

# Systems Archetype Analysis on Some Problems of Chinese Enterprises Cross-border M&A

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**Abstract-** *China's entrance into WTO is a new departure in China's opening to the outside world. With the implementing of "Going-global" strategy, cross-border M&A of Chinese enterprises has become an inevitable trend. This paper uses systems thinking and system archetype theory to identify some typical problems in the process of Chinese enterprises' cross-border M&A. By analysing the merger between Chinese D' long Group and German Fairchild Dornier, we could draw a conclusion that companies should focus on locating the source of the problem, rather than developing remedies for the short-term symptoms. In the process of cross-border M&A, Chinese enterprises need to concern if they have had the ability to merge and integrate the target companies effectively, especially the capability of post-M&A integration.*

**Key words:** Cross-border M&A Systems Thinking Systems Archetype

## 1. Introduction on Cross-border M&A of Chinese Enterprises

China's entrance into WTO is a new departure in China's opening to the outside world. After that, China has faithfully honored its commitments and opened its market further. On the other hand, a lot of WTO members also open up to China and provide their trade investment convenience, which provide good opportunities for Chinese enterprises to invest and operate abroad.

Conceptually, China's Going-global strategy divides into generalized and the narrow sense. The generalized sense refers to Chinese products, services, capital, technology, labor, management and Chinese enterprises going globally to compete or cooperate in the world market. The narrow sense states for investing factories overseas by exporting series of factors and extending production capacity internationally. The Going-global strategy can be viewed from two levels in principle. One is on

commodity export, which includes China's products, services, capital, technology, management and other factors. This mainly touches on goods trade, service trade, technology trade, invisible trade and so on. The other is on capital export, which refers to FDI. It means that Chinese enterprises invest factories and M&A abroad.

As early as 1980's and 1990's, a number of mighty Chinese enterprises have tried to attempt cross-border M&A. The amount of M&A is mounting up obviously since the 21st century. The total sum of cross-border M&A in China was \$ 120 million in 2001, while the figure in a single operation was already beyond several billion dollars in 2005. Chinese enterprises are looking for their partners in developed countries such as America, Australia and Europe etc. What's more, they do not limit their target companies in local small enterprises any longer. In the implementing of Going-global cross-border M&A, abundant Chinese SME's are becoming considerable forces by developing international market actively.

## **2. Analysis on Problems about Implementing Cross-border M&A**

Cross-border M&A has just appeared in Chinese enterprises in recent years. That's why there have variety of problems in the process of M&A. We address them as follows:

### **2.1. Lack of laws and regulations on cross-border M&A**

Chinese actual laws and regulations are dislocating with the development of overseas investment. We are lacking of complete and applicable laws and regulations to regulate Chinese enterprises' cross-border operations. In the field of domestic M&A, laws and regulations are still undergoing a process of being improved, not to say those related to cross-border M&A. The business of overseas investment has been severely affected by the delay of legislation. The negative results include the loss of the due benefit of government supporting policy as well as enterprises' reasonable acts not being protected when involved in investment dispute abroad.

### **2.2. Difficulties in financing and utilizing foreign exchanges**

Up to now, the financing difficulty and overstrict foreign exchanges restriction are still two big obstacles in Chinese enterprises cross-border operations. The present finance and credit system have so many restrictions on Chinese enterprises' financing. Take the loaning for instance, it will subject to the limitation stipulated by domestic loaning guarantee quota, especially foreign currency loaning will be under the limitation of specified foreign exchange quota, which makes some enterprises lose good opportunities to cross-border operations. In the aspect of financing abroad, though some enterprises are already qualified for listing and issuing bonds in foreign capital market, many M&A chances are missed due to the limitation in quotas and approvals.

### **2.3. Level of Policy support to be improved**

Chinese government is lacking of mature, systematic and stable supporting policies on

enterprises investing abroad. Take the investment management policy as the example, it still remains at the basic process of project examination and approval. The promoting policy of investment is far from consummate which mainly focuses on investing factories. Moreover, to some international general cross-border investment ways like overseas merge and acquisition, the support policy is not explicit. There has not appeared the corresponding rule regarding the post investment management and supervising. Though there are many principal regulations that encourage going-global operations, few of them come true to the enterprises and the support scope is limited. Additionally, there is no specific industrial policy and professional guidance regarding cross-border investments. Capriciousness of investment abroad is not rare which affects the overall benefit of Chinese enterprises' cross-border investments.

#### 2.4. Deficiency of cross-border investment insurance system

In the process of cross-border operations, Chinese enterprises are confronted with state risk, political risk, proprietor's repayment risk and the like. These risks are beyond the capability of an individual enterprise to undertake. Due to the vacancy of cross-border investment insurance system in China, sufficient protections cannot be provided against the risks encountered by cross-border investors. Those enterprises that invest in the countries with high political risk would not get any compensation after suffering big economic loss.

#### 2.5. Faced with political and legal risks in the host country

The legal problems encountered by Chinese enterprises cross-border M&A are much more complex than the domestic M&A. Not only before the M&A can display many legal matters, lots of similar issues may also be encountered after that. The former is characterized by the regulations from host country by means of the clean competition law, antitrust law, securities exchange law and so on. The latter is in the way of environment, intellectual property rights, service, contract management, corporate governance and parent company rights etc.

Because of the deficiency of related domestic experiences, Chinese enterprises tend to underestimate the difficulties in this line which may result in the failure of M&A. Furthermore, host government might use their power to tamper foreign enterprises M&A for political and economy safety consideration and protecting domestic core technology as well. They can set up variety of political obstacles while this kind of primary risks and full of uncertainty.

#### 2.6. Falling short of intermediary organizations

China is falling short of intermediary organizations that can provide the correlative information for enterprises implementing cross-border M&A, especially nongovernmental intermediary system, which is mature in developed countries. The system can not only offer full-scale information on the financial status of target firm and local government regulation policy, but also act for a good many legal affairs

involved in M&A. For the present, China has developed some business and financial intermediary organizations, while they are not qualified in supplying variety of information on general M&A, much less to offer useful information and the correlative service for cross-border M&A.

#### 2.7. Management ability and post-M&A integration need to be strengthened

Cross-border M&A is a corporate strategy with high risks and failure rate as well. The inadequate management and post-M&A integration can also result in the failure aside from not grasping the proper opportunity or transaction price, target firm and so on. In the German-China Economic Summit which held in Berlin in the end of 2004, German government gave advice to enterprises which tend to cooperate with China that the ability of Chinese enterprises to integrate and manage after M&A is still very limited. So they warn German enterprises should proceed with caution.

#### 2.8. Void of Talents in cross-border M&A and management

In order to succeed in cross-border M&A, Chinese enterprises need abundant specialized talents who are familiar with international political, economic, social and cultural environment and are proficient in laws and regulations of host country. Besides, these talents should be good at seizing opportunities as well as engaging in integration and management after M&A.

The deficiency of talents is one of the most important factors restricting Chinese enterprises cross-border M&A and management. Although the intermediary organizations can be employed in handling M&A affairs, post-M&A management and control couldn't be implemented by them. Obviously, both are the problems of Chinese enterprises cross-border M&A from exterior environment, and enterprises own ability as well. Most of these problems can be resolved by improving the exterior macroscopic environment including political, economic, society and technology. However, quite a lot can be analyzed by using systems thinking and draw a conclusion.

### **3. The “shift the burden to the intervenor” Archetype**

Systems Thinking originates to System Dynamics which first initiated by Professor Forrester from MIT in 1956. With the rapid development of social economy and scientific technology, the social division of labor is thinner and thinner. Modern people, who live in such organizational structure as “Pyramid” tend to view problems superficially and in isolation because the every variety of division exists. The theory of Systems thinking holds that people can achieve the discipline of seeing straight the basic structure lying behind the complex situation by using systems thinking. Systems thinking calls for people to look on organizational development by using the concept of systems. It guides people to examine the whole system, rather than just trying to fix isolated problems; clarify the structure behind the changes, rather than staying at the surface; recognize the interrelationship among all kinds of factors, rather than just static analysis, then seek after a kind of dynamic balance.

Systems archetype is a vital tool in systems thinking. Systems archetypes are basic and understandable cycles that complex systems go through. The same archetypes recur again and again in political, economic, social, culture or variety of fields. It simplifies life by helping us to see the universality and regularity patterns lying behind the events and the details. It builds to learning to understand the leverage point lying behind the events. The research of system archetype can readjust our cognition, so as to help us recognize the structure of the system and the leverage point in the cycle.

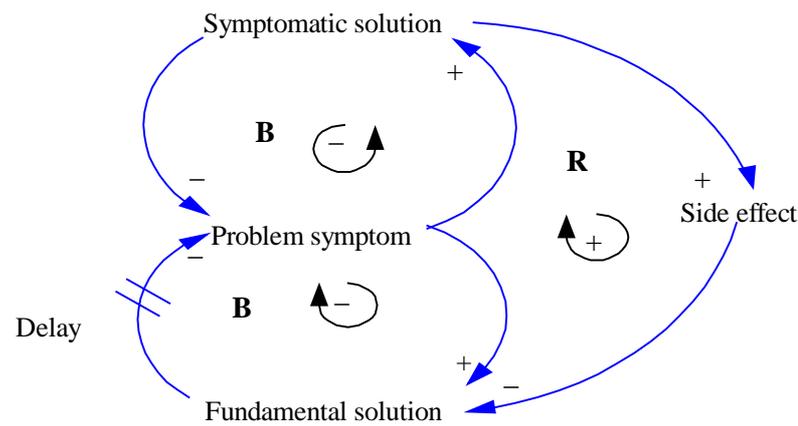


Figure 1: The “shift the burden to the intervenor” archetype

According to systems dynamics theory, any roles acted by people are parts of the feedback loop, rather than the independent existence to the feedback outside. The feedback loop consists of two different types of loops. One is “reinforcing loop”, which specified by “+”, the other is “balancing loop”, which expressed in “-”. The former is the engine for growing, which indicates that as long as the matter is in the condition which continuously grows, we can confirm that it is the reinforcing feedback that operates. Correspondingly, as object-oriented behavior is identified, it means that the balancing feedback works. There are “Time Delays” existing in the feedback loops. This is a process of disturbing and influencing the feedback loops and it makes the result appear gradually. Figure 1 shows the “shift the burden to the intervenor” archetype. It consists of two feedback loops. Both of them attempt to solve the problem. The above balancing loop represents the quick and effective “Symptomatic solution” which can solve the symptom quickly but temporarily. The under feedback loop contains a time delay. But it’s on behalf of the fundamental solution which addresses the problem long term. In the structure of “shift the burden to the intervenor”, there is a reinforcing loop formed by a side effect produced by the symptomatic solution.

The “shift the burden to the intervenor” archetype can be described as follows: people attempts to deal with affairs by “An ad hoc approach” (called Symptomatic

solution) when any problem arises. In the short term it appears to address problem symptoms quickly. But the action siphons off resources that could be used to implement the fundamental solution. The fundamental solution will address the problem long term. However, there is a delay before a positive change starts to take place. This delay, if not accounted for can lead to abandoning the fundamental solution. Then the capability to implement a fundamental solution may be eroded after a certain time which results in the further dependence on symptomatic solution.

The “shift the burden to the intervenor” archetype demonstrates that many so-called “good solutions” may make matters worse in the long run, but in the short term the allure of this quickly effective solution is hard to avoid. Certain tension can be released by using the symptomatic solution. But at the same time, it reduces the attempt on finding out the fundamental solution.

Chinese economy’s rapidly growing up since 21<sup>st</sup> century has not only made the intercourse between China and the world more and more frequent, but also stimulated many private enterprises to go abroad for development. But many enterprises failed in their cross-boarder M&A for overrating their abilities or paying excessive attention to the allure of merging those enterprises in troubles instead of starting with long-term solutions to their development. e. g. In the summer of 2003, Chinese D’ long Group who was beset with trouble at cash all along merged the research program of DO-728 branch passenger jet series from Fairchild Dornier, an old German airplane company with 82 years history, and invested thousands of Euro as first input.

Fairchild Dornier had been among the so-called three biggest worldwide airplane manufacturer magnates, with Canada Bombardier and Air Brazil to be the other two. But Fairchild Dornier was forced to declare bankruptcy in April, 2003 because of the strategic mistake of investing more than a billion US dollars in research when developing the 728 series, which led to the fund chain breaks. At the end of June, 2003 when its trust period of bankruptcy ended, Fair Dornier was confronted with the fate of auction. Just at that time, D’ long who was coveting the big domestic branch airplane market offered an olive twig to the bankrupted Fair Dornier. By right of this project, D’ long could become a branch passenger airplane manufacturer with leading technology in the world. After some argy-bargy, D’ long merged Fair Dornier at 20 million Euro. But not long, D’ long Group was bankrupt because of the capital chain break and on Nov. 19<sup>th</sup>, 2004, Fair Dornier declared its bankruptcy for the unsuccessful 728 branch passenger airplane.

From this case, we could make out that D’ long wanted to be a branch airplane manufacturer with the first-rate technology in the world. Long-term solutions may need long period and patience, while short-term solutions could make a company to be as famous as Canada Bombardier or Air Brazil etc in a short time. It also showed the reason why people would choose symptomatic solution was that it could always work right away. But the problem was that D’ long was in its downward tendency and

was short in capital when merging Fair Donier. The project cost it precious capital of thousands of Euro. Thus in the end, not only the Fair Donier resuscitative project fell through, but also did itself fail.

Many Chinese enterprises prefer merging famous enterprises in trouble with finance. But for those targeted overseas enterprises in bad performance, effective integration after M&A was necessary for them to recover. The post-M&A problems with Chinese enterprises always included the following two. First, they thought much of developing and utilizing targeted enterprises' throughput, market and brand, while ignoring reforming and recombining the original enterprises. e. g. When TCL merged Schneider, a German TV manufacturing enterprise, only 60 workers were installed in the former factory address and the production was transferred to Hungary. Second, there were many managing problems. e. g. Some Chinese investors would abandon targeted enterprises' outstanding staffs and employ Chinese staffs, especially the management, who knew little about the country where the targeted enterprises were in. e. g. D' long replaced many European suppliers with Asian suppliers at cheaper price after it merged Fair Donier.

To solve these problems, systems thinking could be used. Chinese enterprises are forced to face the same problems in the process of integration. Key problems should not be slide over just because of the existing of short-term solutions.

#### **4. Conclusion**

From the above analysis, we could draw a conclusion that cross-border M&A of Chinese enterprises has become an inevitable trend. But in this process, enterprises should be clear that M&A could help them to realize short-term targets quickly, but they also need to concern if they have had the ability to merge and integrate the target enterprises effectively after the M&A.

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