

## Research on Chinese Financial Enterprises' Overseas Acquisitions Based on a Case Study

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**Abstract:** The global financial crisis has left many western financial institutions severely weakened, providing a great opportunity for China's financial enterprises to become more global through overseas acquisitions. However, there is an urgent topic that need us to study on how to seize opportunities, how to make strategic development plan of overseas investment in a rational way. This paper uses of case study method, focuses the Ping An Insurance (Group) of China purchased the Netherlands - Belgian Fortis Group, analyzing the forming process and reasons about this acquisition of failure from the gain of acquisition information, selection of acquisition target, judgment of acquisition decisions and the investment risks, etc.. At the same time, from overall strategy of China's national development, specific lessons will be given for China's financial enterprises. They must draw lessons in the failure, consider their own characteristics, formulate clear and feasible internationalization strategy. They should based on the rules of spreading risks and seeking long-term stable development, correctly judge economic and financial situation, prudently choose M&A partner, reasonably avoid risk, rationally "going global".

**Key words:** China's financial enterprise; Overseas acquisitions; Ping An Insurance (Group) of China; Fortis Group

### 1 Introduction

From worsening of American subprime crisis to the explosion and spreading of Global Financial Crisis, Ping An Insurance's purchasing of the Netherlands - Belgian Fortis Group has experienced the process of acquisition study, agreement signature and the final failure. Only in the first 10 months, Ping An invested RMB 23.87 billion (approximately USD 2.78billion) in Fortis and it has devalued by 95%, with a suspended deficit of RMB 20 billion. This completely defeated overseas acquisition left the profound lessons. No matter whether Ping An could retrieve this defeat, it is worth reviewing and rethinking.

Ping An Insurance (Group) Company of China, Ltd. was the former "Shenzhen Ping An Insurance Company", which was established in March, 1988, with the registered capital of 53.12 million. In June, 1992, with the approval of the State Council, it renamed as "Ping An Insurance Company of China". In February, 2003, it was approved again to change name to "Ping An Insurance (Group) Company of China, Ltd.". After 20 years of development, the Group has developed into an integrated financial services conglomerate with insurance at its core, also engaging in securities, trusts and banking services. It is the only holistic listing financial group in China with the total assets amounted to RMB 651.104 billion in 2007, and was widely regarded as one of the Chinese companies which most possibly challenges the western.

With the rapid development and strengthening power of Ping An, in order to integrate with international insurance, Ping An started the exploration of its own way to go global. Prior to the acquisition, Ping An invested 1.1billion HK dollars to come in the public- issuing of funds with Value Partners Group Limited, covering 9% of the share capital of Value Partners Group Limited. Ping An gained a floating profit of 89 million HK dollars from this investment. This success made Ping An more aggressive, therefore it aimed at the European Fortis for acquisition. Fortis is an international financial services provider mainly engaging in banking and insurance. It ranked 20 among the European companies, and it was the first listed company in Euronext in Brussels and Amsterdam.

The global financial crisis severely weakened many western transnational companies. However, it brings about rare opportunities for the large state-owned Chinese enterprises to go global through overseas acquisition. In 2003, Chinese government issued a series special operational policy measures to promote the overseas investment of Chinese enterprises and encourage those strong enterprises with ready conditions to invest in the overseas market (Yao Shujie 2009). This is the national development strategy of "Going Global". It triggers a new round of wave for Chinese enterprises to speed up its overseas investment. Since the beginning of the economic reform, China has been transforming the

state-owned enterprises. Finally it grasped the long term strategic objective, building the large domestic state-owned enterprises into transnational ones to compete in the international market.

On the other hand, when Chinese enterprises carry out its “Go-Global” strategy, they need Chinese financial circles to provide them with global services. Therefore, China actively promote the national development strategy—“Go-Global”, and non financial enterprises need financial support from Chinese banks and insurance companies in its overseas investment. It promotes the development of Chinese financial enterprises in overseas investment (Yao Shujie 2009).

With the rapid development of Chinese economy, the international competitiveness power of Chinese financial enterprises has been continuously strengthened. A lot of large financial enterprises with both strong financial strength and overseas investment ability come into being. With the appreciation of Renminbi, rapid growth of foreign exchange reserves, more opening of exchanges in foreign economic cooperation and financial business, and deregulation of control in flow-in and flow-out of capital, the steps of overseas investment of Chinese financial circles are obviously speed up.

From 2006, Chinese financial enterprises invest the overseas financial organizations through Merger and Acquisition, and speed up the overseas direct investment. In 2006, 2007 and 2008, it formed the “√” shape. In 2007, owing to the effect of the global financial crisis, it went down obviously. In 2008, it went up to another climax (see Figure 1). By 2008, 5 large commercial banks have acquired and purchased the shares the overseas organizations, total amount is up to 7.13 billion US dollars. For example, Industrial and Commercial Bank of China Limited purchased 20% shares of Standard Bank of South Africa, the biggest bank in Africa. China Development Bank participates in the capital increase of Barclays Bank of Britain with 2.2 billion euro, holding its 3.1% share. Bank of China invested 965 million US dollars to purchase 100% shares of Singapore Aircraft Leasing Enterprise Pte. Ltd. Ping An of China first invested 1.81 billion euros to purchase 4.12% shares of Fortis Group, later invested 2.15 billion euros to purchase 50% of Fortis Investment, finally it failed nearly completely with large amount of floating deficit. As initially estimated, by 31, December of 2008, the total investment in overseas financial enterprises amounted up to 35 billion US dollars through both merger and share holding. Among them, the floating loss amounted to 20 billion US dollars (Zhang Guohong, Le Jiachun, 2009).

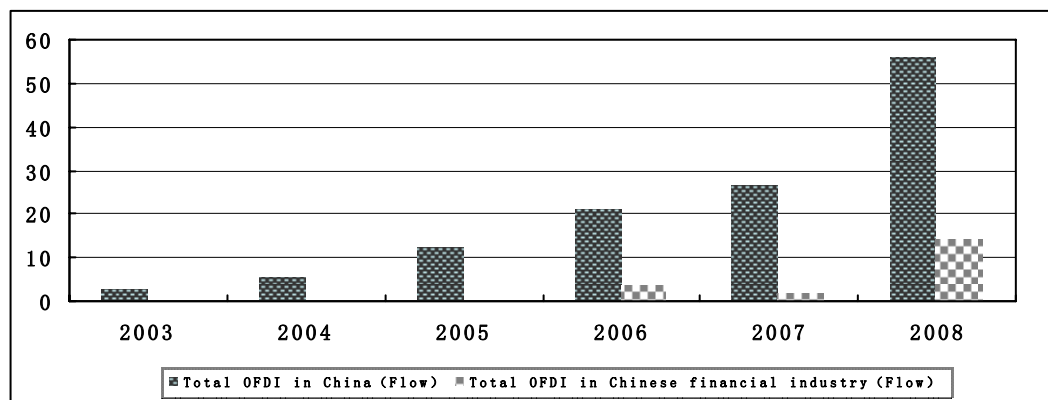


Figure 1 A Comparison Between Chinese Financial Industry OFDI and China's OFDI (\$billion)

Source: MOFCOM, China's OFDI statistical bulletin, 2003—2008

## 2 Reasons behind Ping An Insurance's Failure in the Acquisition

It was considered to be conducive for both sides if Ping An Insurance conducted the acquisition of Fortis Group and co-established the Fortis investment management company with Fortis Bank at the very beginning, which was highly praised and welcomed by the public and the media. However, why an action supposed to be promising and successful has turned out to be a failure? Why a sweet dream has been replaced by a nightmare? There are a lot of reasons behind it. To be specific, they are as follows:

### 2.1 Information asymmetry and inauthenticity of the acquisition.

Although Ping An Insurance had already made an investigation for more than one year and hired JP Morgan Chase & Co. as the only financial investment consultant to made evaluation for them. But the information acquired was not symmetrical; the positive information was much more than the negative one and some important information was even concealed from the investor. For example, Fortis Group had a lot of assets were in subordinated debt of USA including Collateralized Debt Obligation (CDO) and Collateralized Loan Obligation (CLO) of €123 million, but Fortis Group concealed all the harm of

its junk bonds from all the people. The deficit of €4 billion wasn't exposed to the public until the very last minute.

## **2.2 Inappropriate or impractical acquisition target.**

It's a right choice for Ping An Insurance to expand to the overseas market, but this acquisition of Fortis Group was set too high and it was an unpractical target to become a group company of international assets quickly by taking advantage of Fortis Group. At the very beginning, the acquisition was considered as a milestone for the insurance area in China by the leaders of Ping An Insurance when they made comment on its two investments on Fortis Group. In their opinion, this acquisition would lead Ping An Insurance to enter the global market of assets, and it would become a new growth point of profit. In fact, there is no any complementary advantage between Ping An Insurance and Fortis Group. Fortis Group itself has a disorder in company orientation, it shall not become a platform or back-up of Ping An Insurance's going overseas market. There would be a due failure because of the impractical acquisition target.

## **2.3 Incorrect or untimely acquisition decision.**

Ping An Insurance started to conduct the acquisition of Fortis Group in October of 2007 is because of the good quality and low price of Fortis Group stocks. After the investigation, the leaders of Ping An Insurance reckoned that the share price of Fortis Group had decreased from €40 to around €19, which had become a good quality stock with 1.1 times of net assets and 5 times of p/e ratio but no bubbles. So it was a definitely a rational choice to invest in Fortis Group and it was a perfect time to acquire by bottom fishing. But as a matter of fact, that was the very time when the crisis of Fortis Group had been formed. Fortis Group Bank decided to buy ABN-AMRO Bank with other two banks in a €71 billion move. This huge acquisition itself was indefinite, but the leaders of Ping An Insurance saw it as the manifestation of Fortis Group's strong competitiveness which guaranteed a promising future. However, it's this acquisition and global financial crisis that triggered the collapse of Fortis Group. And then the failure of Ping An Insurance's acquisition was inevitable.

## **2.4 The investment risks can not be dispersed or controlled.**

Ping An Insurance's acquisition of Fortis Group was supported by China Banking Regulatory Commission. The floating foreign exchange investment amounts approved to obtain by Ping An Insurance was 5% of the total assets, which was 31 billion yuan, but the acquisition cost Ping An Insurance 23.87 billion yuan accounted for 64% of it, which was not in conformity with the principle of investment risks dispersing. Particularly, Ping An Insurance didn't request for the operation and management rights of Fortis Group. Their spending a lot to buy Fortis Group stocks and becoming it's the biggest shareholder brought about no practical value but more risks. And the fact has shown that when crisis occurred in Fortis Group, in order to protect their own country, Belgian government and Netherlandish government carried out the nationalization, they neither asked for shareholders' opinions nor got the formal authorization from the board of directors of Fortis Group, they handled the deal alone and forced the board of directors to sign on the documents of corporate restructuring. However, Ping An Insurance, as the biggest sole shareholder of Fortis Group was excluded, having nothing to do but waited. They had no right to control their investment risks. At last they issued a statement expressing their sorry about the result.

## **3 Important Implications from Pin An Group's Failure**

Ping An Insurance is both a renowned star enterprise and a flagship model of enterprises in financial area in China. On its road of internationalization, the overseas investment initially considered as milestone by the leaders turned out to be a battle of waterloo, which provided profound experience and lessons for us. Especially in the era of post-crisis, it provided very important implications for the financial enterprises in China on how to generate the strategy of overseas investments rationally.

### **3.1 Long-term goal development should be taken into consideration in transnational acquisition in financial area**

As regard to long-term development, financial enterprises' strategy of going global is necessary and following the trend as well. However, going global is not a easy task at all because financial area is the key branch of economy in every country or region especially in developed economies like Europe and USA. Banking area particularly must have the monopoly letting no others to set foot in. In this global financial crisis, more than 250 medium and small banks went bankrupt in USA alone, but they seldom acquired by foreign enterprises by bottom fishing let alone the enterprises in China. Therefore, it's necessary for Chinese enterprises to set long-term development objectives of overseas acquisition and

generate long-term development strategy and they can not count on one or two overseas acquisitions to realize their objective of internalization.

One of important factors in Ping An Insurance's failure in acquisition is that the objective they set was too high and they underestimate the fact, which shows that the leaders of Ping An Insurance are eager for quick success and instant benefit. After the sub prime crisis occurred in USA, many famous people or leaders in enterprises in China talked actively about overseas bottom fishing, which was totally a misleading. If Ping An Insurance had set the long-term development objective of overseas acquisition, they would neither have been so impulsive to invest when the crisis came nor have considered the acquisition of Fortis Group as the important platform for the internationalization of Ping An Insurance. This is a profound lesson.

### **3.2 Investment risks should be recognized in transnational acquisitions in financial area**

There are many indefinite factors and perplex relationships in the market of financial area compared to other areas, which can not be integrated in an easy way, so the result is that the risks of transnational acquisitions in financial area is very complicated and unpredictable. In recent years, the overseas acquisition of financial enterprises in China developed rapidly, and some of acquisitions have already been finished, but which doesn't mean the success. Because entering the foreign financial area is just the first step, it's hard to say whether you will encounter traps or not next. What's more, the risks of financial products with high internationalization level, the risks of differences integration of enterprise cultures as well as the risks of response to the financial crisis should be taken into consideration, or you will lose it all.

When Mr. Ma Mingzhe, the chairman of Ping An Insurance summarized the lessons they learnt from this acquisition, the first one is that they didn't well realize and understand the risks of acquisition, which was a truth. If the leaders of Ping An Insurance had noticed well the risks, they would neither have decided to conduct the acquisition when the timing was totally inappropriate nor got themselves involved when Fortis Group hadn't finished their acquisition of other bank, which cost a lot. Of course, Ping An Insurance didn't realize the risk from the nationalization policy implemented by the country in which the Fortis Group located either. We can say that the failure of Ping An Insurance rings the alarm for Chinese enterprises' going global.

### **3.3 Investment objects of transnational acquisitions in financial area should be chosen and evaluated carefully**

The most important step of overseas acquisition is choosing the acquisition objectives. Especially in the financial area, searching for the acquisition objectives can start from focusing on the emerging markets in those regions or countries like China who are taking their initial step, growing very rapidly and complementary to each other including South-eastern area, Latin America, South Africa, Middle East, etc.. The financial door of those developed countries is hard to be opened, so more cautions should be needed when the acquisition objectives are so easily to be got without that much cost. The fact shows that when it comes to choosing acquisition objectives, the objectives are neither the cheaper the better nor the more famous the better. They should make an elaborate plan to search and analyze the characteristics of enterprises and industries and then narrow down the acquisition objective and evaluate whether it can promote their development strategies.

Ping An Insurance's acquisition of Fortis Group was considered as the best acquisition objective, which is not consistent with the fact. The stakeholder of Fortis Group is scattered and it is a diversified financial institute with banking as its main part, having no complementation with Ping An Insurance, so the future ahead is still gloomy even though this acquisition is successful. Ping An Insurance's failure told us that failure is inevitable if the acquisition object is inappropriate. Chinese financial enterprises should stick to the development strategies and lead the acquisitions in accordance with these strategies. After several years' speculation, they can figure out the potential acquisition objects and keep a friendly long-term relationship with them. Then they have the possibility to realize the acquisitions as well as their objective of internationalization step by step.

### **3.4 Transnational acquisitions should comply with the strategies of internationalized operation of Chinese enterprises**

After the strategy of going global has been implemented, the overseas investments mushroomed rapidly. But currently, the internationalization level of financial services in China still can not meet the needs of transnational operation's sustainable development, and the problems like financing system is lagging behind and capital requirements always can not be well met are emerging gradually. The essence of financing is providing convenience for the financing of entity economy. But over the recent years, some financial innovations can not meet the needs of entity economy and some financial derivatives

changed from a tool to avert and manage risks into a speculation tool to get high return. Some financial products are idling in the financial system and can not enter the entity economy. International experience shows that financial support plays a significant role in overseas investment development. In policy-related finance area and commercial banking area, work must be divided appropriately according to the various characteristics of different businesses and enterprises, support focal point must be highlighted to give fully expression to the national interests and industrial policy guidance.

On the road of conducting overseas acquisitions, as a business group with the integration of various financial services, if Ping An Insurance had used part of its assets from overseas investments as the funds support for some enterprises who are going global selectively, it wouldn't have been in total failure because this method complies with the overall national development strategy, so that the economic competitiveness of enterprises who are going global can be strengthened, besides, investment risks can be diversified. Ping An Insurance also can take part in the operation of the international enterprise and get the profit. Therefore, the root of financial enterprises' going global is the integration of transnational acquisitions in financial area and the international operation strategies of Chinese enterprises.

#### 4 Conclusion

Some overseas financial institutions have been put into a dilemma because of the global financial crisis. The financial circles of USA and even the whole world have entered a shrinking period. Market value has become devaluated dramatically and the capital is not sufficient at all; there is an urgent demand for the financing in international financial market, which provides a good opportunity for the international services and overseas development of Chinese financial institutions with good liquidity. For Chinese enterprises, they should make a clear and practical international strategy according to their characteristics based on the former experience. Besides, they should adopt the principle of risks diversification and long-term sustainable development to judge the correct economic and financial trend, choose the acquisition objects with caution, avert risks properly, emerge in the overseas market rationally, establish international operation network, and promote the integration capacity of internal and external business, risk management capacity and culture adaptation capacity, then gradually become a transnational financial enterprise with international competitiveness.

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