Research on the Risk of Transnational Merger and Acquisition

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Abstract: Base on the conditions of economic globalization, transnational mergers and acquisitions have become an important method for companies to implement internationalization strategies. From the current situation, many Chinese enterprises try to expand overseas by adopting transnational mergers and acquisitions. This research collected financial data from the annual reports from 2012 to 2014 and then calculated financial indicators, and utilized the DuPont Analysis, based on the integration of quantitative methods and propose solutions and countermeasures based on the analysis. The basic research structure of corporate transnational MandA performance will be constructed on the macro and micro basis, and the performance problem will be defined from the perspectives of theories, methods, and data, thus forming the basic system of research. Through the case of Wanda's merger and acquisition of AMC, analyze the existing problems of corporate cross-border merger and acquisition performance, to summarize the influencing factors, and make recommendations.

Keywords: Mergers and acquisitions; Risk analysis and prevention; Wanda group; AMC

Paper type: Research paper

1. Introduction

Since the 1990s, the economic globalization formed by the continuous penetration and interdependence of the economies of various countries has enriched the content and forms of economic exchanges among countries. More and more great enterprises in China have begun to participate in global resources reallocation and asset restructuring activities. However, among many companies that took part in M and A, the success rate was shallow. For the rapidly growing Chinese companies, how to conduct cross-border mergers and acquisitions, how to deal with the risks they face after mergers and acquisitions, and how to successfully integrate were the most important issues they had to solve.

On May 21, 2012, Dalian Wanda Group and AMC Corporation—— the world's second-largest cinema group signed a formal merger agreement, and Wanda acquired 100% of AMC's equity by 3.1 billion US dollars while undertaking AMC-related debts. Before the merger, the American AMC company had been in a state of loss. After the Wanda Group's merger and acquisition, it turned into a profit at the end of 2012 and obtained a net profit of 50 million US dollars. This success had enabled Wanda Group to continue to expand in scale and continue to develop. The reasons are worthy of our investigation and provide important experiences and enlightenment for cross-border mergers and acquisitions of other domestic companies.

Although Wanda Group successfully obtained a 100% stake in AMC's loss-making state, it was lower than the market price and was successfully introduced into the Chinese cinema after the merger. However, it also bears some related debt problems of AMC. This article mainly explores the risks in the process of Wanda Group's acquisition of American AMC company after its debt repayment, and its profit model turns into a profit. Thus, the research questions are formulated accordingly:

(1). Will Wanda Group's net profit margin increase after the acquisition of AMC?
(2). Is the increase in AMC's asset turnover rate affected by the merger and acquisition of Wanda Group?
(3). Is Wanda Group's profitability after merging the AMC company optimistic?

The research aims to use financial data and analysis of related indicators to analyze whether Wanda Group's merger and acquisition of AMC is the correct decision at the macro and micro levels and to find potential problems after the merger through the data, and then propose solutions. Measures not only the company's financial situation, but also provides a reference value for other companies.

2. Literature Review

Multinational mergers and acquisitions can play a better management effect on the target company by strengthening the protection of the rights of internal investors and can also help control the international market for the governance of the entire company and improve operating conditions. (Rossi and Volpin, 2004) The position of investors shows that the long-term gains of mergers and acquisitions are not only reflected in their immediate wealth growth; they also have to consider the instability of interest rate fluctuations to wealth growth. This is also a reason that may cause MandA companies to face financial risks and cause failures. (Rao and Mishra, 2020)

After the merger, the company's performance, especially integration, is related to organizational factors such as leadership. Socialization will lead to a successful transformation of MandA companies (Waldman and Javidan, 2009) Some of the reasons for poor performance after MandA come from poor management of the acquirer, overconfidence of the leadership, and poor merger execution and integration. These unfavorable factors will have a negative impact on long-term business performance. (Renneboog and Vansteenkiste, 2019) MandA companies with relatively high management capabilities will achieve better long-term operating performance and stock returns after the merger. Mergers and acquisitions in the same industry can also make the company have a higher synergy. (Cui and Chi-Moon Leung, 2020) The direction of mergers and acquisitions is mostly horizontal, and the company is more inclined to merge with other companies in the same industry. Rather than cost-effectiveness and short-term profits, they hope to achieve profit growth through market expansion and increased product lines. (Rahman and Lambkin, 2015)

There are political and regulatory uncertainties, which are closely related to MandA activities. Moreover, taxes, government expenditures, monetary and fiscal policies will affect the company after the merger. (Bjorvatn, 2004)

DuPont analysis can measure the company’s operating performance and plays a vital role in financial statements. (Doorasamy, 2016) DuPont analysis breaks down net operating income assets into profit margins and asset turnover ratios used to assess current operating conditions and predict the future Variety. (Soliman, 2005)

3. Research Design

A. Research context

This article is divided into five parts. The first part is an introduction, mainly elaborating on the research background and existing problems of Dalian AMC after the acquisition. The second part is to study the analysis of cross-border MandA cases and financial risk research by domestic and foreign scholars. The third part is to elaborate on the research method of this article. The fourth part is based on the two evaluation indicators of operating income and profitability. It conducts a detailed performance analysis of the merger and acquisition of Dalian Wanda Group after acquiring the American AMC company. Finally, it uses the Z-score model to evaluate the financial warning to prove the success of the merger. The fifth part is based on the successful experience of Wanda's merger and acquisition of AMC and summarizes the risks and preventive measures of MandA to other domestic enterprises.

B. Research methods

This article uses a combination of quantitative and qualitative analysis methods, combined with financial risk theory, through DuPont analysis, combined with financial indicators to compare and analyze AMC companies before and after mergers.

C. Measures

This article mainly uses the data on Wanda Group's financial statements, analyzes the company's profitability and operation through the financial index method, and evaluates the company's financial early warning coefficient through the Z-Score model multivariate.

D. Data analysis

Quantitative analysis of the Z-Score model using Spss, combined with financial indicators to analyze the risk of Wanda Group's acquisition of AMC company.

4. Analysis

4.1 Operating income before and after MandA

Table 1. Comparison of relevant indicators

Comparison of relevant indicators before and after AMC MandA		
	Before MandA	After MandA
Box office income	$ 2.5 billion	$ 2.7 billion
operating conditions	2011 loss	2013 profit of $816 billion
listing conditions	$82 million, two failed IPOs	Listed on the NYSE in 2013

Source: Wanda,http://www.wanda.cn/

According to Table 1, the total assets increased from RMB139.28 billion in 2010 to RMB5341 billion in 2014. Operating income increased from RMB 73.49 billion in 2010 to RMB 242.48 billion in 2014, and the growth rate of operating income for more than 5 years has exceeded 30%. Although Wanda's merger and acquisition of AMC cost US$3.1 billion in 2012, after the completion of the merger, the operating income growth rate was still as high as 34.8%. The merger plan not only increased the company's assets but also increased the company's income. Although the asset growth rate in 2013 has decreased, the operating income still has a 31% growth rate. In 2014, asset growth accelerated and operating income growth remained stable, Wanda's commercial real estate contract sales revenue was RMB 160.15 billion, 100.1% of the completion target, an increase of 26.8% year-on-year; of which rent payment was RMB 11.08 billion, an increase of 32.7% year-on-year, and the rental return completion rate was 100%, continuing to maintain the global leading level; The total area of properties held was 21.57 million square meters, a year-on-year increase of 32.0%.

Cultural Group's revenue was RMB 34.14 billion, 108.9% of the annual plan was completed, a year-on-year increase of 32.3%. Wanda Department Store opened 24 new stores, with a total of 99 stores and revenue of RMB 25.6 billion. It completed 101.6% of the plan, a year-on-year increase of 65.3%, and exceeded its annual profit target. In the general difficulties of the department store industry in 2014, Wanda Department Store's performance became the industry highlight. In 2014, Wanda Group achieved remarkable results in its transformation and upgrading. The revenue growth rate of the cultural tourism industry exceeded the growth rate of real estate income, and various business segments of the cultural tourism industry performed outstandingly. Wanda Travel revenue has reached 7.51 billion yuan, ranking at the forefront of the national industry in only one year and is a Wanda cultural tourism project transporting a large number of passengers.

Wanda film and television masterpieces are frequent, with revenue of RMB 430 million, and 121% of the plan is completed. Cultural tourism has become Wanda's new pillar industry. All data indicated that the entire MandA is still relatively successful, and Wanda Group’s operating status remains a good development trend.

Table 2. Relevant indicators before and after MandA

Wanda Group's relevant indicators before and after MandA					
	2010	2011	2012	2013	2014
total assets(billion)	1392.8	1950	3000	3800	5341
growth rate	--	40%	50%	27%	34.50%
sales	130	1051	1416.8	1866.4	2424.8
growth rate	88%	43%	34.80%	31%	30%

*Source: Wanda,*http://www.wanda.cn/

After the merger and acquisition, AMC turned losses into profit in the second half of 2012, creating a profit of 50 million US dollars. From January to June 2013, the passenger traffic of the AMC Cinema increased by more than 80%, and the box office revenue was as high as US$1.34 billion, an increase of 2.6% year-on-year. As of the end of June, September 2013, it had emerged from the predicament of an annual loss of 82 million US dollars, with sales and net profits of up to 2.7 billion US dollars and 81.6 million US dollars (see Table 2).

From the above analysis, it can be seen that after the merger and acquisition, Wanda Group's operating income continues to increase, and Wanda's cinema line AMC's operating income also continues to increase, achieving the expected purpose. Both domestic and foreign cinemas are actively developing, and the entire group has a good development.

4.2 Profitability before and after MandA

DuPont analysis system is to use financial data to calculate various financial indicators, and systematically evaluate the company's profitability through the relationship between financial indicators.

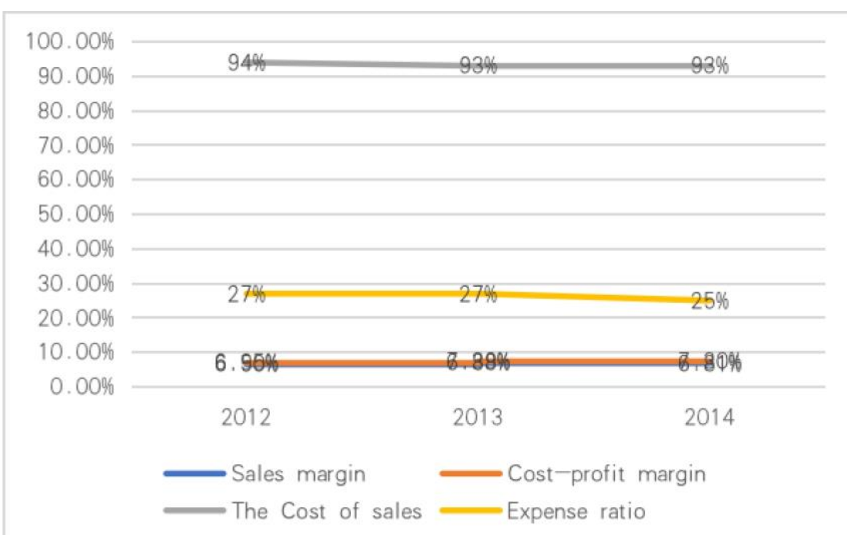
We analyze the financial indicators through the financial statements disclosed from Wanda's official website. The net profit margin is determined by the profit margin and the cost of sales. AMC's net sales margin was 0.02 in 2012 and 0.13 in 2013, a substantial increase, and then fell back to the same level as in 2012 in 2014.

First of all, Sales margin Ratio = Operating Profit / Operating Income
Sales margin in 2012 = 131.05 / 2017.56*100% = 6.50%
Sales margin in 2013 = 189.14 / 2749.43*100% = 6.88%
Sales margin in 2014 = 183.46 / 2695.39*100% = 6.81%

Second, the Cost-profit margin Ratio = Operating Profit / Cost
Cost-profit margin in 2012 = 131.05 / 1886.51*100% = 6.95%
Cost-profit margin in 2013 = 189.14 / 2560.28*100% = 7.39%
Cost-profit margin in 2014 = 183.46 / 2511.93*100% = 7.30%

Again, The Cost of sales Ratio = Cost / Operating Income
Cost of sales ratio in 2012 = 1886.51 / 2017.56*100%=94%
Cost of sales ratio in 2013 = 2560.28 / 2749.43*100%=93%
Cost of sales ratio in 2014 = 2511.93 / 2695.39*100%=93%

Finally, The Expense Ratio = Total cost / Operating Income
Expense ratio in 2012 = 543.69 / 2017.56*100%=27%
Expense ratio in 2013 =746.66 / 2749.43*100%=27%
Expense ratio in 2014 = 671.56 / 2695.39*100% = 25%



From the above analysis, it can be seen that AMC companies are roughly similar to the premise of cost control. The sales profitability and cost profitability of 2013 are higher than those of the previous two years. Both the higher rate of return and the net profit margin of sales in 2013 were significantly higher than the other two years. However, the expense ratio in 2014 was lower than in the other two years, and the expense decreased.

4.3 Total asset turnover

The total asset turnover accounts receivable turnover and inventory turnover of the company would have effects on return on equity. The information about the asset turnover of AMC among three years is in the following Table 3.

From Table 3 we can see it clearly that the inventory turnover in 2013 and 2014 improved significantly compared with 2012. Accounts receivable turnover rate and total assets turnover rate are flat; at the same time, the return on equity has no impact.

Table3 AMC 2012-2014 asset turnover

Year	2012	2013	2014
Total Asset Turnover	0.12	0.54	0.55
Accounts Receivable Turnover	29.54	26.88	26.75
Inventory Turnover	203.09	212.56	211.22

Source: Wanda,http://www.wanda.cn/

The equity multipliers among those given three years are 5.56,3.34,3.15, respectively. The figure for 2012 ranked first and then decreased successively. Observing the equity multiplier of AMC, there was a substantial decrease in 2013 compared to 2012, and a slight decrease in 2014 compared to 2013. The relative reduction in equity multipliers has a significant relationship with Wanda's acquisition of AMC.

Now that we know the net profit margin, total asset turnover, and equity multiplier, we can calculate the return on equity. Analyze the changes in equity returns and the reasons for the changes. We take 2012 as the base period and 2013 and 2014 as the reporting period—the relevant indicators of return on equity from 2012 to 2014 areas following Table 4.

Table 4 AMC 2012-2014 Relevant indicators of return on equity

Period	Return on equity	Net profit margin	Total asset turnover	Equity multiplier
2012（base period）	0.02	0.024	0.12	5.56
2013（report period）	0.23	0.13	0.54	3.34
2014（report period）	0.04	0.024	0.55	3.15

Source: Wanda,http://www.wanda.cn/

As can be seen from the above analysis factors, it can be seen that the return on equity of AMC to the company increased in 2013 compared with 2012, much lower than in 2013 and 2014, but it was higher than the return on equity in 2012. In 2013, the asset turnover rate and net sales rate were both higher than in 2012, so even if the equity multiplier in 2013 is less than 2012, the return on equity in 2013 is much higher than in 2012. The total asset turnover rate in 2014 has increased significantly. However, the net profit margin and equity multiplier, especially the net profit margin, are much lower than in 2013, which is the same as in 2012, which caused a decline in the return on equity in 2014. Wanda acquired AMC in 2012. AMC's return on equity increased in 2013 one year after the acquisition, which brought benefits to Wanda Cinema, but in 2014 it fell to the same level as 2012. From the perspective of the primary income, AMC's income is still considerable, Wanda's acquisition of AMC is profitable.

4.4 Financial early-warning model

In this paper, the Z-score model index is used, and the SPSS software is used to evaluate the multi-variable financial risk of the enterprise. Here we select 5 financial indicators and their specific calculation formula: Z =（3.3*EBIT+1.0* Sales revenue+1.4* retained earnings+1.2* operating income）/Total assets.

We will select 5 variables, which are：1.EBIT, 2 Sales, 3.Retained earnings, 4.Total assets. The calculation results are as follows:

ZA1	ZA2	ZA3	ZA4	ZA5
-0.9033145	-0.9505168	-0.917008	-0.5478305	-0.7680463
-0.3143439	-0.842478	-0.4607108	-0.9841003	-0.769686
-0.3403738	-0.0507924	-0.2031626	-0.6023976	-0.6032385
-0.1579001	0.33691801	-0.1194972	1.28031529	0.7859565
1.71593239	1.50686926	1.70037858	0.85401306	1.35501437

In summary, the Z value of the AMC company during the five years indicates that its financial risk is lower than that of ordinary companies, indicating that the company’s operating status after the merger and acquisition is good. Through a profit analysis of the AMC company, we can know that Wanda merged with the AMC company in 2012 After that, AMC’s sales net profit margin and asset turnover rate have increased significantly, which not only caused AMC to turn into a profit gradually but also brought a lot of benefits to Wanda Group. Therefore, Wanda Group acquired AMC’s behavior was undoubtedly successful and opened Wanda's world journey, allowing Wanda to go international and be recognized internationally.

5. Conclusion

In the process of carrying out cross-border MandA, enterprises should consider many factors from inside to outside to make trade-off assessment and take reasonable preventive measures in time to deal with the problem.

Externally, the merger and acquisition of multinational enterprises should consider the cultural and market environment of the acquired party, especially for the operation of subsequent multinational enterprises, and the stability of the external market should be ensured by the internal stability of the acquired party. In the merger case between Wanda and AMC, Wanda showed respect for the US market standards and local corporate governance rules in the early stages of the merger, which also ensured AMC's smooth transition to the local market after being acquired by Wanda.

Internally, MandA of multinational companies must fully respect and understand the diversified corporate culture within the company and must be reasonably integrated. For example, in this merger between Wanda and AMC, Wanda is equivalent to merely changing the largest shareholder in the proportion of shares and maintaining AMC's original business strategy, management, and management team. Not only that, after the merger, Wanda also implemented a more effective incentive mechanism for the AMC management team and highly affirmed and positively adjusted the original corporate culture. All of these have significantly reduced the potential management risks in this multinational merger and acquisition project.

International cross-border mergers and acquisitions are to increase the company's scale and ability to cope with market risks under the wave of globalized industries and to improve profitability. This successful merger of Wanda and AMC is different from the previous reorganization of resources and culture adopted by domestic or other multinational mergers and acquisitions. They are a successful transition of multinational mergers and acquisitions under the constantly changing cultural and market situation. After MandA, multinational companies need to pay close attention to the policies issued by the host government and local governments to adjust their business strategies. Although the acquisition of companies in the same industry will give the acquirer more advantages, Wanda also needs to develop appropriate management methods to ensure the smooth integration of the acquired company to obtain long-term profits.

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