

# The benefits of Chinese lessons

## CHINA

A CASE STUDY OF A UK ENGINEERING FIRM ACQUIRED BY A CHINESE COMPANY SHOWS HOW BOTH PARTIES GAINED BENEFITS FROM THE DEAL, WRITES ASSOCIATE PROFESSOR **SHAOWEI HE**

**The past decade has witnessed a significant surge of Chinese investment in developed countries, much of this in the form of M&A.** This, however, has been received with mixed feelings in the host countries.

On the one hand, many host countries welcome the injection of investment, particularly after the financial crisis. On the other hand, many in the West are still very hostile to any form of investment from communist China, believing such investment would be damaging to the local economy and business.

The evidence on the ground, however, is very thin. Two scholars recently conducted a detailed case study of a Chinese acquisition in the UK and examined the changes the acquisition has made to the acquired British companies.

### The rise of Chinese innovation

The rise of Chinese corporations is already well documented in mainstream business magazines. The number of Chinese companies in Fortune's list of the world's top 500 largest, for example, has risen from 16 in 2005 to 120 in 2017. Chinese companies have become not only bigger but also more innovative on the globe stage.

The EU Industrial R&D Investment Scoreboard tracks the world's corporations that have the biggest R&D investment across different industries. Focusing on the top 685 biggest R&D investing



Illustration by John Holcroft

companies, only two Chinese companies, PetroChina and China Petroleum & Chemical, achieved a place in the scoreboard in 2003. However, the number of Chinese-listed firms has since jumped rapidly, reaching 71 in total in 2017, with Huawei being the world's sixth largest R&D investor, ahead of Apple.

In their ongoing quest for innovation and technology development, many Chinese companies have invested heavily in R&D – not only domestically but also overseas and particularly in developed countries. This is a striking feature that differs from the dynamisms of the past where innovation-related FDI increasingly went from developed economies to developed economies, or developed economies to leading emerging market economies. We believe that this Chinese-led, innovation-related FDI towards advanced

economies has the potential to fundamentally change the landscape of global innovation.

### Mission impossible?

Much of the Chinese innovation-related investment in developed countries has come in the form of M&A and the main motive behind such deals has been to seek knowledge and access to develop strategic assets. A key question, from the perspective of host countries, however, is whether the Chinese acquisitions would become 'asset-stripping' investments, leading to a hollowing-out of the host countries' industrial base.

Looking at the issue from a different perspective, as Chinese companies are widely perceived as lacking advanced knowledge and innovation, to many commentators it is almost unthinkable to imagine Chinese M&As creating learning and

transformation opportunities for companies in developed countries. This counterintuitive phenomenon is, however, exactly what we recently found in a case study of a Chinese acquisition in the UK.

The Chinese acquiring company operates in the rail equipment industry, while the acquired British company produces semiconductor components and modules that not only can power transportation systems, but can also be used for industrial control and other areas.

Prior to the acquisition, the British company was relatively small but already had a unique history and position in terms of developing high-end technological products. The Chinese acquirer was much larger but was keen to upgrade its technologies.

As expected, the Chinese firm took advantage of the acquisition and quickly made impressive progress in electric power systems. Also interesting is the significant transformation that the British acquired subsidiary has experienced. For instance, the new parent firm has brought to the British subsidiary much-needed financial stability and key design knowhow related to power converters and electronic design. In addition, the Chinese parent injected significant investment that enabled the subsidiary to upgrade its outdated production facilities – which in turn significantly increased production capacity but also improved product reliability and robustness.

Moreover, after the acquisition, the Chinese parent helped the subsidiary to establish a new R&D centre and also maintained significant and stable growth in R&D expenditure at the subsidiary, which broadened and strengthened R&D activities at the subsidiary. Last but not the least, because of the push and support from the Chinese acquirer, the past few years have seen the British subsidiary increasingly applying its technologies beyond the traditional market to expand and venture into new markets such as renewable energy, smart grids and electric cars.

#### **How did it happen?**

In the process of subsidiary transformation, our analysis demonstrated that the Chinese

acquiring company not only provided much-needed financial investment and stability but also acted as source of knowledge and learning. We revealed that, for example, as a lead firm in the railway equipment global value chain, the Chinese acquiring firm brought to the subsidiary some crucial knowledge of the Chinese railway system, which proved critical in designing and manufacturing railway-related products. In addition, the Chinese acquiring firm steered and monitored the process and therefore ‘propelled’ upgrading and transformation in the subsidiary by setting specific parameters for the subsidiary to comply with in order to qualify the latter’s products for the railway and related markets.

Furthermore, we found that both the acquiring and acquired companies were eager to learn from each other and over time a ‘symbiotic relationship’ and mutual learning environment was established that facilitated a ‘recursive, multidirectional’ information flow and joint reflection and experimentation with resultant progress in jointly producing electric vehicle components.

Both the acquiring and acquired companies made significant efforts to facilitate the above transformation. For example, there have been dedicated efforts by senior managers of both parties to help the subsidiary’s employees appreciate the parent firm’s strategies, capabilities and ambition and, therefore, enhance trust building between the acquirer and the subsidiary.

In addition, despite the acquiring company’s steering role, it appeared to have adopted a ‘light touch’ management style towards the subsidiary (for example, although it owned 75% of the stake, the acquiring firm did not seek domination of the subsidiary’s board, thus giving it the needed autonomy). These efforts helped to ease subsidiary employees’ doubts on the Chinese acquiring company and their fear of ‘working for communist China’.

There have also been regular exchanges of senior managers and engineers between both parties that facilitated knowledge exchange and sharing. Indeed,

the recently established R&D centre has since become a joint research centre, with the presence of more than a dozen engineers from the acquiring firm. Moreover, various efforts have been made to build trust and facilitate communication between the Chinese and British engineers, including dedicated team-building activities and social events.

#### **Implications for businesses**

In developed countries, both governments and the public tend to view the acquisition of local companies by Chinese companies at best as finance providers that have little to offer to the latter and at worst ‘scavengers’ that will inevitably hollow out the local industrial base. Our analysis challenges the conventional wisdom and demonstrates that there could be potentially significant transformation and learning opportunities brought over by the Chinese firms. It is, therefore, important for governments and businesses in developed countries to appreciate this and not to demonise Chinese overseas investment.

Our analysis suggests that, in order to maximise the potential benefits, it is important for managers in the West not to dismiss Chinese companies’ capabilities and competences but to embrace a humbler attitude, since such companies bring substantial learning and transformation benefits to their acquired firms.

The vast majority of Chinese firms are still on their long march to innovation, but many of them have complementary assets and competences (particularly their manufacturing knowhow, responsive supply chain and competence in e-commerce) that could be very useful for firms in developed countries. With the rise of digitisation, gaining access to complementary specialised knowledge will enhance innovation and value creation in the acquired subsidiaries. ■

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