

Analysis of Synergy Effect of Successive Mergers and Acquisitions of Enterprises

-- Take New Hope as an Example

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Abstract

With the increasing improvement of the M&A market, corporate M&A tends to be more continuous and diversified. M&A is an important way for companies to integrate resources, and multiple consecutive M&A plays an effect of widening the industrial chain and reducing the industry barriers. Based on this, this paper takes New Hope as an example and studies M&A transactions, M&A motives, M&A synergies, and causes of poor synergies. It is found that too rapid successive M&As do not produce good synergy effects and are easily decoupled from actual operating capacity. Companies need to identify the motives of successive M&As and bring into play synergy effects in M&A integration.

Keywords

Sequential M&A; Synergies; M&A Performance.

1. Introduction

China's market-based resource allocation system is gradually improving, and the relaxed relevant policies and favorable market environment are directly promoting corporate M&A behavior, and more companies tend to choose M&A to enhance their competitiveness and occupy market share. One of the motivations for M&A is to obtain synergy effect, but not all consecutive M&A can achieve the expected effect. This paper takes New Hope as an example to explore whether consecutive M&A brings synergy effect for enterprises.

2. Text Review of the Literature

Schipper and Thompson (1983) first distinguished between a single M&A activity and a series of M&A activities (programs of acquisition activity). It was found that firms often achieve strategy by means of successive acquisitions. The phenomenon of multiple acquisitions by a company to achieve a strategy can last for several years. The study of sequential M&A in China started late, and there is currently no clear definition of sequential M&A. Zhang Lan (2018) considers the act of M&A as a series of strategic layouts with contiguity from the motivation of M&A. Huang Manli et al. (2020) combed through the domestic and international literature related to sequential M&A and deliberately emphasized the significance of strategic objectives in the concept of sequential M&A, arguing that it is under the guidance of strategic objectives that companies engage in interrelated M&A transactions. He, Tian Yue et al. (2021) studied the consecutive M&A performance of case companies and found that the act of consecutive M&A did not improve the financial and operational indicators of the company, nor did it improve competitiveness. Using data from A-share listed companies in China during 2006-2019, Zhuang et al. (2021) found that the continuous M&A behavior of a company even increases the risk of a company's share price collapse in the future.

3. Case Study

3.1. Merger and Acquisition History

New Hope Company was successfully issued and listed on the Shenzhen Stock Exchange in 1998 under the name of Sichuan New Hope Agriculture Co. 31 M&A events, and the M&A events with transaction amounts exceeding RMB 50 million are specifically introduced below in chronological order.

- (1) On December 19, 2014, it increased its capital in Puhui Agricultural and Livestock Financing Guarantee Co. To expand its business scope to include feed, breeding, food, etc., and to expand its business scope and realize its diversification strategy, the Company proposed to increase capital of RMB 15,000,000 for Puhui Guarantee.
- (2) On February 17, 2016, the Company acquired 70% equity interest in Yangling Benxiang Agriculture Co. New Hope chose to complete the purchase of the equity interest in the form of both public issue of shares and cash payment in the transaction on that day.
- (3) On March 25, 2016, acquired Beijing Jiahe Yipin Enterprise Management Co. The transaction was to further shift the focus of the industry chain backward and strengthen the competitiveness of the food processing segment.
- (4) On November 23, 2016, New Hope and Liuqiao Group Co., Ltd. established a joint venture company, whose main business is duck feather processing and down products manufacturing. The joint venture company adopts a leased asset operation model, and the registered capital of the joint venture company is 50% owned by each of New Hope and Liuqiao Group, with a total amount of approximately 60 million.
- (5) On April 28, 2017, the company established Shibing New Hope Farming Co. The company's development plan is basically based on the "New Six" approach to pig farming, with the scale of a small-scale farm.
- (6) On April 28, 2017, new companies were established in Jiangsu and Guangdong respectively for pig breeding by way of foreign investment, with the transaction amount of each project being RMB 632.02 million.
- (7) On August 01, 2017, increased the capital of New Hope Finance Co.
- (8) October 31, 2017, acquisition of Shaanxi Province Zhidan County Dingxiang Agricultural Technology Development Co.
- (9) December 29, 2017, established Meizhou New Hope Biotechnology Co., Ltd. by way of foreign investment, with total investment of 72.15 million RMB for this project.
- (10) On February 14, 2018, an engineering management company was established by way of foreign investment. New Hope shifted its.
- (11) On March 29, 2018, the Company increased its investment in Dong'a Liuhe Lvjia Food Co. To promote the development of the Company's food processing business and breeding business.

3.2. Motivation for M&A

- (1) Complying with the trend of industry development

In recent years, the national requirements for food safety have become stricter. The Ministry of Agriculture, the Ministry of Commerce and the General Administration of Quality Supervision, Inspection and Quarantine have issued a number of basic standards, standards for raw materials and products, standards for hygiene requirements and standards and regulations for quarantine methods. The promulgation and implementation of these policies and regulations have given impetus to agribusiness mergers and acquisitions, which have become the key to improving the profitability and survival value of the industry.

- (2) Meeting their own expansion needs

Successive mergers and acquisitions of enterprises are opportunities for enterprises to come into contact with other industries, which is conducive to diversifying business risks and also forming a closed loop of the agricultural ecological industry chain, broadening the industrial dimension and occupying the market of new industries on the basis of consolidating the original market share, thus satisfying their own expansion needs.

(3) Building a whole industry chain system

Because of the shortcomings of traditional industries, the integration of industrial chains has become the inevitable direction of agricultural reform. In order to build a whole industry chain system and improve the overall cooperation ability of the company's industry chain, through the acquisition of feed enterprises, New Hope has reasonably optimized the regional layout of the feed business and closely integrated with the breeding business.

3.3. Analysis of Synergy Effects

(1) Profitability analysis

New Hope's return on net assets before M&A was stable at 10%-13% compared with the industry average, which was higher than the industry average but the difference was smaller. 2014-2020's return on net assets was significantly higher than the industry average compared with the pre-merger period. The net operating profit margin before M&A was 10.24% in 2010, but the rest of the years were declining and basically smaller than the industry average. The net operating profit tends to be more stable during the course of successive M&As, and the profitability has also improved since 2014, because successive M&As have achieved the integration of upstream and downstream enterprises in the industry chain and formed vertical integration.

(2) Analysis of growth capacity

The growth rate of total assets of New Hope before the merger and acquisition was basically on a downhill trend, and then increased after decreasing from 2014 to 2020, which is because the company shifted its focus to the downstream of the industrial chain, pursued the improvement of the company's back-end business operation capacity, and abolished the single pursuit of feed scale growth method. Before the merger and acquisition, in 2012, New Hope's operating profit and net profit were already in a serious negative growth situation due to the constraints of the market situation, the initial strategic plan of the whole industrial chain had just been reached, and the business level could not follow the footsteps of the market, and the net profit and operating profit showed a fluctuating growth trend between 2014 and 2016, which was related to the company's pursuit of business growth at the back end of the industrial chain, and in 2017 and 2018 The slight decline in both values again in 2017 and 2018 is due to the ongoing impact of the large-scale epidemic on the company's operations. The changes in these figures illustrate that the company's growth capacity will not stabilize with the adjustment of the company's industrial chain structure brought about by mergers and acquisitions due to the cyclical fluctuations of agricultural production and operations.

(3) Analysis of solvency

The current ratio of the company before the M&A always remained above 80%, but after the successive M&A, the company's current ratio tended to decline significantly, even to 65.58% in 2019, and the gap with the industry average gradually increased, because the company used a lot of cash in the process of successive M&A and thus reduced its current assets, and the cooperation with financing institutions accelerated the rise of current liabilities, and the value of current liabilities gradually exceeded the value of current assets. The value of current liabilities gradually exceeds the value of current assets. In addition, due to the improper choice of the M&A method, there were too many cash payments and serious capital outflows, which led to a decrease in the current ratio. Finally, the company neglected other capital investments required after the completion of the M&A. In addition to paying a large amount of money for

business integration, the M&A party had to make additional investments to promote the joint development of the business of both parties, which showed an increase in the company's financial risk.

The balance sheet ratio of the company before the M&A remained basically at the same level with the industry average, and during the period of 2014-2016, the industry average was higher than that of New Hope, and the company's balance sheet ratio also showed a decreasing trend, indicating that the company's dependence on external borrowings was low and its financial strength was strong, and the M&A that occurred within these three years helped the company to improve its long-term debt servicing capacity, while from 2017 onwards, the company's The increase in the gearing ratio indicates that the company has made full use of its financial leverage on the one hand, and on the other hand, it also represents that the company is facing debt servicing risks.

(4) Analysis of cash flow management level

The flow of cash is the key to the company's income generation. From 2014 to 2020, the net cash flow generated by the company will be -1.024 billion yuan, -1.561 billion yuan, -539 million yuan, -2.557 billion yuan, -2.392 billion yuan, -8.737 billion yuan and -3.4 billion yuan, respectively. -8,737 million yuan, and -3,401 million yuan, indicating that the process of mergers and acquisitions has been good and bad for the conduct of investment actions. Regarding financing. The net cash flow from financing activities shows a negative to positive situation, indicating that the M&A act makes the company actively broaden. as for the cash inflow from financing activities, the cash received from borrowing accounts for a significant portion of the cash received and the cash received from the acquisition. However, cash received from borrowing activities accounted for a large proportion of cash inflows and continued to rise, while capital expenditure due to debt repayment also continued to account for a very high proportion of overall cash inflows. For the cash inflow from financing activities, the cash received from borrowing accounts for a large proportion and continues to rise, while the capital expenditure caused by debt repayment still accounts for a very high proportion of the overall outflow.

4. Causes of Poor Synergy

4.1. The Delayed Benefits of Industrial Chain Synergies have not Yet Positively Impacted Performance

New Hope Liuhe has been effective in building its industrial chain, but the delayed benefits of its industrial chain have not yet been truly demonstrated and have not yet made substantial contributions to performance improvement, while the substantial cost investment in the construction of the industrial chain has been reflected in the accounting data, resulting in the company's less optimistic performance results in successive mergers and acquisitions.

4.2. Managers' Overconfidence Generates Misestimation

The company's better results after the first few M&As caused the management to be overconfident and to misbelieve their own judgment ability in the later M&As. They were also overly optimistic about the company's ability to withstand the negative effects of the M&As and its internal management, and made a series of untimely M&As before the delayed economic effects of the M&As were released and the organization was not able to react in time. Looking at the subsequent market performance and financial indicators, it can be found that such behavior led to poor market response and a downward trend in financial figures.

4.3. High Frequency and Fast-paced Successive M&As are not Conducive to Performance Improvement

New Hope M&A has the characteristics of high frequency and fast pace, with an overall trend of diminishing wealth effect as time shifts back. This is due to the fact that the greater frequency of M&A per unit of time compresses the events of pre-preparation and post-integration of New Hope, resulting in a strong sense of time pressure within the company in dealing with M&A events. It indicates that the uneconomic compression of time will make the company too hasty in decision making and integration, which will lead to excessive expenses in the current year in terms of overhead and other expenses.

5. Conclusions and Recommendations

The study found through the synergistic effects after successive M&A that managers should be cautious in implementing successive M&A and focus on the sustainable development of the company. When implementing consecutive M&As, it is necessary to fully consider the frequency and rhythm of M&As, evaluate whether the company has fully integrated the resources of the last acquired company, and whether it has fully learned and summarized its experience and can provide good M&A experience for the next M&A. Careful consideration should also be given to the way of consecutive M&As, if a large amount of cash is used as the transaction consideration, it will inevitably have an impact on the company's solvency and its financial risk. The ability to cope with financial risks decreases. The company should evaluate the situation after each acquisition and make adjustments accordingly, so as to clarify the value of successive mergers and acquisitions to the company's industrial chain construction and the impact on subsequent development.

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