

# Analysis of Financial Risks and Preventive Measures in The Process of Reverse Transnational Merger and Integration of Chinese Enterprises

-- Take Geely's Acquisition of Volvo as An Example

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**Abstract:** Reverse transnational merger and acquisition is a kind of international operation mode in which enterprises in emerging markets merge or acquire enterprises in advanced countries, so as to obtain strategic resources. This is also a "springboard" for enterprises in emerging economies to obtain foreign resources and quickly move to the international market. The Chinese government plays an important role in cross-border mergers and acquisitions, and the integration process is becoming more difficult and the merger is becoming more likely to fail. In addition, Chinese enterprises show new characteristics in many aspects, such as the object of merger and acquisition, the industry and the way of merger and acquisition. Through cross-border mergers and acquisitions, enterprises can expand overseas markets, achieve transformation and upgrading, and improve the core competitiveness of enterprises. Based on the case of Geely Auto's acquisition of Volvo, this paper analyzes various financial risks it faces in overseas mergers and acquisitions, and puts forward corresponding countermeasures for Chinese enterprises to prevent and guard against financial risks in overseas mergers and acquisitions and promote the smooth progress of mergers and acquisitions.

**Keywords:** Reverse cross-border merger and acquisition; Financial risk; Preventive measures.

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## 1. Introduction

With the rapid rise of emerging economies, transnational mergers and acquisitions are no longer dominated by enterprises in developed countries, but more and more reverse transnational mergers and acquisitions initiated by enterprises in emerging economies to enterprises in developed countries. Chinese companies have an important role to play in this process and have an important role to play in this process. According to the trend of overseas mergers and acquisitions of Chinese enterprises in recent years, including the United States, the United Kingdom, Germany, Australia, Japan, these countries and regions with rich knowledge, advanced technology and developed economy are gradually becoming the first choice for Chinese enterprises to carry out overseas mergers and acquisitions. Chinese enterprises can make use of these resources to acquire strategic resources such as resources, technology, brands and markets, accelerate the process of internationalization and achieve a leap in international competitiveness.

Although reverse cross-border mergers and acquisitions can quickly obtain advantages in patents, trademarks, research and development capabilities, customer relations, etc., 60%-80% of enterprises will fail to integrate due to the asymmetry of resources and capabilities of the merger and acquisition parties, lack of merger and integration experience, and improper management processes. As to the reasons for the failure of merger and integration, many scholars have focused on the effect of merger and integration. Due to the challenges of institutional deficit, source country disadvantage, resource asymmetry and other challenges in reverse M&A in developed countries, it is more difficult to obtain the legitimacy of the organization after M&A, which will make the absorption, symbiosis and retention integration

patterns of enterprises from developed countries in the past play a limited role in guiding the practice of reverse M&A in China. In short, different situations mean that there are different merger and integration models and effective mechanisms. Therefore, it is important and urgent to explore the integration model of reverse mergers and acquisitions and its context-matching relationship.

## 2. Overview of Reverse Transnational Mergers and Acquisitions

### 2.1. Reverse cross-border mergers and acquisitions

The traditional cross-border merger and acquisition is usually the merger of strong brands and weak brands, and in this process, there is a trend of emerging market companies dominated by developed markets. The reverse transnational merger is a kind of international operation mode for the purpose of obtaining overseas strategic resources. In reverse cross-border mergers and acquisitions, because the two sides are in different positions, it is easy to produce the difference in "organizational identity", that is, there is an obvious identity gap between them, which is easy to cause the failure of mergers and acquisitions. At present, the research on reverse transnational M&A mainly focuses on two aspects: 1. Research on the motivation of reverse transnational M&A. Through reverse transnational mergers and acquisitions, not only can technology brands be obtained, but also can promote enterprises to achieve industrial transformation and upgrading. At the same time, through the implementation of transnational mergers and acquisitions, we can not only obtain foreign advanced technologies, but also promote the transformation and upgrading of our economic structure. In order to achieve certain goals, some enterprises will acquire

the resources of target companies through cross-border mergers and acquisitions. 2. M&a performance research. Knowledge transfer in reverse cross-border M&A is conducive to the improvement of M&A performance, and presents different characteristics at different stages. Reverse cross-border M&A of Chinese enterprises has neither created value nor improved the long-term business performance of the company. In fact, whether enterprises can improve the performance of cross-border mergers and acquisitions is affected by many factors, such as institutional distance and cultural differences.

## **2.2. Influencing factors of cross-border merger and integration strategy**

### **2.2.1. Resource similarity and complementarity**

The enterprise has a variety of different resources, and its core capabilities are composed of a variety of different resources. Post-merger integration is the similarity and complementarity of resources between the two parties. The main objective of cross-border mergers and acquisitions in China and some other emerging market countries is to acquire foreign advanced technology and management experience, and it is also an important part of international brands. For example, when both parties are highly similar in terms of operation, product market and channels, both parties can share similar resources through information communication, so as to achieve integration after merger. Developed countries take the lead in cutting-edge technology and management experience, while China and other emerging economies have certain advantages in labor costs and resource ownership. The asymmetry of resources and capabilities makes enterprises in emerging economies lack the experience and absorption capacity of reverse cross-border mergers and acquisitions of enterprises in developed countries, so it is easier to use new integration strategies such as "light contact".

### **2.2.2. Organizational identity differences**

Organizational identity difference makes Chinese enterprises bear huge risks in reverse transnational mergers and acquisitions. Organizational identity gap reduces the legitimacy of mergers and acquisitions through the three levels of individual, group and organizational identity, thus affecting the success or failure of mergers and acquisitions. The high failure rate of reverse cross-border mergers and acquisitions is largely due to the neglect of organizational identity management, which leads to constant conflicts and conflicts in the later integration process. Whether an enterprise can achieve effective integration after merger and acquisition plays an important role in the organizational identity of the acquirer. Therefore, it is particularly important to pay attention to organizational identity management in the process of reverse transnational merger and integration. Because the asymmetric organizational identity relationship will not only reduce the legitimacy of the late transnational M&A enterprises, but also bring pressure to the integration of the M&A enterprises and the merged enterprises.

### **2.2.3. Institutional distance**

When enterprises carry out international operation, they should be subject to the system environment of their own country and the system environment of the host country. Because the cultures, legal systems and customs of countries are very different, the institutional distance between enterprises is also greater. It is found that there is a negative effect between M&A performance and the distance between

formal and informal institutions, and institutional distance can not improve M&A performance. In the process of reverse transnational M&A, whether the institutional distance can be shortened directly determines whether the enterprise can achieve successful integration. Generally speaking, the smaller the institutional distance, the more favorable the merger and integration; On the contrary, if there is too large institutional spacing, it will seriously hinder the merger and integration of enterprises, and even lead to the failure of merger and acquisition.

## **3. Reasons for Geely's Acquisition of Volvo**

### **3.1. Make up for the shortcomings of the enterprise itself**

The cost-oriented development strategy has been implemented by Geely since its inception, but many problems in practice and the lack of advanced automotive technology make it difficult to break its limitations and join the ranks of middle and high-end cars, and it is always in a low-end car market. Therefore, Geely Auto must change its brand strategy, among which the biggest obstacle is the development of science and technology, Geely knows that alone, not only difficult, but also time-consuming and laborious. Therefore, it is the best choice for Geely to take merger, combination and other means to control its core technology as soon as possible. Therefore, Geely Auto quickly set its sights on the troubled Ford, they hope that through the acquisition of Volvo, to fill its shortcomings in the car market, so as to establish a foothold in the market.

### **3.2. Leverage management synergies**

Low prices are Geely's biggest advantage. There are many differences between Volvo and Geely. Geely lacks talents and low-end technologies, while Volvo is an old car company. Since its establishment, it has accumulated a lot of cutting-edge technologies and has a team of high-tech talents from home and abroad as well as an efficient operation and management team. So as to improve their brand value, in the high-end market to gain a firm foothold.

### **3.3. Improve their own capabilities and brand effect**

Volvo has a history of more than 100 years from its birth to now, and this brand is very famous all over the world. Long before Geely bought Volvo, Volvo already had a huge global distribution network, and its reputation is needless to say. Through this acquisition, Volvo can not only exert its brand influence, but also use Geely Auto's marketing platform to achieve complementary advantages and improve its own brand recognition.

### **3.4. Expand market share**

In the process of merger and acquisition, Geely acquired some valuable intellectual property rights of Volvo, perfect dealer team and perfect supplier system, which greatly improved Geely's market share both at home and abroad, and became an important part of mid-to-high-end cars. Moreover, Geely has already secured the sales of domestic cars, and has effectively increased its original share in the field of cars through both internal and external efforts.

## 4. Analysis of Financial Indicators

### 4.1. Profitability analysis

As can be seen from Table 1, Geely achieved sales of more than 20 billion yuan in 2010, an increase of 42% over the same period last year. Net profit after the merger hasn't budged much, but return on equity has been on a downward trend since 2008. It can be seen that after Geely bought Volvo, its profits did not improve significantly, but it spent a lot of money in the process of merger and acquisition, which can be seen that this is mainly caused by the strength gap between the two companies.

**Table 1.** Sales net profit rate and return on equity from 2008 to 2012

Year	Net profit margin on sales	Return on equity (%)
2008	0.20	20.94
2009	0.08	18.55
2010	0.02	17.06
2011	0.02	16.11
2012	0.02	15.83

### 4.2. Solvency analysis

As can be seen from Table 2, in 2007, Geely's asset-liability ratio was significantly lower than the international level, and its business operation gradually became cautious. After 2007, Geely planned to acquire Volvo, and the asset-liability ratio rose sharply. Geely has taken on a lot of debt since deciding to buy Volvo. From 2008 to 2012, Geely's asset-liability ratio has remained stable, but the total debt is constantly increasing, and the risk of debt repayment is also rising. According to this analysis, the main reason is that cross-border mergers and acquisitions involve a large amount of capital investment, which brings the corresponding debt burden to enterprises.

**Table 2.** Asset-liability ratio from 2007 to 2012

Year	Asset-liability ratio (%)
2007	12.78
2008	52.89
2009	62.26
2010	62.65
2011	63.22
2012	57.92

As can be seen from Table 3, after Geely Auto acquired Volvo, its current ratio, quick ratio and other indicators showed that its short-term solvency was not strong. In 2007, China's capital market has better liquidity, which provides favorable conditions for risk prevention. Then, there is a large amount of acquisition funds, resulting in a large reduction in liquidity. After the merger and acquisition, Geely's long-term and short-term solvency will decline, which is a common situation in the process of company merger. Although Geely finally bought Volvo for \$1.55 billion, it still needs a huge amount of capital to support it in order to operate better in the future.

**Table 3.** Current ratios and quick ratios, 2008-2012

Year	Current ratio	Quick ratio
2008	0.97	0.52
2009	1.37	1.09
2010	1.33	1.01
2011	1.13	0.91
2012	1.19	0.94

### 4.3. Risk analysis of value assessment

First, Geely's acquisition of Volvo is a brand merger, so special attention should be paid to the reasonableness of the price such as goodwill and patented technology in the valuation. Second, due to the differences in accounting standards, systems and accounting systems between the two countries, information asymmetry is very easy to occur, which makes it difficult to obtain high-quality financial information of Volvo. However, Volvo is a listed company and its financial information has strong transparency and transparency. Therefore, the quality of accounting information of listed companies is reliable. Third, Geely has never done a merger or acquisition, so it has no experience in Volvo's evaluation, net asset investigation, negotiation and approval process. To that end, Geely hired accounting advisers from Deloitte and Fuld's lawyers to complete the entire process of the \$1.55 billion acquisition. Fourthly, Geely acquired Volvo in 2008, when the global financial storm was raging, the American auto industry, which relied excessively on the development of the auto finance industry, suffered an unprecedented heavy blow. The industry as a whole fell into a trough, and Volvo also suffered a heavy blow. Volvo's sales and profits fell sharply in 2008, and even suffered huge losses. The collapse in market value forced Ford to rush to sell Volvo, which not only reduced the cost of the acquisition and lowered the valuation, but also made Geely the world's largest automaker, which is a typical multinational acquisition.

## 5. Preventive Measures and Inspiration for Financial Risks of Reverse Mergers and Acquisitions

### 5.1. Preventive measures for financial risks of reverse mergers and acquisitions of enterprises

First of all, we should broaden the financing channels and diversify the financing methods. M&a transaction is to evaluate the target company, finding the right price is the key to the success of M&A. In the case of information asymmetry, if the acquirer can not have a comprehensive understanding of the actual situation of the target company, it is possible to misjudge the target company and overestimate, resulting in high acquisition costs. Therefore, before the transaction, the company should make full work preparation, conduct due diligence on the target party, and make a reasonable judgment on the price of the transaction through its industry status, business model, asset structure, sales profit, cash flow and future profit forecast reflected in the financial statements. Secondly, we should design the financing structure scientifically. Cross-border mergers and acquisitions are generally large enterprises that require huge capital backing. Enterprises should proceed from their own reality, avoid taking one road, and ensure the abundance of capital. Corporate merger and reorganization are accompanied by various risks. Different financing models and different financing times will bring different risks to enterprises. In the process of financing, we should take into account our own asset-liability ratio and other issues. In the case of a high asset-liability ratio, we should avoid more capital from liabilities. Since capital has time value, it can improve the efficiency of cash use of the company. All in all, in the process of mergers and acquisitions, we should choose reasonable and efficient financing methods according to our actual situation.

Finally, a reasonable integration plan should be formulated. The difficulty of merger and acquisition integration lies in this stage, which is extremely prone to mistakes and is the most critical and risky stage in the whole stage of merger and acquisition. The core of successful M&A integration is to deal with the good guys first. Enterprises should actively create a working atmosphere of mutual respect and trust, establish common goals and values, form a centripetal force, improve the sense of responsibility, and thus produce a strong collective force. At the same time, through the integration of strategy, organization, human resources and finance and other related modules, improve the core competitiveness of enterprises and achieve synergy. In terms of financial integration, enterprises should clarify the strategic objectives of M&A transactions and strive to maximize the benefits. At the same time, the responsibilities of relevant personnel are clearly stipulated in the management system, and each performs its duties to avoid loopholes in the work. The team should also be strict in personnel selection, improve the entry threshold, optimize the personnel structure, strengthen the quality of personnel, and ensure the high quality of the enterprise team to a certain extent.

## 5.2. Enlightenment

### 5.2.1. Pay attention to the impact of organizational identity differences on mergers and acquisitions

Due to the great differences with developed countries in terms of technology, talent, brand, etc., we try to shorten the distance with developed countries as much as possible through reverse cross-border mergers and acquisitions. In reverse transnational mergers and acquisitions, the difference of organizational identity between the merged company and the merged company increases the merger risk, which mainly comes from two aspects: First, within enterprises, in reverse transnational mergers and acquisitions, merger-acquiring enterprises are often from developing countries, whose economic development level is far lower than that of developed countries. Employees of enterprises in host countries may naturally discriminate against the image of their home countries, that is, they believe that the purpose of mergers and acquisitions is to plunder their technologies and brands, resulting in employees of enterprises in host countries not recognizing the organizational identity. And then there are strikes, affecting the normal operation of enterprises. Second, from an external point of view, when a weak brand merges a strong brand, it will be threatened by brand confusion. On this basis, a new M&A strategy is put forward, that is, the external reputation and brand value of the acquired company will be affected after the M&A. Therefore, when implementing "reverse" cross-border M&A, Chinese enterprises should fully consider their own organizational identity differences and take corresponding countermeasures to reduce their impact on M&A activities.

### 5.2.2. Implement an appropriate organizational identity management model

In reverse transnational merger and integration, if there is a large difference in organizational identity between two companies, the company can adopt the governance mode of organizational identity separation to effectively integrate them. This kind of separation of organizational identity is helpful to maintain the identity independence of the enterprise, maintain the original organizational structure of the enterprise, and maintain the scientific and technological research and development. The chairman of Geely Group has made it clear

to the outside world on many occasions that Geely and Volvo are two independent organizations, and the status of the two is equal. Facts have proved that this management model is completely correct, which not only maintains Volvo's high-end car brand image in the world, but also helps Geely achieve technology integration and improve the brand effect of the enterprise. The reverse transnational merger and integration is a complicated process. Due to the lack of merger and integration experience of enterprises in China and other emerging economies, the failure rate of merger and acquisition is very high. Transnational mergers and acquisitions are only the beginning of the implementation of an enterprise's internationalization strategy, and the play of its core competitiveness will directly affect whether an enterprise can acquire strategic assets, such as advanced technology, management experience and brand development. In the process of reverse cross-border mergers and acquisitions, enterprises should fully consider the differences in organizational identity between the two companies and adopt appropriate organizational identity management methods, so as to help enterprises quickly achieve internationalization through the resources obtained by mergers and acquisitions.

### 5.2.3. Establish a dialogue and exchange mechanism

In the reverse transnational merger and integration, the process of merger and integration will face many obstacles because of the strategic merger between two companies. After Geely's acquisition of Volvo, a "Dialogue and Communication Committee" was set up to promote efficient communication between the two companies in areas such as technology, operations and strategic cooperation. In this way, it not only provides an exchange platform for employees of the two companies, enhances their knowledge and understanding of each other's companies, avoids employee strikes and enterprise operation stoppage due to poor communication, but also helps Geely and Volvo achieve rapid integration of enterprises. Therefore, in the process of "reverse merger" integration, China and other emerging economies can build dialogue and communication mechanisms among enterprises to strengthen the interaction and communication among personnel within enterprises, so as to enhance mutual trust and reduce conflicts.

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