41% in 2009. In addition to the increase in net margin from 2010 to 2011, the gross margin of GEELY decreased due to the increase in its marketing costs after the merger. At the same time, influenced by the large amount of cash spent by the merger, the current ratio of GEELY significantly decreased.

However, after 2012, GEELY’s net margin showed an upward trend. By 2016, compared with the year of the merger, it increased by 3 percentage points, and the earnings per share increased to a certain extent, from 0.19 before the merger to 0.65 in 2016. This shows that the profitability of GEELY has improved, and mergers and acquisitions have brought about an increase in its asset management and profitability. However, from the debt paying ability, the current ratio of GEELY has declined. So, GEELY should pay attention to the debt control after mergers and acquisitions to avoid the financial risks and unnecessary debt paying pressure.

From the data, it can be seen that the turnover of GEELY after the merger has been continuously increasing, from 14,069,230 million yuan before the merger to 53,721,580 million yuan in 2016, the pretax profit and net profit have also been continuously increasing, from 15,504.6 million yuan before the merger to 62,309.4 million yuan, 118,274 million yuan and 51,112.4 million yuan in 2016 respectively. GEELY’s development scale has been continuously expanding. Compared with Volvo group, the size of GEELY is small. If Volvo group has been losing money since the merger, it will be a certain burden for GEELY and will bring certain challenges to its merger and acquisition. From the data, it can be seen that both turnover and assets of GEELY have increased to varying degrees. This sufficiently shows that GEELY has made great progress in its operation and development through this acquisition now. According to the data verification over the years, GEELY’s acquisition and future integration are very successful.

### TABLE II. FINANCIAL CHANGES OF GEELY FROM 2009 TO 2016

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<tbody>
<tr>
<td>Total assets</td>
<td>1880219</td>
<td>2397434</td>
<td>2759676</td>
<td>3137983</td>
<td>3359931</td>
<td>3728015</td>
<td>4229246</td>
<td>6758284</td>
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<tr>
<td>Gross margin</td>
<td>18.06%</td>
<td>18.51%</td>
<td>18.22%</td>
<td>18.51%</td>
<td>20.08%</td>
<td>18.23%</td>
<td>18.13%</td>
<td>18.32%</td>
</tr>
<tr>
<td>Net margin</td>
<td>8.41%</td>
<td>6.81%</td>
<td>7.36%</td>
<td>8.28%</td>
<td>9.28%</td>
<td>6.58%</td>
<td>7.50%</td>
<td>9.52%</td>
</tr>
<tr>
<td>Current ratio</td>
<td>1.37</td>
<td>1.33</td>
<td>1.13</td>
<td>1.19</td>
<td>1.29</td>
<td>1.42</td>
<td>1.24</td>
<td>1.16</td>
</tr>
<tr>
<td>Earnings per share</td>
<td>0.19</td>
<td>0.22</td>
<td>0.26</td>
<td>0.34</td>
<td>0.41</td>
<td>0.2</td>
<td>0.31</td>
<td>0.65</td>
</tr>
</tbody>
</table>

### TABLE III. COMPREHENSIVE PROFIT AND LOSS STATEMENT OF GEELY FROM 2009 TO 2016

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</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>1406923</td>
<td>2009939</td>
<td>2096493</td>
<td>2462791</td>
<td>2870757</td>
<td>2173836</td>
<td>3013826</td>
<td>5372158</td>
</tr>
<tr>
<td>Pretax profit</td>
<td>155046</td>
<td>190032</td>
<td>218321</td>
<td>252908</td>
<td>330418</td>
<td>194331</td>
<td>287481</td>
<td>620394</td>
</tr>
<tr>
<td>taxes</td>
<td>36772</td>
<td>53189</td>
<td>63977</td>
<td>48911</td>
<td>64105</td>
<td>51272</td>
<td>61428</td>
<td>109155</td>
</tr>
<tr>
<td>Net profit</td>
<td>118274</td>
<td>136844</td>
<td>154344</td>
<td>203997</td>
<td>266314</td>
<td>143059</td>
<td>226053</td>
<td>511240</td>
</tr>
</tbody>
</table>

Data from: GEELY’s Annual Report

Data source: GEELY’s Annual Report

IV. Preventive Measures against Financial Risks in Merger and Acquisition

A. Prevention of Pricing Risk in Mergers and Acquisitions

Enterprises should pay more attention to financial risks and take effective measures to reduce financial risks before M&A for the smooth development of M&A activities, achievement of more enterprises’ economic benefits through cross-border M&A, and improvement of the overall competitiveness of enterprises [10]. First of all, they should strengthen the understanding of the financial situation of the merged enterprise before the mergers and acquisitions, and formulate scientific and reasonable merger and acquisition plans according to the real situation of the merged enterprise, so as to ensure the improvement of economic benefits and prevent the failure of the merger and acquisition of the merging enterprise due to the lack of understanding of the situation of the merged enterprise [11]. In the process of mergers and acquisitions, they have fully understood the cultural environment, national policies and so on, which has a very positive impact on GEELY’s successful merger and acquisition of Volvo. Due to the wrong assessment of liabilities, the debt burden has been increasing for two years.
after the completion of mergers and acquisitions, which has affected the further improvement of GEELLY’s economic benefits and reduced the benefits of mergers and acquisitions. In the process of selecting valuation methods, GEELLY adopts the discounted cash flow method in the future, which is closely linked with its future business development and has positive significance for improving the accuracy of valuation. If other methods can be considered more comprehensively, then the enterprise’s value evaluation for the merged enterprise will be more scientific and effective.

B. Prevention of financing risk in Mergers and Acquisitions

In order to effectively reduce financing risks, first, enterprises should carry out an effective budget before financing to improve the scientific nature of financing schemes, ensure the minimum of financing costs and reduce financing risks [12]. Second, they should reasonably plan the financing structure and diversified financing schemes to lay a solid foundation for the improvement of financing efficiency. In order to effectively improve the financing efficiency, they need to consider a variety of financing methods such as combination of bond financing and equity financing to maximize the amount of bonds and reduce the debt service pressure of enterprises for the smooth development of their financing activities. Third, in order to effectively reduce the financing risks, in the process of mergers and acquisitions, they should pay more attention to financing and strengthen the supervision and management of financing activities. Once the risks occur, they can find them at once and put forward effective solutions to reduce the economic losses caused by financing risks to enterprises, which lays a solid foundation for the successful completion of mergers and acquisitions [13].

C. Prevention of Payment Risk in Mergers and Acquisitions

Mergers and Acquisitions costs a large amount of money, increasing the payment risk in mergers and acquisitions and adversely affecting the daily operation and development of enterprises. Therefore, in order to continuously reduce payment risks, enterprises should pay more attention to payment methods, adopt various payment methods, organically combine cash, equity and bonds, reduce their pressure of cash payment and lay a solid foundation for their better development [14]. Cash payment enterprises should choose relatively safe payment methods such as bank transfer and check in order to reduce the payment risk to the greatest extent and fully ensure the payment safety.

V. CONCLUSION

With the continuous development of the economy, there has been a trend of the mergers and acquisitions among large transnational corporations. It has a broad prospect of development and will also bring inevitable financial effects and risks which become important factors affecting the success or failure of mergers and acquisitions. Only by the financial effect’s attention, effective identification and targeted control in mergers and acquisitions can we reduce the financial risks of mergers and acquisitions and improve the success rate of mergers and acquisitions [15].

First, enterprises should comprehensively consider various factors before merger and acquisition activities, pay attention to merger and acquisition work for its better development and lay a solid foundation for maximizing their benefits of mergers and acquisitions. In view of the financial risks in mergers and acquisitions, enterprise managers should pay more attention to them, ensure better development of financial work, and lay a solid foundation for improving the level of financial work. Second, in the process of merger and acquisition activities, positive measures should be taken to reduce financial risks, lay a solid foundation for the successful completion of merger and acquisition work so as to achieve better development of enterprises and enhance economic and social benefits of mergers and acquisitions.

REFERENCES