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Study on the ideas for developing M&A funds in China in the context of economic transformation

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2021

I hereby declare that this PhD dissertation is my original work

and it has been written by me in its entirety.

I have duly acknowledged all the sources of information

which have been used in this dissertation.

This PhD dissertation has also not been submitted for any degree

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SONG Xiaoming

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ABSTRACT

STUDY ON THE IDEAS FOR DEVELOPING M&A FUNDS IN CHINA IN THE CONTEXT OF ECONOMIC TRANSFORMATION

SONG Xiaoming

M & A fund is one category of private equity investment fund. In the past 25 years, private equity fund has grown into a considerable asset section. Since 2008, China's economy has experienced the pounding pain of structural transformation multiplied with other challenges, e.g. international economy's lack of growth momentum, increased trade friction, aging population and so on. The trade friction between China and the United States has further exacerbated. Against this backdrop, from September 2018, there was a significant shift in the domestic central government's economic policy, particularly the capital market policy, has undergone major changes with the repressed capital market elevated to an unprecedented strategic level. M & A, as a crucial means to optimize the social resources allocation and enhance the efficiency of social capital utility, has been given great expectations by the government.

This study mainly discusses the role of M & A fund in China's economic transformation, and a medium-term development road-map of M & A fund

under the new capital market policies today. After thorough research, data statistics and analysis, a potentially feasible M & A fund domestic development strategy is proposed to meet the needs of current economy and development.

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CHAPTER 1. INTRODUCATION

1.1 Background and Academic Contribution

This paper mainly analyzes the influential factors of M & A fund operation, especially those with Chinese characteristics, politically, economically and financially, focusing on the impact of macroeconomic factors on M & A fund development, e.g., economic cycle, economic growth, monetary policy, exchange rate, regulatory policy, and combined with the current domestic macroeconomic situation of China's economic transformation, thus shedding lights on China's M & A funds development.

1.1.1 Background

As one category of private equity investment fund, M & A fund mainly obtains certain control of the target enterprise by acquiring the equity of the enterprise through reorganization and transformation with its comprehensive advantages leading or assisting financial optimization, management reorganization, adjustment of development strategy and other measures, to strongly boost the capital, asset and industrial value of the invested enterprise, and choose the opportunities to withdrawal by equity transfer or assets realization. In the past 25 years, private equity has grown into a comparatively large asset class. Take the United States as an example, its private equity management scale has exceeded US $10 trillion in recent years. Through empirical data, a large proportion of private equity can be categorized into M&A funds. According to China Securities Investment

Fund Association, by the end of March 2019, the scale of China's private equity funds is about 12.79 trillion yuan, of which of M & A funds accounts a relatively small portion, leaving significant room for improvement.

The development of M & A fund in China is still in the initial stage, and it is still learning and growing from foreign experience. Compared with western countries, China's reform and opening-up is only 40 years, thus relatively short development of China's market economy; Shanghai Stock Exchange and Shenzhen Stock Exchange were established in 1990, less than 30 years till now, with China's capital market is still in the process. 2004 is widely regarded as the initial year of private equity development in China, which is 15 years till now. and 2008 witnessed the beginning of M&A fund and till 2011, M&A fund has been recognized. Currently, M&A fund is still emerging new and is still on the way of progress and exploration.

The development of finance, especially M&A fund, is closely related to the macroeconomy, regulatory policies, capital liquidity and capital markets. The long-term, stable and rapid development of China's economy provides a good environment and base for finance and private equity funds. But private equity investment funds in China are particularly vulnerable to changes in regulatory policies in related fields due to China's political and financial regulatory system.

China's economy has entered a new stage with accelerated growth, re-structured transformation and an increasingly complex context. New challenges and opportunities are brought along in private equity funds, especially M&A funds. Since 2008, China's economy has entered a painful structural transformation. Internal challenges combined with external pressure make the economic development more difficult. With its obvious industrial cycle, finance also faces great challenges and adjustments in relation to wavering regulatory conditions. At the end of 2018, along with a continuous economic downturn, the central government's economic policy, especially the capital market policy, has undergone major changes, and the capital market has risen from being repressed into a strategic height. M&A, as a crucial means to optimize social resource allocation and improve social capital efficiency, has received great expectations from the government.

Against this backdrop, China's M&A funds ushered the second historical development opportunity. It is of great theoretical and practical significance to study the development roadmap of M&A funds, to seek the correlation and influencing factors between M&A funds & macro-economy, thus shedding light on the development of M&A funds in China under the new economic situation.

1.1.2 Academic Contribution

Each country's M&A fund has its own business and profit model due to different political, economic, regulatory and cultural situations. Analyzing specific characteristics of global M&A funds is conducive both to understanding the development ideas of financial business in different political systems and in different stages of economic development and to integrating M & A as a crucial financial instrument into different economic classifications, especially into certain developing countries to achieve higher economic development.

Currently, China's economic momentum is slowing down, facing the pressure of transformation and structural upgrading. The central government needs to achieve economic goals through financial means and industrial policies in the new era, in which M&A funds can play an important role. However, M&A fund research in China is relatively limited, contained mainly the analysis of overseas M&A fund mode, M&A fund development in China and its investment effect evaluation. The research framework of M&A fund for domestic status quo has not yet been established. By studying China's M&A funds' development characteristics and external factors, this paper attempts to establish an analysis framework with Chinese characteristics that are more suitable for China's M&A funds analysis, thus creating more theoretical and practical value.

The commercial activities of the financial industry are constantly changing with the economic situation and is of high political sensitivity. Hardly can we expect a country to copy the successful model of other regions to ensure its adaption to local markets' needs. Based on the analysis of China's economy and finance, the current economy has undergone great changes compared with the past few decades, and so has China's financial policies. It was viewed from specific issued policies that M&A fund policies are regarded as important in the holistic puzzle of China's central economic and financial regulations. Its significance is greatly enhanced. In this particular period, it is also of great significance to provide theoretical and practical guidance for the development of M & A fund in China through a thorough analysis of the relevant internal and external economic environment.

The development of M&A funds correlates closely with the macro-economy, especially for China with its planned economy characteristics. The impact of macroeconomic factors is expected to be significantly higher than that of Western capitalist countries. Therefore, the research on the relationship between macro-economy and M&A funds has a strong practical significance in guiding real life.

Finally, the research on current M&A funds and private equity investment funds domestically and abroad mostly focuses on the empirical research on the fund's operation mechanism and investment returns, with little analysis through the macro-economic perspective M&A funds development cycle, operation factors, and investment returns. Therefore, the relationship between M&A funds and private equity investment funds is also of great theoretical significance.

1.2 Literature Review

The international M&A fund began to develop in the 1960s, stemming from the development of private equity and the M&A wave in the 20th century.

M&A fund is a private equity fund that focuses on M&A of the target enterprise. By acquiring the target enterprise's equity, it can obtain certain control of the enterprise, and then use its own comprehensive advantages to lead or assist in its restructuring and transformation. M & A fund mainly acquires certain control of the target enterprise by acquiring the equity of the enterprise through reorganization and transformation with its comprehensive advantages leading or assisting financial optimization, management reorganization, adjustment of development strategy and other measures, to strongly boost the capital, asset and industrial value of the invested enterprise, and choose the opportunity to exit through listing, resale or management buyback. M&A fund is different from the general equity investment as to whether it can significantly impact the investment target company. If no significant impact is made, it generally is not considered as M&A Fund investment. In the fourth wave of M&A in the United States in the late 1970s and early 1980s, leveraged M & A investment funds emerged, represented by private equity giant KKR. By the end of 1980s and the beginning of 1990s, due to the collapse of junk bonds and the bankruptcy of certain enterprises using junk bonds for leveraged M & A, leveraged M&A investment funds entered a depressed period. In the mid-1990s, thanks to the sustained economic growth in the United States, leveraged M&A funds rose again and were closely connected with private equity funds.

Because the holistic development of M&A fund is not long, there is limited academic research in this field in China. To explore the development pattern of M&A fund, especially the relationship between it and the macro-economy, and to provide references for business development in today's financial environment in China, this paper sorts through related theories and articles.

1.2.1 Introduction to Existing Literature

The second section of theoretical research is to strengthen the understanding of M&A and M&A funds. This section offers M&A concept definition, categories, causes, and its comprehensive business model.

(1) Definition and Categories of Merger and Acquisition

M&A is the general term of merger and acquisition. Internally these two words are usually combined and short-termed as M & A. The transfer of control is the fundamental feature of M&A activities.

A merger means that two or more enterprises form an enterprise through the merger of property rights. Generally, the less competitive enterprises are absorbed by the more competitive ones. A merger is equivalent to the merger mentioned in Chapter 9 of the Company Law of the people's Republic of China, including a merger by absorption and merger by new establishment. Acquisition refers to the transaction that one enterprise purchases the assets, business departments, or shares of another enterprise (called the target enterprise), to obtain control. The legal entity of the target enterprise does not disappear. The main difference between merger and acquisition is that merger integrates two or more enterprises, while acquisition is the control of one enterprise over the other. But in real life, merger and acquisition are often intertwined, difficult to strictly distinguish, so the academic and industrial experts habitually combine these two words. In addition, M&A is different from reorganization, in which the former is included of the latter. According to Weston (1988), enterprise reorganization includes expansion, sale-out, company control, ownership re-structure, etc., while M&A is one form of enterprise expansion.

According to the industrial role in the market before M&A, M&A can be divided into horizontal, vertical and mixed. Horizontal M&A, also known within-business M&A, is the consolidation between two or more enterprises that produce or sell the same or similar products. Its purpose is to eliminate competition, expand market share, increase the monopoly power of the merged enterprises or form scale effect. Vertical M&A, also known as alone-the-value-chain M&A, refers to the merger with suppliers or customers of an enterprise. It is a merger between enterprises that produce the same product and at different production stages. It can expand the scale of production and operation, save shared equipment and costs, strengthen the cooperation along the process and various connections, facilitate collaborative production, speed up production process, shorten production cycle and save energy Province transportation, storage, resources and energy. Mixed M & A refers to M & A between enterprises that are neither competitors nor potential customers or suppliers. Mixed merger can be divided into the following two forms: the merger of large products, the merger between enterprises in the relevant product market; the merger of expanding, an enterprise to expand its market and to merge the enterprises producing similar products in unpenetrated areas. The main purpose of mixed merger is to reduce the risk brought by long-term operation within the same industry; in addition, the by-products and waste products of one industry can be indispensable raw materials of another and make full use of raw materials can be achieved through a merger.

Classified as whether the target company's management team cooperates, M&A can be divided into friendly M&A and hostile M&A. Friendly M&A, when the managers of the target company are satisfied with the acquisition conditions given by the acquirer, then the acquisition behavior of is welcome by the target enterprise, and the entire acquisition process be carried out in a friendly atmosphere. Hostile M&A, if the managers of the target company are not satisfied with the acquisition proposal, and the acquisition is an unwelcome or hostile behavior. The acquirer will bypass the target company's manager and directly issue an offer to the target company's shareholders, and the target company's manager will also take tit-for-tat measures to resist the merger of the acquirer.

According to the purpose of M&A, it is divided into synergistic M&A and Disciplinary M&A. Synergistic M&A, the purpose of the acquirer is to obtain synergistic benefits in the business or financial structure between enterprises, including economies of scale through business or financial integration, vertical integration of transaction cost savings, or financing convenience, tax incentives and benefit, etc. In Disciplinary M&A, the purpose of the acquisition by the acquirer is to drive out the incompetent managers of the target company or managers who do not meet the requirements of shareholders. In synergistic M&A, both the shareholders of the acquired company and the target company can obtain the benefits from the M&A, with the target company shareholders undoubtedly gain more benefits in Disciplinary M&A. The purpose of M&A determines the atmosphere. Synergistic ones are mostly friendly, while disciplinary ones are mostly hostile.

According to the method of capital contribution in M&A, it is divided into cash, share swap, additional issuance and leveraged ones. In cash M&A, the acquirer pays a certain amount of cash or other assets to obtain the ownership of the target company. The shareholders of the target company receive the cash, but at the same time lose the ownership of the sold shares. In stock exchange M&A, the acquirer replaces the target company's stock with newly issued stocks. There is no need to pay cash for the stock exchange merger; for the target company's shareholders, their shares are transferred from the target company to the acquiring company. For additional issuance stock M&A, the target shall issue additional shares of the company to the acquirer, and the acquirer will obtain the newly issued shares of the target company with currency or other non-monetary assets as consideration. Leveraged M&A are carried out by one or several companies with the support of financial credit and are characterized in that the merging company only needs a small amount of its own capital to conduct external M&A, and often uses the capital and earnings of the target company as credit collateral.

According to whether the public transaction is through the stock exchange, it is divided into public acquisition and agreement acquisition. A public acquisition refers to an acquisition in which a company bypasses the target company’s board of directors and directly invites shareholders to bid at a price higher than the market. While acquisition by agreement is when the acquisition company does not go through the stock exchange, but directly contacts the target company, negotiates to reach an agreement, and realizes the acquisition of the target company's equity transfer, which generally is considered as a good faith acquisition.

(2) Theories on Motives of M&A

In this paper, we hope to find the main reasons for the development of M & A fund. The core of the development of M&A fund lies in the activity of M&A transactions, whose occurrence and vitality depends on its motives.

Weston(1998) made a relatively complete summary of the M & a theory. They believe that efficiency, agency and managerialism, free cash flow hypothesis, market forces, tax factors can constitute M&A motives.

Differential efficiency theory. Some scholars call the theory management synergy hypothesis. The main content is that if a company has an efficient management team and its ability exceeds the needs of the company's daily management, the company tends to make full use of its additional management resources by purchasing a company of low management efficiency. The management ability, i.e., human capital resources, is the combined product of organizational experience and organizational capital. Rosen divides organizational experience into three classifications: general management experience, industry expertise and non-managerial organizational experience. He also divided organizational capital into three kinds: specific corporate information represented in certain individual employees; the correlation between employees and related jobs; the combination and correlation among employees. Weston (1998) believes that human resources can be divided into three types: general management capability, i.e., the combination of general managerial organizational experience and relevant organizational capital; industry-exclusive managerial knowhow; non-managerial human capital, among which the general management capability can be transferred to most other industries, and the industry exclusive management capability can only be transferred to related industries, while the non-managerial human capital is difficult to be transferred into other enterprises.

Weston (1998) claimed, for example, those enterprises that are R&D oriented and lack of marketing are often acquired by enterprises with strong sales and marketing in relevant business fields. This theory can be used to explain horizontal, vertical and mixed M&A. A similar theory is Manne's inefficient management theory. Manne believes that management control mainly depends on the costly external takeover. Inefficient management refers to those incompetent and fail to give full play to the business potential, while another management team can have more effective outcome. The theory of differential efficiency is more likely to be the theoretical basis of horizontal M&A, while inefficient management theory can provide the basis for unrelated business M & As.

Synergy theory. According to synergy theory, M&A produces synergy effect, i.e., the so-called "1 + 1 > 2" effect. This theory contains two basic points: first, M&A and restructuring is conducive to improving the business performance; second, it will lead to certain forms of synergy. The M&A synergy can be summarized into managerial synergy, operation synergy, financial synergy and market power. Improving the management efficiency of the target company is one way to achieve synergy. When a well-managed company acquires a comparatively lower one, through appropriate integration, the value of the target company will be increased, bringing not only efficiency to a single enterprise, but also social welfare as a means of Pareto improvement. M&A synergy is also achieved through the economies of scale. If the companies within the same industry do not reach the optimal production, they can achieve economies of scale through M&A, when manufacturing or R & D resources are shared, cost and negotiation costs lowered through vertical M&A.

Financial synergy effect theory believes that M&A between enterprises with a large amount of internal cash flow but a small amount of investment opportunities together with enterprises of investment opportunities but lacks internal funds, can obtain lower capital costs by M&A. In addition, while some projects are of positive cash flow and due to certain corporate reasons, the projects cannot obtain enough funding. At this time, the company may carry out mixed M&A, i.e, the M&A with a company in an emerging industry to attract investors ‘attention. From this perspective, mixed M&A has become a purely technical approach helping certain projects getting over financial difficulties. Once their profitability improves, the synergy of financing ends, and these companies are thrown out again. Gan Chunhui (2004) believes that this theory can explain some mixed M&A in China's securities market, such as backdoor listing, whose purpose may only be to obtain the direct financing from listed companies.

Principal-agent theory. The principal-agent problem originates from the separation of two rights under the modern enterprise system. The primary reason for agency is that the contract between manager and owner cannot be signed and executed without costs. The resulting agency costs include: I. the cost of constructing a series of contracts; II. the cost of the principal's supervision and control of the agent's behaviors; III. extra costs due to the supervision and control on the agent's behavior which contains the agent to carry out the best decision or the second best decision; IV. residual loss, i.e., the welfare loss suffered by the principal from the deviation between the agent's decision and the principal's decision to maximize the welfare.

The residual loss may also be caused by the cost of contract’s full performance exceeding its expected income. These agency costs will undoubtedly reduce corporate market value, and the agency costs may become very high due to the inconsistent goals of shareholders and managers, asymmetric information, free riding among shareholders and other reasons. Agency theory believes that the manager of a company will make a M&A decision for the sake of maximizing his own interests, which may infringe on the interests of shareholders. Specifically, the agency problems of M&A activities include: I. building corporate empire and over-investing. Managers tend to build empires because, with the expansion of enterprises, they control more resources and their salaries will increase. Meanwhile, the continuous expansion of enterprise scale also creates more promotion opportunities for subordinate employees, which provides room for rent-seeking in terms of power distribution. If the construction of enterprise empire can bring private benefits of personal control, then the managers will not only have the tendency of over-investing, but also maintaining control over their Empires. II. Diversified. Mangers like diversification with the purpose to disperse business risk and their own professional risk. III. Free cash flow hypothesis. The manager is not willing to return the free cash flow to shareholders. On the one hand, returning free cash flow to shareholders reduces the resources that managers can put their hands on. On the other hand, if free cash flow is paid to shareholders now, they may face refinancing problem when money is needed in the future. Therefore, there is a conflict of interest between shareholders and managers in the use of free cash flow. Managers may abuse the free cash flow generated by the company and invest in low return projects, including M&A activities that cannot create value for shareholders. IV. Hubris Hypothesis. As early as 1986, Roll put forward that managers' arrogance may lead to over-paying of the target company in M & A activities, thus causing the shareholders of the acquired company to suffer. It is worth noting that the hypothesis does not assume that managers are selfish. Managers may have good intentions at the beginning but getting too optimistic in M&A evaluation due to ambition, arrogance or pride. In recent years, with the development and maturity of behavioral finance, managers' overconfidence has become a heated topic in corporate finance. Miller and Ross (1975) found that people tend to attribute success to their actions and failure to bad luck because they want success. When people evaluate their own skills, they often estimate that their ability is better than that of ordinary people. This sense of superiority may as well be extended to decision-making economically. V. Large shareholder tunneling theory. The existence of large shareholders can solve the agency problem between shareholders and management to a certain extent. Other factors being unchanged, with the increased proportion of large shareholders, large shareholders will enhance the company's value. If small shareholders can share the consequential cash flow, then there is a shared income. But large shareholders also have the motive to abuse the control to consume the company's resources or monopolize the income shared by small shareholders. Large shareholders often get unproportionate income compared with their shares, the additional income is the private interest of control. Johnson and Shleifer (2000) use the term "tunneling" to describe the phenomenon that resources are transferred by controlling shareholders, manifested in direct theft, manager’s excessive compensation, guarantees for controlling shareholders, corporate embezzlement of the development opportunities, etc.

Market power theory. Horizontal M&A can bring economy of scale and increase the market power comparatively within the same industry. Classical economists believe that when there are a great number of competitors in the industry and are of more or less the same strength, all companies can only maintain the lowest profit level. Competitive enterprises can effectively reduce the number of competitors and increase the possibility of generating monopoly profits through intra-industry M&A.

Gan Chunhui (2004) states that M&A aimed at enhancing market power mostly occur in the following situations: excess production capacity and oversupply of the industry; fierce international competition and strong penetration and head-wind from foreign competitors on the domestic market; laws and regulations restricting various collusion and market monopoly behaviors among companies.

Speculation motive theory. Gort put forward the discrepancy valuation behind M&As, which stresses that due to incomplete information and different valuation on information, the shareholders have different judgments that generate discrepancies. For example, the frequent change in technology and stock prices. When the technology changes too fast, the product life cycle is shortened, and the company will have difficulties explaining future changes based on current information; the change of stock price reflects the imbalance between the past and the present, because it takes time for the alignment between investor’s expectation and the market real price. As a result, frequent changes of stock price changes lead to frequent M&A. In a booming M&A market, excess capital gains are possible through speculation since perfect competition market does not exist, and behind M&A activities, there are speculation motives.

Undervaluation theory. The theory includes two aspects: the undervaluation of target enterprises and the difference between the market assets value and their replacement costs. Weston (1998) believes that one of the possible reasons for the target getting undervalued is that its management cannot fully realize the potential of the company; the other possible reason is that the acquirer has insider information, which may give the stock a higher estimated price than the general market. Another aspect of undervaluation theory is the difference between the asset market value and its replacement costs. This difference is especially obvious during inflation. Tobin called the ratio between market value and replacement value Q ratio.

Diversification theory. After a certain period of development, decentralized management will play an important role in the company. Decentralized operation can be achieved through internal development and M&A. Under specific circumstances, M&A is better than internal development. To choose the right timing is crucial. Through M&A, we can quickly achieve decentralized operation. At any time, there are many companies seeking decentralization.

In Implicit Right Theory, Klein and Leffler (1981) hold that there is an implicit contractual relationship between a company and its customers. This implicit contractual relationship includes the guarantee that the products provide expected quality, etc. and customers are willing to pay a premium for this implicit contractual relationship, resulting in goodwill or brand of the company. There are tangible and intangible assets (including goodwill). One of the biggest differences between M&A and new investment in tangible assets is that the former includes the acquisition of intangible assets.

In fact, it seems that the motivation of some M&A is to obtain goodwill or brand. Companies of high implicit claim price are not willing to invest in products that have not been tested by the market and prefer having innovative products through merging small companies.

(3) Concepts of M&A funds

M&A fund focuses on the M & A of the target enterprise. Its investment method is to acquire the stock equity of the target enterprise, taking control and carrying out restructure and transformation, hold it for a certain period and then sell the acquired company. The difference between M&A fund and other investment is that venture capital mainly invests in entrepreneurial enterprises, while M&A fund chooses mature enterprises, and when other private equity investments have no interest in ownership, M&A fund aims to obtain control of the target company.

M&A funds are generally raised in private, when the sale and redemption are carried out by fund managers through private negotiation with investors. The investment period is long, usually 3-5 years. Historic data shows that it takes 5-10 years for international M&A funds to invest and exit with the acceptable annual internal rate of return (IRR) around 30%.

In terms of investment pattern, M&A funds mostly adopt equity investment and seldom use debt. The investment targets are generally private companies. Different from VC, M&A funds tend to seek targets of certain scale and stable cash flow. The common way of M&A operation is to achieve listing or selling equity through reorganization, improvement and enhancement after M&A as to obtain rich profits. Leveraged buyout is frequently used often in MBO and MBI.

The exit channels of M&A fund investment are diversified: IPO, trade sale, M&A, target company management buyback, etc.

M&A funds are mainly divided into holding M&A and equity M&A. The former is the mainstream in the United States, which emphasizes the control of M&A targets, leading to the integration, reorganization and operation of target enterprises. The latter does not obtain the control of the target but provides debt or equity financing to assist other leading M&A parties to participate in the integration and reorganization of the target enterprise, which is the main mode of M&A funds in China.

With case analysis at home and abroad, this paper summarizes the following common M&A fund profit models

I. Debt restructure. M&A funds can reduce company’s liabilities by capital injection, that is, to reset the balance sheet, or replace the original high-cost funds with low-cost ones, after which the heavily indebted enterprises can be deleveraged, the cost of debt greatly reduced, and the opportunities earned for enterprises to breathe, survive and recuperate. Such debt restructure often helps enterprises enhance efficiency and obtain better valuation in the capital market.

II. Asset restructure. M&A fund can lead or participate in new asset injection and inefficient asset divestiture, thus building a new asset portfolio recognized by the capital market and speed up profitability and turnover.

III. Management optimization. Through guiding and participating in the daily operation of the invested enterprises, the company's operating costs are lowered, and efficiency improved, resulting in better business performance. Some targets originally are state-owned or family companies, and with the establishment of a more scientific and reasonable board of directors, corporate governance, incentive system, etc., the enterprise's behavior and corporate culture are transformed inside out, leading to better performance and better returns.

IV. Tax optimization. Reasonable tax planning can effectively reduce operation costs, but insufficient attention is received leaving quite lot of room for improvement. Some M&A funds are good at improving targets' economic benefits through scientific and reasonable tax planning.

V. Asset securitization. Institutions with unlisted industrial assets, after controlling the listed companies, can obtain considerable premium between the primary and secondary markets through assets injection into the listed companies.

1.2.2 Literature reviews

The research aims to identify the core factors that affect the development and performance of M&A funds and give reference for China's following-up M&A funds. In literature review, limited research on M & A fund is found, thus we accordingly expand the scope of literature research, and studied previous articles on the influential factors of private equity fund development, and on the influential factors of M&A, including organization structure, M&A pricing, ways of payment, financing mechanism, etc. The literature review gives inspiration for our follow-up research and analysis on M&A funds.

The research between macroeconomics and M&A usually focuses on the analysis of the driving factors of the M&A, including the research and development of M&A motive theory.

industry shock theory believes that significant external shocks change the value expectation between owners and non-owners and increase the difference between them, leading to M & A. Mitchell and Mulherin (1996), Andrade, Mitchell and Stafford (2001) found that technological change or deregulation is the driving factor of M&A. Jovanovic and Rousseau (2001) believe that when technological reform and the dispersion of Q-value distribution become greater, the high-Q companies will likely to purchase the low-Q companies. Harford (2005) conducted an empirical study on the behavioral hypothesis and industry shock, and found that economic, regulatory and technological shocks lead to M&A within the industry, and then expand across different industries. In general, foreign empirical evidence is consistent, i.e., when the industry is experiencing technology, policy and supply shocks, industrial M&A is likely to happen.

Lu Dongbin and Wang Xiaolong (2010) conducted an empirical study on the M&A of China's listed companies from 1999 to 2009 in perspective of the international financial crisis and its impact. The result shows that M & A of listed companies are not balanced among industries, and the changes of the external environment that affect the income of enterprises will have an important impact on the M&A activities within the industry.

Market timing theory believes that M&A is the result of capital market mispricing. Asymmetric information and investor's limited rationality lead to the inefficiency of the stock market, and the stock price will deviate from its real value. As rational insiders, managers know whether their company's stock price is overvalued. Nelson (1959) pointed out that M&A often occur in high stock market price, and stock is used as the main way of payment. Shleifer and Vishny (2003) believe that stock market valuations is the key driver behind M & A. They suggest that the overvalued stock acquirer will use stock to overpay the undervalued target, while the of short-sighted target management will accept the share of overvalued stock. Rhodes Krolf (2004) used the book market value to measure the market value and found that M&A occurs when the market price of the company is higher than its real value.

As for the organizational structure of M & A fund, Illig (2007) pointed out that limited partnership is the most common form of PE Fund. Sahlman (1990) studied the organizational form of PE funds in the United States and concluded that the conflict of interest caused by information asymmetry is common between investors and managers of PE funds in the United States. He also points out that the limited partnership can encourage and restrict the fund managers. Cumming and Johan (2008) think that the investors of PE fund decide which organization form the PE fund should adopt by comparing the cost of self-management fund with that of entrusting other managers. If the cost of self-management is lower, they choose the company governance, otherwise the partnership governance. The analysis of Ribstein (2010) shows that the agency cost of partnership fund is lower than that of company governance fund, and partnership is more suitable for PE Fund.

At present, foreign studies generally believe that the principal-agent problem is the most important question in the governance structure of private equity funds (including M&A funds). Kut (2007) thinks that effective incentive can solve the "principal-agent" problem to a certain extent, so incentive mechanism is an important part of fund governance structure. Sahman and William A. (1990) think that a reasonable compensation mechanism, distinction from the management fee and excess return sharing, and the alignment of fund performance and manager's return, can constrain manager's behavior. Metrick and Yasuda (2007) found that the excess return sharing as an incentive has a significant impact on managers. In addition to incentive mechanism, the constraint mechanism is also a way to solve the "principal-agent" problem. Litvak (2004) studied PE funds in the United States and found that the arrangement of "installment investment" can alleviate the "principal-agent" problem. Graben Warter and Weidig (2005) found that the "no fault divorce" clause (that is, investors can change the manager even if the manager has no fault in fund loss) has a better binding effect on the manager.

Maquieira, Megginson and Nail (1998) are more interested in share swap in the M&A patterns. They find that mixed M&A may cause wealth loss, while horizontal and vertical ones will not. On the contrary, the latter two M&A improve company’s efficiency and improve financial synergy. Their result is based on 260 M&A events from 1963 to 1996.

Shelton (2000) believes that the key to the success of M&A lies in the supply-demand of the acquired company's shares. He also believes that the earnings of the acquired and acquirer are influenced by factors like similar strategies between the two, alike scale, and reasonable M&A cycle arrangement, in addition to acquisition methods and market supervision being the key factors.

Liehtenberg and Siegel (1990) focused on leveraged buyout in the manufacturing business. They selected LBOs in the manufacturing industry from 1981 to 1986 as samples. Results show that the workers’ welfare have been significantly improved after M&A with better wages and allowances. In contrast, non-production workers’ welfare has not significantly changed, leaving many of whom being forced to leave the company. In addition, from company's perspective, TFP growth is faster than others within the industry.

Through preliminary literature review, the research in of M&A funds is relatively limited in and outside China, and the research mainly focuses on the causes of M&A activity, its governance structure and performance. There is a large gap in the M&A fund study.

The existing data shows M&A has different characteristics in different countries, different economic and political environment and along different stages. As a later participant in the M&A market, the organizational structure, business model and profit direction of M&A fund are continuously changing due to the influence of macro-economy and industrial environment.

1.2.3 Methodology

The thesis will be analyzed both qualitatively and quantitatively, using theoretical analysis, case comparison, survey research and empirical research method for thorough comprehension.

First, based on literature review and in real life, this paper analyzes and diagnoses China's current macroeconomic situation and the factors that affect China's macroeconomic development, discusses the core links and factors of M&A fund, and analyzes the main external and internal factors that affect the development of M & A fund.

Second, to make a more intuitive and qualitative analysis on the impact of macro-economy on M&A funds, this paper analyzes two typical cases in

China and the United States, KKR's M&A of Nabisco in the United States, and Baoneng Group’s case with Vanke in China, trying to figure out the relationship, characteristics and differences of M&A funds between China and the United States, reflected in the case the relations, features and differences of macro-economy, thus further study influential factors between the macro-economy and M&A funds.

Third, to further understand the relationship between macro-economy and M&A fund, this paper designs a questionnaire for M&A fund practitioners and experts, to obtain their judgments on China's current and future macro-economic development, and to obtain and analysis macro-economic factors that affect M&A fund development.

Fourth, on the basis of the former three studies, and targeting at the core indicators and data of macro-economy and that of M&A funds, this paper puts forward and verifies certain indicators that show the relationship between macro-economy and M&A funds development, and based on the judgment of China's macroeconomic development, provide suggestions for the development of M&A funds in China.

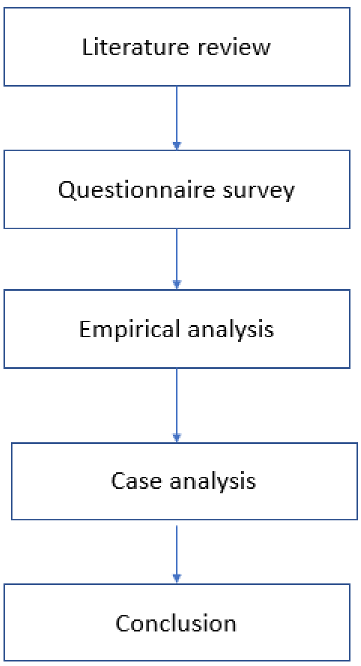
1.3 Framework and Methodologies

1.3.1 Basic Design

The development strategy of M&A fund is a comprehensive topic. This paper needs to identify comparatively more crucial important factors from many elements and patterns. On the other hand, at present, China is in an important period of economic transformation and upgrading, and the government's policy for M&A has changed a lot. Therefore, it is necessary for this paper to learn from the past and analyze status quo. Through literature review, questionnaire survey and case analysis, we can find the macroeconomic factors that affect the development of M&A funds, and test their relationship through empirical methods, and finally form relevant conclusions.

Given above considerations, from the research process perspective, the research preparation of this article is roughly carried out in the following stages:

Figure 1 Research Stages



(1) Literature Review

Through systematic study and research on the development history and main problems of macroeconomics, especially the frontier theory of modern macroeconomics, we focus on the economic cycle, economic growth and modern monetary theory, analyze and predict the current situation and development trend of China's economic development, observe, analyze and track the core indicators affecting China's macroeconomic development.

This paper searches and consults domestic and foreign theories relating M&A and M&A funds in terms of their organizational structure, operation mode and business performance. Analyze, consolidate, summarize and finds out the influential factors of M&A funds development to provide a theoretical basis for following research. With referral to US and European M&A funds development, both its process and mode, this paper hopes to provide helpful information and support for subsequent research.

The literature research is the foundation of the entire process and provides a comprehensive and accurate research direction for the subsequent work.

(2) Questionnaire Survey

This paper conducts a survey on the financial professionals engaged in the M&A fund related business in China. Through the open-ended and closed-ended questionnaires, we explore and screen out the most critical factors in the development mode of M&A fund, investigate and discuss the most important macroeconomic factors affecting M&A fund, and discuss the development trend of China's macro-economy.

At this stage, the experience and thinking of Chinese front-line practitioners is obtained, to verify and supplement conclusions of theoretical research and case study and provide the basis for following empirical research.

(3) Empirical Analysis

Based on the selected key elements of macro-economy and M&A funds from literature research and questionnaire, this paper will make quantitative analysis and test on the relations of certain elements, and analyze the correlation and significance among macro-economy factors such as GDP, price index, money supply, interest rate, unemployment rate, stock index, population, oil, technology and the scale of M&A fund, foreign investment amount and investment scale, exit pattern, exit returns, etc., and drawn conclusions accordingly.

(4) Case Analysis

This paper will screen several M&A fund cases in the United States and China for in-depth analysis, and explore the external environment, fund characteristics, the successful and failure experience and lessons. It is a scientific feedback and correction of theoretical research to verify the previous research conclusions by checking and comparing the obtained experience from previous chapters.

(5) Conclusion

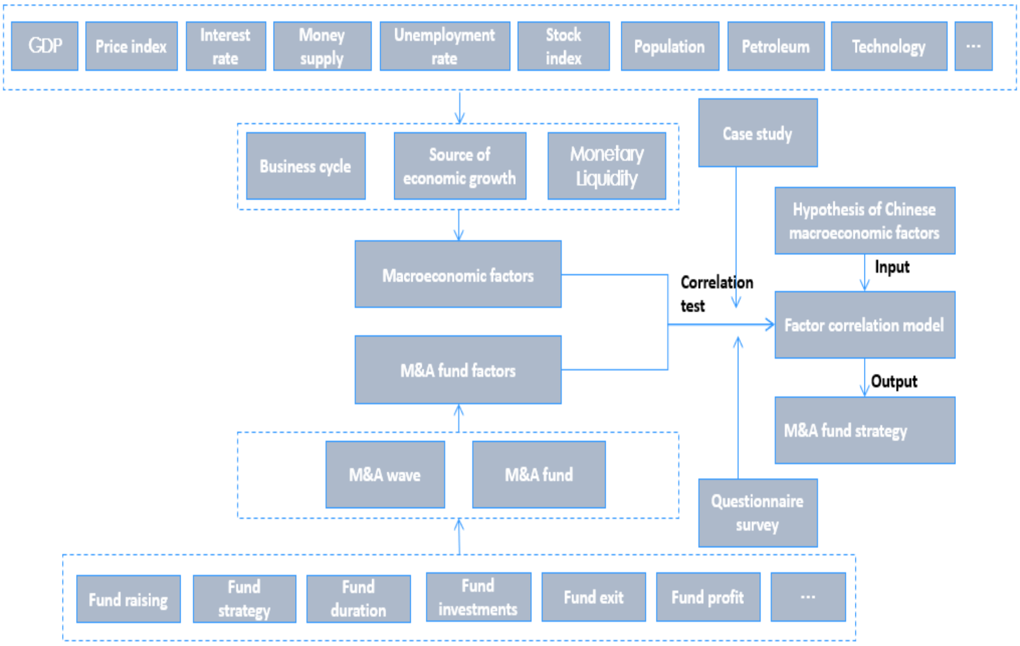
From the results of empirical research, the conclusion of the macro-factors that affect the development of M&A funds development can be drawn. Meanwhile, in view of significant correlation between M&A fund and macroeconomic factors, combined with prediction of China's macroeconomy, this paper shall provide reference for China’s M&A funds.

1.3.2 Research Method and Approach

In order to study the correlation between macro-economy and M&A fund development and obtain a feasible suggestion for the development of M&A fund in China, this paper needs not only to refer to the development and lessons of M&A fund in China and abroad, but also needs to consider the current economic development situation in China, including the specific characteristics of regulatory environment, economic and financial environment, and finally analyzes and studies the above factors to find out the key factors and correlation, combined with China's future economic development to give relevant suggestions.

the research method and approach of this paper is demonstrated below:

Figure 2 Research Method and Approach Framework



Based on the above-mentioned research methods, this paper hopes to systematically sort out the various factors related to the development of China's M&A funds, at the same time investigate the macro factors and provide proposals and suggestions for the funds' future development. Regarding the research content, it can be divided into four categories

(1) Factors in the Context of Macro-economy

The development of the macro economy is affected by many aspects and combined with the current domestic status quo, this article believes that it is of more significance to analyze from the angle of economic cycle, economic growth, and currency quantity.

First, this paper attempts to explore the current position of China's economy in the economic cycle, and specifically analyzes the change indicators that affect the prediction of the economic cycle, including the leading indicators such as money supply, stock price index, the number of approved housing construction permits, the number of machinery and equipment orders, and the synchronous indicators such as GDP, gross industrial output, total retail sales of social consumer goods, etc, Lagging indicators, such as unemployment rate, inventory, Unrecovered bank loan, national fixed asset investment, commercial loans, fiscal revenue and expenditure, total retail price index, consumer goods price index, market trade price index, etc., can make a relatively accurate judgment for the follow-up development of China's economy, and also play an important role and partially influential factors in the overall development trend of M&A.

Second, based on the analysis of business cycle, this paper analyzes the theory of economic growth, factors of population, resources, capital, technology, innovation, etc. in view of the status quo of China's economy, from the perspective of production function to study China’s possible follow-up economic development measures. Combined with American M&A fund development, this paper gives qualitative guidance for China’s M&A fund in future investment strategy and direction.

Thirdly, this paper will study the current market liquidity of China's economy from the perspective of monetary theory, analyze M2, total social financing, DF007 and other factors, summarize the historical impact of money supply on the economy, predict the trend of China's following monetary supply, and make a qualitative judgment on the overall tendency and fund-raising situation of M&A funds in view with domestic and foreign M&A funds development experience.

Finally, on the basis of the above analysis, given that the time for China’s market economy development is short and the government intervention is strong, we will sort out and compare the economic and financial regulatory policies while adopting comparison methods between the U.S. macroeconomic and that of China, screen out major macro-control policies from a qualitative perspective as element reference for the follow-up empirical research, and provide a hypothetical basis for following suggestions on China's M&A funds development.

(2) Analysis of M&A Fund Elements

As one category of private equity investment fund, M&A funds have many characteristics of private equity funds. Meanwhile, because they focus on the acquisition of control rights of the M&A target, they are closely related to the development of the M&A market. This article will analyze the overall M&A industry and the characteristics of M&A funds.

Based on previous research on M&A industry, this article will focus on the analysis of the driving forces of the M&A activities, including economic and technological shocks, liquidity influences, policies and other factors, hoping to better comprehend the overall domestic M&A market and its opportunities.

The element analyze of the funds will cover the fund-raising, investment, management, and exit, especially those relatively quantifiable elements like fund-raising scale, investment strategy, investment industry, investment scale, investment period, exit channels, returns and benefits, etc., evaluate M&A fund performance in different economies, on which fund strategy and recommendations are based.

The above two aspects are the direction and factor selection of this article. Besides theoretical analysis, this research will also adopt case study and questionnaire survey for further understanding and measure correlation. Qualitative analysis will not be excluded after case analysis or the questionnaire survey, this article will adjust the above-mentioned direction and element selection when the analysis conclusion or the survey information changed.

(3) An Empirical Test of Macroeconomic and M&A Fund Factors

Based on the element analysis and screening of the above two aspects, we collect US macroeconomic performance data and related data on M&A funds and conduct empirical tests. Considering that there are many factors influencing the macroeconomics, the qualitative analysis and screening of the factors affecting M&A funds are carried out based on theoretical analysis through case analysis, and then the selected macroeconomic factors and quantifiable M&A Fund elements undergo a pairwise correlation significance test, and finally the verified elements are subjected to a multi-factor test with the qualitative analysis results to explore their rationality, and select macroeconomic elements and M&A fund elements with good correlation as the base for following guidance.

(4) Using empirical test results guiding Chinese M&A Funds

This article will make predictions on the future development of China's economy and input the core elements of the prediction into the test model obtained in step (3), to derive some guidance for China's M&A funds development strategy. In addition to the questionnaires, an effective comprehensive operation strategy would form.

For the result of the empirical test is based on the relevant analysis of the US macroeconomic and M&A fund data, although its experience is universal, the test of step (3) The results may be biased when used in the guidance of Chinese M&A funds given the differences between US and China’s economic environment and the development of M&A funds.

The above-mentioned four aspects are of independence and correlation to a certain degree. The whole research is more likely to be a comprehensive investigation. This article is up to change and adjustment in line with research and the questionnaire progress.

1.3.3 Research Innovation

The M&A fund business is affected by various economic and financial factors and is sensitive to regulatory policies and other man-made factors. Therefore, to have more scientific conclusions, it is necessary to conduct objective analysis through historical data and fully consider the subjective judgment of industry practitioners and experts.

This research mainly uses case studies, quantitative analysis and expert opinions to explore the development trend and reasonable pattern for China's M&A funds. This method of combining subjectivity and objectivity is different from the previous mainstream research, which is also one of the main features of this research.

CHAPTER 2. DOMESTIC M&A DEVELOPMENT

For China, the M&A market and the M&A fund market are young. Since the 1990s, corporate M&A appeared one after another, and in 2008, M&A funds appeared.

2.1 M&A market development in China

Strictly speaking, before the mid-1990s, China had not established a modern enterprise system, so there were no M&A activities. Before the mid-1990s, the domestic reforms of state-owned enterprises tried to bypass the property rights and seek solutions between power centralization and decentralization, none of which achieved substantial results. In 1997, state-owned enterprises began to implement property rights reform, and the " state-owned economy stepping back and private economy stepping in " officially began. With an expanded large scale in 1998 and lasted for nearly six years, basically completed in 2003. The author believes that the M&A activities represented by the reform of the property rights system of state-owned enterprises in this interval is the first wave of M&A activities in China.

In this M&A wave, the transfer of state-owned enterprises was mostly promoted by the government, the property rights were diversified, but the pricing lacked a complete set of market evaluation mechanism, causing a large number of loopholes in the transfer and uneven wealth distribution.

However, the positive effects of this M&A wave are obvious. Both the newly-born state-owned enterprises and the private enterprises transformed from state-owned enterprises have greatly liberated their productivity, achieved rapid development, and formed the structure that state-owned enterprises in the upper industrial reaches, and private sector in the middle and lower ones. Private enterprises transformed from state-owned enterprises, making full use of the industrial space left by the withdrawal of state-owned enterprises, have greatly improved their operating efficiency, and achieved extraordinary development. It is from this period that "Made in China" has become the crucial turning points in changing the pattern of world economy. The “state-owned enterprises” that maintain its holdings have not only improved their operating efficiency through the establishment of a modern enterprise system and a series of supporting regulatory measures, but also occupied the commanding heights in the upstream fields of energy, resources, finance and other industries, and rapid development is made. In the following ten years, a certain sense of "state-owned advances and private sector stepping out" was once again formed. From 2003 to 2012, the new round of " state-owned advances and private sector stepping out", together with the transformation of economic growth mode and industrial restructure, laid the foundation for China's second wave of M&As.

The first wave of M&A in China was an institutional arrangement under a special environment and did not rely on the capital market and financial instruments innovation. However, this wave has promoted China's economy and capital market and laid a good foundation for the emergence and development of China's M&A funds.

2.2 Main development phrases of M&A funds

M&A funds started late in China. In the field of private equity investment, venture capital institutions were the first to appear in China. In the late 1990s, venture capital institutions represented by IDG entered China, and private equity management institutions began to appear. Around 2000, some venture capital institutions with state-owned shareholders began to appear, such as Shenzhen Capital Group Co.,Ltd. under the Shenzhen's State Assets Administration Committee Capital Administration, and Fortune Capital Co., Ltd. under the Hunan Broadcasting and Television Industry Center. In 2003, Hony Capital (Beijing) Co., Ltd., a subsidiary of Lenovo Group, was established, and China's private equity investment institutions began to extend beyond venture capital.

In 2006, *the Partnership Enterprise Law of the People's Republic of China* was issued, solving the organizational structure obstacles of the private equity investment industry. With the establishment of ChiNext, the domestic private equity industry has entered a stage of rapid development. However, during this period, all domestic private equity institutions focused on financial investment in the form of venture capital and PRE-IPO.

At the end of 2008, Greatwalle Investment Management Co., Ltd. was established in Shenzhen, being one of the earliest domestic M&A fund management institutions, and domestic M&A funds began to emerge.

In early 2012, following the successful acquisition of Hangzhou Tian-Mu-Shan Pharmaceutical Enterprise Co., Ltd., a company listed on the Shanghai Stock Exchange by Greatwalle M&A Fund, M&A funds started to receive attention. In June 2012, with the approval of the China Securities Regulatory Commission, the first M&A fund under a brokerage firm, CITIC M&A Fund, was established. Since the end of 2012, since direct listing on the domestic A-share market was suspended, a large number of private equity investment institutions with PRE-IPO business models have been forced to transform and move closer to M&A funds. M&A funds have entered a stage of explosive growth in China. In the short eight years since the kick-off of M&A funds, its development can be roughly divided into three stages.

In the first phase, from 2012 to the end of 2016, this is the first golden stage for Chinese M&A fund. This stage started with the acquisition of Tian-Mu-Shan Pharmaceutical by Greatwalle M&A Fund and ended with Baoneng's attempt to acquire Gree.

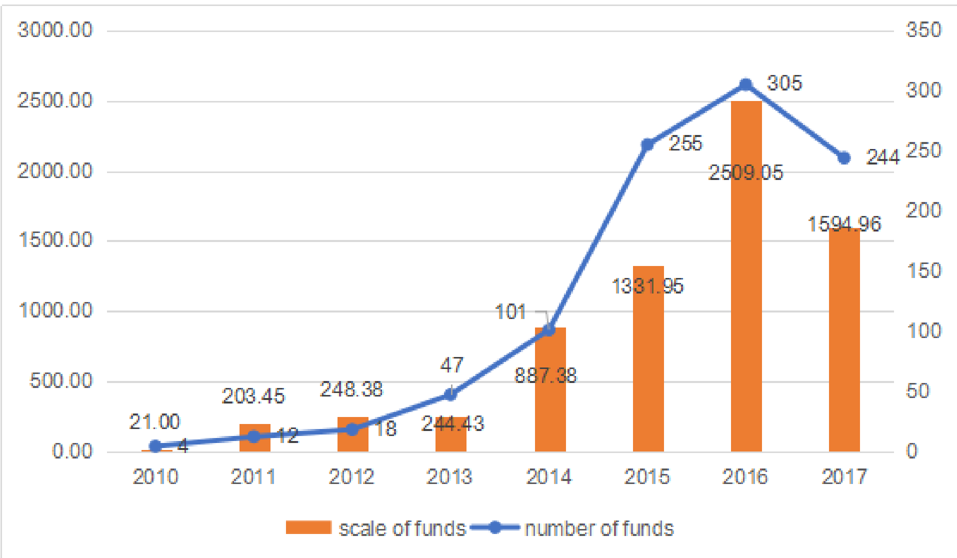
The second phase, from the end of 2016 to the end of 2018, the three years when M&A funds fell rapidly. Various regulatory agencies, centered around China Securities Regulatory Commission, adopted extremely negative attitudes towards leveraged buyouts and M&A funds, and forced a large number of M&A funds to withdraw from the capital market through regulatory measures.

The third phase, from the end of 2018 to the present, is the stage of recovery and redevelopment of M&A funds. Before that China's capital market suffered a sharp decline, and its economy faced the risk of stagnancy. The central government began to re-aware of the role of capital markets and M&A, and on the regulatory level, has begun to promote the re-boost of M&A and restructuring businesses through continuous voicing and issuing encouraging policies.

2.3 Main industrial data

In the past 10 years, China's M&A funds have developed from scratch, though they are still a relatively small investment section, more and more institutions and investors are paying attention to the development of M&A funds. As of the end of 2017, the number of M&A funds and the data raised are roughly as follows:

Figure 3 Number of domestic M&A funds issued and their scale from 2010 to 2017



(Data source: 2017 China M&A Fund Development Research Report)

It can be seen that after 2012, the number and scale of M&A funds began to increase exponentially. This situation continued until 2016. In 2017, the number and scale of M&A funds declined by a large proportion. In 2018 and 2019, we have not found accurate data, but based on our research with capital market participants, it is very likely that its number and scale declined further from 2017.

2.4 Main business model

The business model of domestic M&A funds can be roughly divided into three categories: relatively sole industrial M&A funds, relatively sole listed company M&A funds, and "listed companies + PE" funds.

2.4.1 Pure Industrial M&A funds

This fund is mainly based on primary market targets(unlisted enterprises), and the main profit model is to take the controlling rights of target companies with industrial value, through operation and integration, and then exit through domestic and overseas listings, or exit through M&A. Managers of this fund includes: independent fund managers, fund managers with large industrial groups, fund managers with local government background, fund managers established by brokers or banks. Typical funds include: Hony Capital, CITIC Capital, CCB International, Bohai Industry Fund, Fosun Investment, etc. This type of fund generally focuses on investing in primary market targets with restructuring value and listing expectations, or market targets that have synergy with the industry group behind the fund. If it is an industrial fund established by a local government, it also has the responsibility for attracting investment and increasing employment for the local government. But overall, its basic operating logic is still "acquisition, reorganization, listing, and exit."

2.4.2 M&A Fund Targeting Listed Companies

This fund mainly targets listed companies for M&As. The main profit model is to purchase listed companies whose stock prices are undervalued in the short term. Such companies generally have a large restructuring value and can quickly improve the company's operating and profitability levels through debt or asset restructuring, or management optimization. After the evaluation of listed companies has been increased, the exit can be realized by transferring controlling rights.

The initiators of this type of fund are generally independent fund managers. Typical funds include: Greatwalle, Baoneng, etc. These funds mainly focus on are more traditional industries with relatively obvious cyclical fluctuations, and it is relatively easy to intervene during the industrial downturn. The involved company may have a low share price due to various factors and the company is undervalued in three aspects: capital value, asset value, and industrial value. It can release the potential through those three aspects through reorganization and integration.

2.4.3 'Listed Company + PE' Funds

"Listed company + PE" is a unique type of M&A funds in China. In this model, PE cooperates with listed companies to establish M&A funds to promote the industrial transformation and upgrading. In general, the capital contributions of listed companies and PE are respectively 10% of the total fund (in fact, there are many other percentages of capital contributions). PE, as the general partner of the M&A fund, is responsible for the operation and management, and is responsible for fund-raising for the remaining 80% of the M&A fund. This model is a multi-fold leverage ratio for listed companies. It can also take advantage of PE's project resource and investment management capabilities to promote upstream or downstream industrial chain participation in line with the listed companies' development strategy. The listed company will sign an agreement with PE to buyback the equity of the target company. After the target company's integration and performance reach the agreed level, the target company's equity will be sold to the listed company to realize the fund withdrawal.

Since 2011, when Silicon Paradise Asset Management Group and Dakang Agriculture Group initiated the establishment of M&A funds, “listed companies + PE” M&A funds have become popular in China. At present, the main cooperation model of domestic M&A funds is “PE+listed” companies. Both parties have complementary advantages. PE institutions have professional capital operation and asset management capabilities to provide technical support while listed companies endorse with good reputation for fundraising and provide convenient channels for subsequent withdrawal. Typical fund management institutions include: Silicon Paradise, Zhongyu Capital, etc.

CHAPTER 3. DOMESTIC M&A FUNDS STATUS QUO AND FUTURE PREDICTION-BASED ON 100 INDUSTRIAL EXPERTS

Given it is difficult to collect multiple direct data in M&A funds, especially the verification and accuracy, this chapter mainly hopes to use the qualitative professional knowledge of industry practitioners as the basis to obtain some quantitative basic research conclusions. A comprehensive analysis is conducted on the status quo, key development factors, development trends of M&A funds.

3.1 Research Approach and Data Processing

3.1.1 Approach Overview

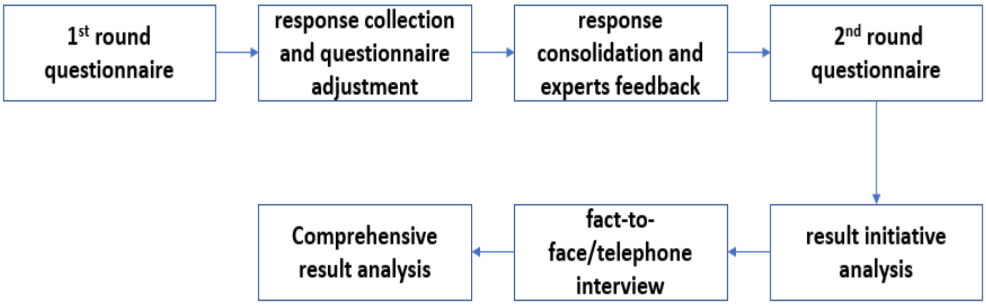
During questionnaire analysis, the research method we used is the Delphi method, that is, we set up an expert pool, and sent the questionnaire to all experts in the first round for investigation and opinion collection. All questions and answers were conducted back to back. And then integrate all effective responses for statistics and analysis. Then send the statistical analysis conclusion to all the experts who responded effectively and ask them to provide the second round of opinions. Finally, based on the opinions of 2nd round, the conclusion in this chapter is formed.

Considering that the experts participating in the survey locate in a relatively scattered areas, to improve the efficiency of the survey, we adopted a combination of e-mail and paper questionnaires. The selection of experts is critical. Our selection criteria include familiarity with domestic private equity funds, especially M&A fund business, enough accumulation of economic and financial knowledge, and sufficient interest in participating in this research.

With the above standards, the composition of the research staff mainly includes: M&A fund practitioners, actual controllers or executives of listed companies that have carried out M&A fund business, M&A and restructuring business practitioners of securities companies, M&A and restructuring business practitioners in law firms and economic and financial researchers in concerning field.

During the research, we sent a total of 176 questionnaires in the first round, of which 169 valid responses were received. In the second round, we sent 169 questionnaires and received 167 valid responses. After two rounds of surveys, we conducted a comprehensive analysis of related issues. On this basis, we conducted telephone interviews or face-to-face interviews with some key investigators to conduct in-depth exchanges on some of the more critical issues.

Figure 4 Questionnaire Process



3.1.2 Questionnaire Design

When it comes to the questionnaire design, we adopted a combination of multiple-choice questions and open question. The questions are contained within 30. Before the survey, we introduced the background and purpose of the research to the experts participating in the survey in detail to ensure their accurate understanding of the content.

The whole questionnaire is divided into three parts. The first part is the collection of some basic information of the participating experts. The second part is about the judgment and prediction of macroeconomic development, and the third part is about their thinking of the current development of M&A funds and the suggestions for future development. In terms of specific question setting, we try our best to ensure a more comprehensive coverage and possible important topics, and at the same time, we may lose restrictions on the participants' opinions of participants. Even if it is a multiple-choice question, we set supplements answers in addition to the preset choices. Simultaneously, through the Delphi method of investigation, we can adjust the questionnaire based on the feedback of the first round of investigation.

3.1.3 Research Goals

According to the research direction of this paper, we hope to focus on the following contents through the questionnaire:

(1) The overall trend of the domestic economy in the future

(2) Changes in domestic financial policies in the future

(3) Major risks in the financial industry

(4) Operation experience of the M&A fund industry

(5) Main factors affecting the M&A fund industry

(6) Main factors affecting M&A fund business

(7) Future development trend of M&A fund industry

The statistical results are mainly used in this chapter, and will also be covered in Part 4 and Part 6 of the paper.

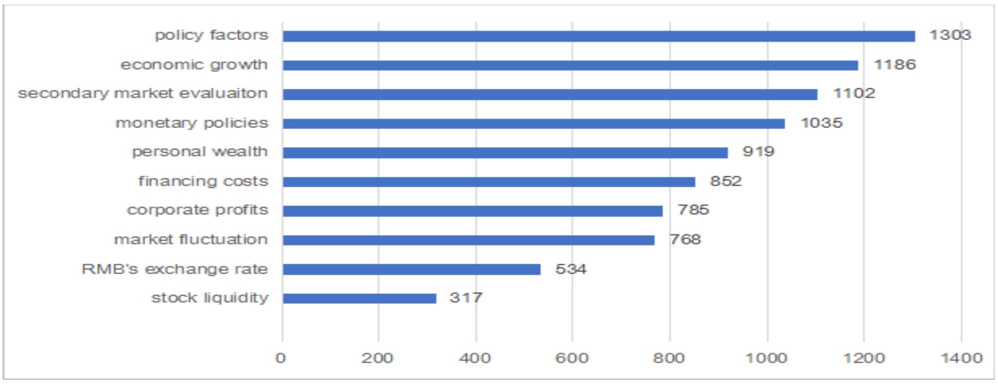
We follow the structure below to analyze and present the main statistical data and preliminary conclusions obtained from our research.

3.2 Influencing Factors of M&A Funds

As for M&A funds, which influencing factors are more critical is a basic step in our quantitative analysis in the following chapters. Therefore, in this survey, we asked all the participants select 10 most critical factors from quantifiable indicators we provided and rank their impacts (top down from the most important factors scoring 10 points to 1 point). Experts can also propose new elements that are not included in the first round of research. In the second round, these newly proposed elements were also added to the candidate list of answers.

After the analysis of the second round, we have obtained the list of the ten most important factors and their ranking. The details are as follows:

Figure 5 Important Factors From Questionnaires



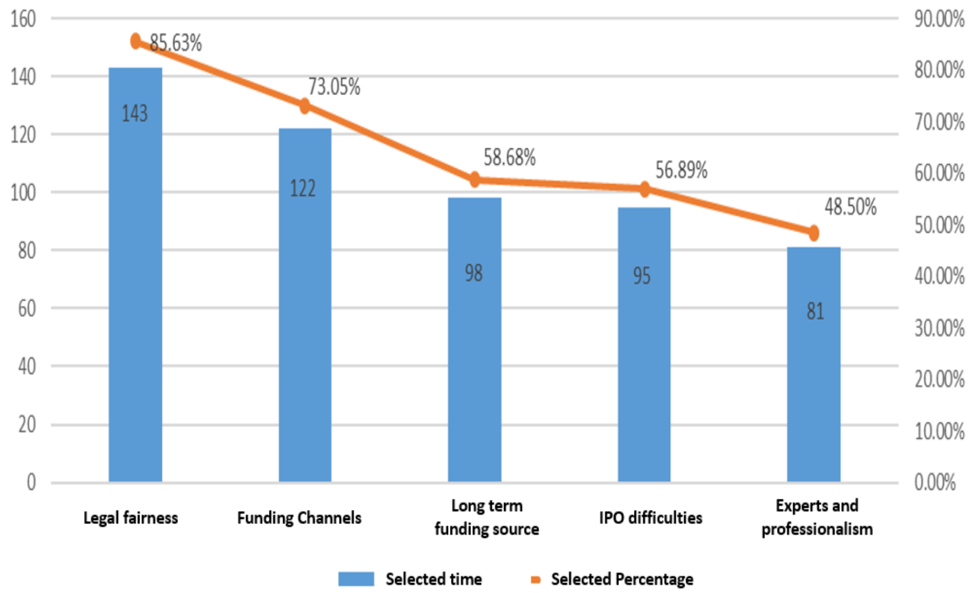
The research in this part mainly focuses on macroeconomics and other related factors, which are external factors that affect the performance and development of M&A funds. According to the preliminary analysis of statistical information, experts generally believe that external factors do have a relatively obvious impact on M&A fund performance, with some factors exerting a greater impact, such as policy factors, economic growth, secondary market evaluation, currency policies and personal wealth. The conclusions of this part are particularly important for our follow-up research. We will further analyze the key external factors and the weight of their influence in the following chapters.

3.3 Constraining Factors of Domestic M&A Funds

In this part of the survey, we gave the expert group a series of factors to choose from. Each expert can choose the five most important factors. At the same time, in the first round of research, experts can supplement the factors not included in the questionnaire. In the second round of research, we will also list the supplementary factors into the questionnaire. According to collected data of the questionnaire, practitioners believe that the top five factors restricting the development of domestic M&A funds include: legal fairness, financing channels, long-term funding sources, IPO difficulty, professionals and expertise.

We conducted one-to-one communication with some experts and got some specific reasons why they chose these five elements:

Figure 6 Elements Of M&A Funds



3.3.1 Legal Fairness

Legal fairness is the most concerned issue of experts. In the second round of 167 valid questionnaires, 143 people selected this factor. Experts chose this factor mainly because M&A business contains many variables and great uncertainty. A key element to increase the winning chance is finding the most effective plan beneficial to one's own side within current rules and regulation, meanwhile seeking flaws and loopholes in regulations and articles of association. The present scheme can only be conducted within the framework of legal and regulatory system. At the same time, legitimacy and compliance are ensured, and all parties' rights and interests can be guaranteed. However, the participants generally agreed that there is still much room for improvement in China.

3.3.2 Financing Channels

From the perspective of M&A funds financing, there is very little room for diversified instrument to choose from in China, and basically practitioners rely on targeted fund-raising from investors.

There are rare cases of diversified financing of existing private equity funds and they can mainly be divided into several categories: 1) large state-owned private equity fund institutions issue bonds in the open market; 2) private equity funds with large corporate backgrounds. When its parent company’s credit enhancement, it obtains financing from financial institutions; 3)the secondary market fund can use stocks or bonds to pledge funds in securities companies or banks through financing and securities lending. However, the first and second are individual cases, and the third method is a specific species, and the practice tend to get tightened in recent years. In addition, financial institutions can provide financing, but its approval takes a long time, and it is difficult to match the fast operation characteristics of M&A

funds. Therefore, a common dilemma for many practitioners is how to organize funds as soon as possible when obtaining a high-quality M&A target. If funds cannot be obtained quickly, M&A chances are often fleeting, which makes M&A funds at a disadvantage when competing with other industrial capital or government platforms.

3.3.3 Long-term Fund Resource

As mentioned in the previous section, when comparing China-US M&A cases, there are significant differences in the duration of domestic and foreign private equity funds. Most domestic closed-end funds are within five years, most of which less than three years. Foreign funds over five years are more common.

In this survey, many experts paid great attention to this factor and believed it was another important reason restricting the M&A funds. M&A operations are relatively complex, involving a series of formalities such as preliminary research, negotiation, acquisition, taking control, reorganization and integration, and exit. For M&A funds of listed companies, the restructuring and integration process is critical and takes a long time. At the same time, the regulator has a series of requirements for major shareholders under-weighting. Therefore, the overall project operation can hardly be less than two years with all the conditions favorable. It usually takes 3-4 years. As for M&A funds in the primary market, if they want to withdraw through IPOs and other means, the time required will be even longer.

For domestic market-oriented M&A funds, fund investors are mainly high-net-worth (HNW) customers. This customer group's current investment habits are still mainly short- and medium-term investment products, such as bank wealth management as short as 1-3 months, 1-2 years of trust plans, or 1-3 years of private equity funds, etc. Customers have higher psychological requirements for liquidity, and it ’is not easy to sell products with long terms.

However, long-term funds such as FOF established by pension and schools, family trusts, and sovereign funds in foreign countries are still underdeveloped in China.

3.3.4 IPO Difficulties

IPO, especially domestic market IPO, is the most ideal exit for primary market M&A funds. However, the current domestic IPOs are still subject to regulatory control. Including the newly established STAR Market (the Science and Technology Innovation Board), the number of IPOs per year is about 300, which is far from meeting the listing needs of eligible companies. Many companies have queued for IPOs for more than a year. The reduction in underweighting after the listing is also strictly restricted.

For listed company M&A funds, the difficulty of IPO also affects the operation of the fund, mainly due to the existence of “shell value”, it is difficult to privatize through a lower evaluation after the merger. Once it is delisted, it is difficult to go public again and its listing time can be hardly managed. Therefore, M&A funds in the domestic secondary market will basically not consider the model of privatization and relisting.

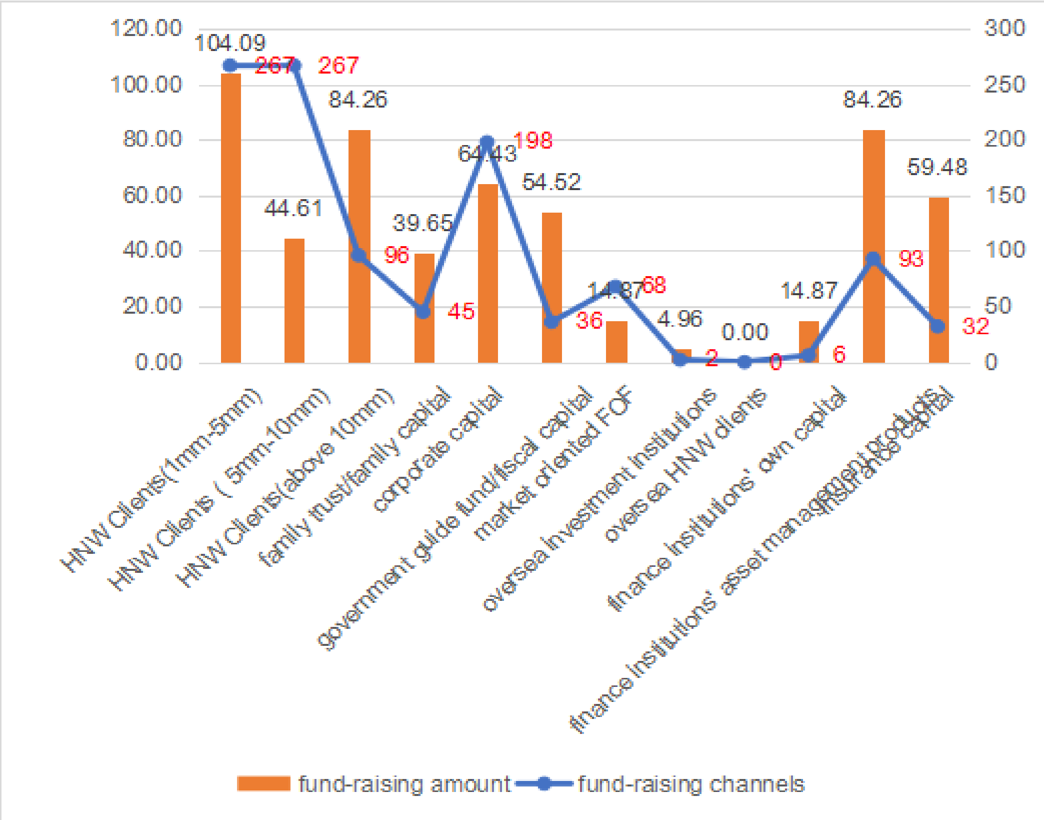
3.3.5 Experts and Professionalism

M&A is a highly professional job. From our experience and purely professional perspective, at least a M&A team should deploy the following experts to obtain the ideal outcome: due diligence personnel, business negotiators, capital market experts, business operation experts, investment experts familiar with major industry classification, legal experts, tax planners, etc. At present, the overall staffing and quality of the domestic M&A funds are still inadequate. As a result, there is a blind investment in the overall operation, heavily invested and lighted managed, or heavily invested and lighted exit.

3.4 Funding Sources Analysis of Domestic M&A Funds

In this survey, there are 167 valid feedback from experts involved more than 285 domestic private equity funds. A statistical analysis was made on the actual fund-raising channels of the private equity funds. The statistics are as follows:

Figure 7 Source Of Funds



Statistics show that the main source of funds for domestic private equity funds is still personal high-net-worth (HNW) clients. Among the 285 private equity funds, there are 267, 261 and 98 funds raising funds through three categories of high-net-worth clients, accounted for 40% of the total fund-raising. Among HNW clients, we can also see that the two ends are high, and the middle is low (the investment amount is between 1 million-5 million and that exceeds 10 million is relatively large, when 5-10 million account less).

In addition to high-net-worth customers, other important channels include corporate funds (excluding government financing platforms), government guidance funds and fiscal funds (including state-owned enterprises and government financing platforms), insurance funds, family trusts, etc. These types of capital contributions also take great shares.

Financial institution asset management products (mainly bank wealth management) have a relatively large amount of capital, but most of whose capital is concentrated in products raised before 2017, and most of which are priority funds. After 2018, such funds have encountered major obstacles.

3.5 Trends of Domestic M&A Funds

The experts participating in the survey gave open-ended answers to the development trend of domestic M&A funds. We summarized these responses and found the more common views are:

(1) Professionalism of Investors

The rise on ultra-high-net-worth customers, family funds, corporate funds, government funds, etc., while the fall on high-net-worth customers with less funding and little professionalism.

The rise and fall will be the result of a two-way selection between the fund and the client. The M&A fund has a longer cycle and higher risk. It is not very suitable for clients with a small amount of funding from the perspective of security and liquidity.

(3) 2^{nd} Peak in the Next 5 years

As mentioned earlier, since the end of 2018, regulators have changed their previous resistance to capital market M&A and M&A funds, started to encouraging funds to participate in the market and restructure, and at the same time introduced a series of favorable policies.

The domestic financial business is greatly affected by policies. With favorable policies, M&A fund business is expected to usher in new development.

(4) More Focus on Post-investment Management

Most of the previous M&A funds have the problem of focusing on investment but not on management. Many have not participated in the operation and management of the target after investment or have a relatively low participation level, most of whom still rely on the original management team or the original major shareholders for operation. Listed company M&A funds mainly rely on the expected asset restructuring of listed companies to increase evaluations and quickly exit cash. However, if not improved, the operation level and profitability of listed companies or due to the principal-agent problem have been possible business deterioration. Another situation is the M&A in the primary market. Previously, most M&A funds focused on finding IPO opportunities, or looking for large industrial groups or listed companies for acquisitions, and they did not focus on improving and enhancing corporate operations.

There are many reasons accountable for this situation, including the lack of professional management capabilities of the funds itself, the relatively complicated domestic control rights struggle, and the relatively short duration of the fund, which seldom gives enough time.

But the drawbacks are also obvious. the M&A fund has given up the dominant power of the company. The profitability of the fund can only rely on the improvement of market evaluation but lacks the buffer of income brought by operations improvement. When the market is inconsistent with expectations, the investment returns of M&A funds will not be guaranteed. This situation has been reflected more obviously during market adjustment in the past two years.

Therefore, various experts predict that the following M&A funds will pay more attention to post-investment management, gradually deepen its dominance of the target companies, and gradually hold the power in their own hands.

(5) Increased M&A for Real Industrial Consolidation

In the past few years, the investment direction of M&A funds has mainly focused on heated projects. A large number of M&A funds that cooperate with listed companies have made cross-industry investments in pursuit of maximum market value, such as education, medical care, photovoltaics, games, IDC, New energy batteries, etc. These M&A targets are often not related to the original industries of the acquirer, and the acquirer also lacks operating experience in these industries.

At present, most of these M&As are relatively unsuccessful, and the participating M&A funds have made varying degrees of errors in the judgment of the target value and subsequent operation and management. After capital injection, the integration effect is not satisfactory.

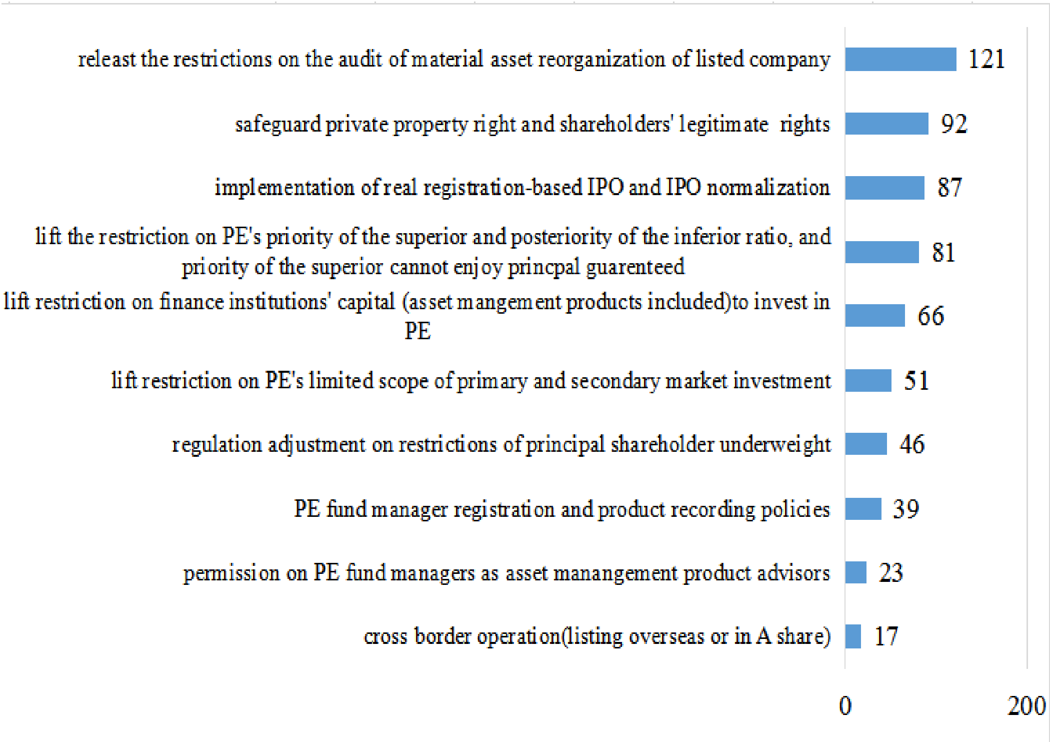
Experts participating in this survey generally believe that real M&A based on industrial value will be valued in the future, that is, so-called vertical mergers and horizontal mergers. Through the synergy effect and operating experience with the original industry, investment risks are reduced and the synergy of integration enhanced.

3.6 Policy Influence on M&A Funds

In the Chinese financial market, financial business is greatly affected by policies. The development of M&A funds in the past 12 years has also proved this point. Regulatory policy acts as an important factor leading its development to the peak and to the valley.

The experts participating in the survey listed the five most critical policies for the development of M&A funds. We combined the similar responses and drew the following conclusions:

Figure 8 Critical Policies of Restrictions Of M&A Funds



Both the M&A funds targeting the primary or the secondary market are very sensitive to capital market-related policies. The second aspect is high requirements on legal norms. The third is the desire to obtain more funding sources (priority funds, financial institution funds, etc.).

Besides, in order to quantify the impact of policy factors, we have set up a concept in our research called policy factors, used to describe the impact of policies on M&A funds.

3.7 Summary on the Status quo and Future development of M&A Funds

Based on the opinions of various experts participating in the research and some interviews in the later section, some general opinions on the status quo and trends of M&A funds are:

Most experts agree with the development achievements of China's M&A

funds in the past ten years and believe that M&A funds have developed rapidly. This development is based on the gradual liberalization of domestic policies, capital market and the overall financial market. Great background. Institutions in the field developed from scratch, from small to big, and from little to a lot. However, the entire development is not a straight upward process, but a back-and-forth path. This repetition is reflected in the continuous exploration and trial and error of practitioners to find the applicable and profitable model of M&A funds that meet the domestic conditions within the policy-permitted scope or among the grey areas where no clear stipulation is made. Various business classifications including primary market M&A funds, secondary market M&A funds, listed companies + PE have been formed.

Among the driving factors of M&A funds, policy is considered as a dominant factor by various experts. It has a significant impact on the business model, funding sources, and exit methods of M&A funds. It is the core that spawns, promotes, regulates and restricts the market.

The other factor is the rapid increase in the invest-able assets of residents in recent years. This situation has been undeniable in the past ten years. We believe that this situation is mainly caused by the appreciation of the assets held by domestic households, among which real estate assets are the major ones, in addition to the appreciation of equity assets after listing and the appreciation of assets brought about by investment in the secondary market.

The increase in the invest-able assets of residents has activated the private sector's financial capital, including M&A funds. High-net-worth clients have also become the main source of funds for most medium and small M&A funds.

The third important factor is that domestic enterprises are currently at a historical point of transformation and upgrading and breakthroughs. 2008 is the 30th year of China's reform and opening-up. Over the past 30 years, various industries in the domestic market have cultivated numbers of high-quality enterprises. Still, along with corporate development and maturity, many enterprises face weak growth momentum due to their original business model. Therefore, at the corporate level or the major shareholder level, it has become a common practice to seek and achieve industrial upgrades and business breakthroughs through outward investment and M&A. This is also an important reason for the rapid development of M&A funds in the past decade.

Meanwhile, there are still potential problems and constraints in M&A funds development, and experts also shared of common consensus on this aspect. Most of the experts concern legal fairness, believing that this is the most important constraint for continued development. Only by relying on a transparent and fair legal environment can we guarantee the smooth implementation of M&As, which are complex, long-term, and multi-stakeholder businesses, and can we attract more capital with confidence, and truly realize profits. In addition, the source of funds is also a core limiting factor, including debt financing and fund raising. Some other factors have already been introduced in the previous article, so no further repeat.

Holistically, experts are still optimistic about the future development of China's M&A funds. The main basis is the important role of M&A funds in China's economy currently. Still, like previous ten years, the high probability of future development will also be a back-and-forth and gradual process. The difference from the previous decade is that people generally believe that subsequent M&A will pay more attention to industrial integration, which is different from the of capital arbitrage logic in many previous cases. At the same time, people also believe that M&A businesses will increasingly be more professionalized, requiring professional teams with knowhow in management, regulation, capital, and industry.

CHAPTER 4. KEY INFLUENTIAL FACTORS OF M&A FUNDS

Based on questionnaire and interviews, we have a comprehensive understanding of the status quo, trends and related factors of domestic M&A funds, but this understanding is still qualitative and not accurate enough, especially the research on the factors that have a significant impact on M&A funds is still not thorough enough. Therefore, to better understand these key factors and their corresponding impact, it is necessary to introduce some quantitative research methods for in-depth research.

Determining the key influencing factors is an important content in our research, and it also has extremely important guiding significance for the development of M&A fund business.

4.1 Form Research Framework

4.1.1 Define M&A Funds Prosperity Index

Based on the literature research, case analysis, survey and other comprehensive methods conducted in the previous article, we have a more in-depth and comprehensive understanding of the development and characteristics of China's M&A funds. In this part, we hope to form an objective evaluation system for M&A funds through certain quantitative means. We will build a new comprehensive index called the M&A fund prospect index.

We define this indicator as follows: in a certain period of time, a quantitative indicator of the prospects of M&A funds under the influence of specific internal and external factors.

4.1.2 Evaluation Framework of M&A Funds Prosperity Index

To construct the overall evaluation framework, we have learnt from the overall methodology of AHP in operations research. The Analytic Hierarchy, AHP for short, is a multi-objective decision-making method that compares the factors at the same level to their corresponding upper-level so to understanding the significance of certain factors. This method is essentially a way of decision-making thinking. It decomposes complex issues into various constituent factors, grouping the dominating relationships of these factors to form an orderly hierarchical structure, and determining the factors in the hierarchy through pairwise comparison. AHP embodies these basic characteristics of people's decision-making thinking, namely decomposition, judgment, and synthesis.

The Analytic Hierarchy Process (AHP) is a decision-making method that decomposes decision-making elements into goals, guidelines, and plans, and then performs qualitative and quantitative analysis on this basis. This method with the topic of "power distribution based on the contribution of various industrial sectors to national welfare" for the US Department of Defense in the early 1970s when applying the network system theory and the multi-objective comprehensive evaluation method, a weighted decision analysis was proposed. The characteristic of this method is in-depth analysis of the nature, influencing factors and internal relations of complex decision-making problems. It uses less quantitative information to mathematicise the process of decision-making, thereby providing solutions for multiple goals, multiple criteria, and unstructured complex problems. It is especially useful when it is difficult to measure the decision result directly and accurately. The steps of the analytic hierarchy process are as follows:

a. Through a deep understanding of the system, to determine the overall goal, the scope of the planed decision-making, measures and policies to be adopted, guidelines, strategies and various constraints and extensive information.

b. Establish a multi-level hierarchical structure in line with different goals and the different functions, divide the system into several levels.

c. Determine the degree of correlation of factors among adjacent levels in the above hierarchical structure. By constructing a pairwise comparison matrix and a mathematical matrix calculation, determine weight of each factors relating to its corresponding factors in the previous level and the relative importance of their related factors in this level, called relative weight.

d. Calculate the composite weight of each factors in every layer and rank all factors to determine the importance of each factors from the bottom of the hierarchical structure diagram.

e. Based on analysis and calculation, consider the corresponding decision.

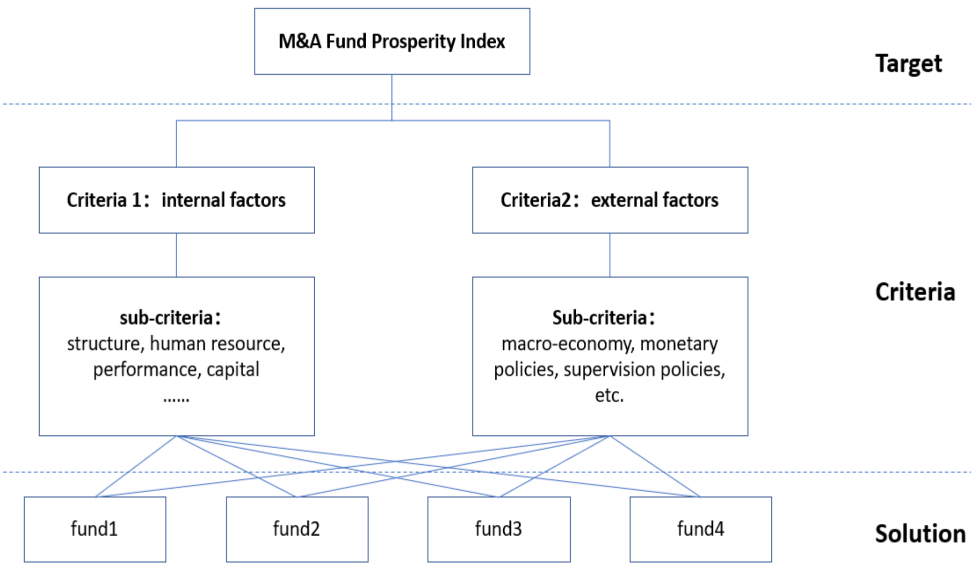
Through analysis, an easy conclusion can be found as below:

I. The advantages of the analytic hierarchy: use pairwise comparison to determine relative importance and dig out absolute value of each factor by mathematical calculation, resulting in improved rationality of weight selection; when the number of indicators is not particularly large, the calculation matrix is comparatively small.

II. Disadvantages of the analytic hierarchy: after the system has been divided into levels, only the dominance of the upper-level factors over the lower-level ones is considered, and the elements in the same level are considered to be independent of each other. This hierarchical structure brings convenient solution to systematic problems, but it limits its application in complex decision-making problems.

According to the basic logic of Analytic Hierarchy and comprehensively evaluation of the various factors involved in M&A funds development, we divide the overall evaluation system into two aspects, internal and external.

Figure 9 Internal and External Evaluation System Of M&A Funds Development



The internal factors mainly include the organizational structure, investment model, historical performance and other factors related to the fund itself. External factors mainly include macroeconomic environment, monetary policy, capital market conditions, and regulatory policies.

In the analysis of this article, we assume that internal and external factors are independent of each other. At the same time, the sub-criteria under internal and external factors are also independent of each other.

4.2 Define Internal and External factors

4.2.1 Define Internal Factors

In terms of internal elements, we mainly selected the following factors based on the conclusions of the aforementioned questionnaire and our reference to various research documents:

(1) Historical performance: Mainly consider the average return of the fund’s products managed in the past five years and the returns of the most recent year.

(2) Stable fund investors: whether there are reliable investor groups and sources of funds, such as strong shareholders as continuous investors, stable cooperative family trust funds, or other types of institutional investors.

(3) Team strength: the expertise of the main investment team and research team, and the experience in the M&A field.

(4) Own funds: sufficient self-owned fund for operation and investment.

(5) Investment strategy: Whether the investment strategy matches the financial and regulatory environment in the next few years.

(6) Brand and credibility: The company's brand and market credibility are mainly affected by factors such as past business, shareholder background, state-owned capital participation, and media promotion.

(7) resource integration capability: the ability to integrate various social resources and improve the success probability of M&A projects. Resources

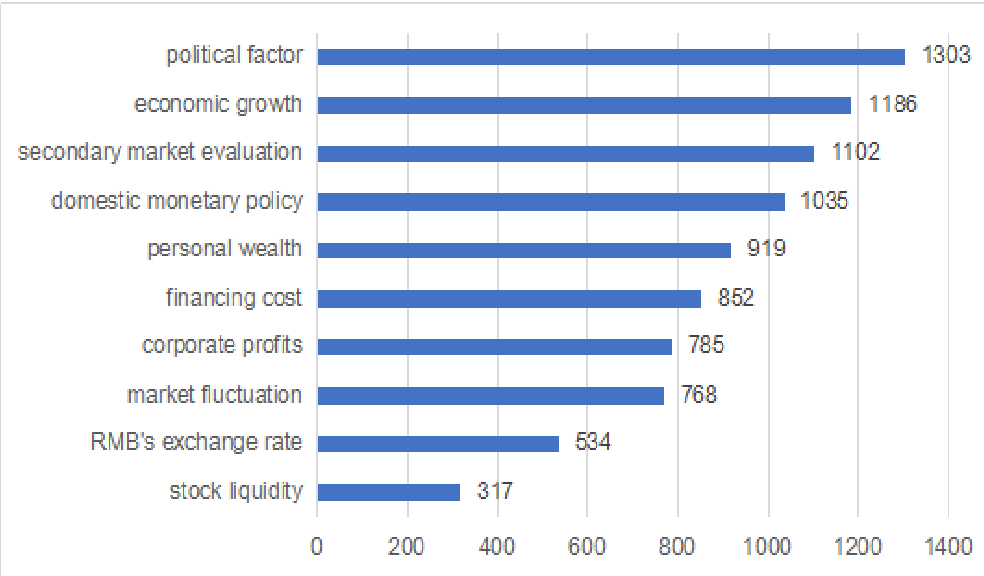
include: financial, industrial, local governments, regulatory resources, etc., mainly affect the control, post-investment management, and exit of M&A funds over investment targets.

4.2.2 Define External Factors

(1) Preliminary screening of external factors

In order to quantify the impact of various factors on the specific business of M&A funds, in the previous section 3.2, we have relied on expert scoring to screen out some of the most critical factors. These key factors include: economic growth, policy factors, national monetary policies, secondary market valuations, personal wealth, RMB's exchange rate, financing costs, corporate profits, market fluctuations, and stock market liquidity. The specific scoring of the relevant elements is as follows:

Figure 10 Scores Of The Relevant Elements



In the original questionnaire, the stock market's rise and fall and the stock market evaluation are highly correlated options. We merged them and unified them as secondary market valuations. The average score given by each expert on the stock market liquidity index is only 1.9 points, so it is not included in the analysis in the subsequent research. Therefore, there are 8 indicators for analysis at this stage which are economic growth, policy factors, national monetary policy, secondary market valuation, personal wealth level, trend of RMB exchange rate changes, financing costs, and corporate profits.

(2) Quantify external factors

We set a quantifiable index for each of the aforementioned eight factors and collected historical data of relevant years as a reference for experts to analyze. They are:

- Economic growth rate: actual GDP growth rate year-on-year
- Policy factors: "policy prosperity" scored by the experts in the previous part
- National Monetary Policy: Year-on-year growth rate of M2
- Secondary market valuation: average price-earnings ratio of A-share listed companies that year
- Personal wealth level: the growth rate of bank personal savings deposits
- The trend of RMB exchange rate changes: the average exchange rate increased over the previous year
- Financing cost: average loan interest rate of commercial banks
- Corporate profit: the increase in the total profit of industrial enterprises above designated size that year

According to the collected statistical data and questionnaire statistics, we can list the aforementioned variables and annual fundraising amounts from 2009 to 2019 as follows:

Table 1 Aforementioned Variables

Year	GDP growth	M2 growth	Personal wealth	Corporate profit	RMB exchange rate	Financing cost	Secondary market valuation	policy prosperity
2019	0.061	0.087	0.135438	-0.06564	0.284908	0.056025	17.09345	89.3
2018	0.066	0.081	0.112262	-0.11433	-0.13452	0.05875	16.19057	31.1
2017	0.069	0.082	0.076983	0.04164	0.106208	0.05675	20.26929	22.7
2016	0.067	0.113	0.094626	0.086639	0.412908	0.052625	20.61198	47.2
2015	0.069	0.133	0.086713	-0.02887	0.08415	0.058925	22.04612	69.3
2014	0.073	0.122	0.089191	-0.00328	-0.05257	0.0697	13.03485	82.1
2013	0.078	0.136	0.135836	0.104489	-0.11674	0.069525	13.09136	80.5
2012	0.079	0.138	0.167028	0.008367	-0.14903	0.07105	13.37066	73.2
2011	0.095	0.1361	0.128632	0.157337	-0.30901	0.075675	16.22999	52.9
2010	0.106	0.197	0.165246	0.535792	-0.06064	0.05715	20.97504	46.9
2009	0.094	0.285	0.192078	0.130221	-0.11691	0.0501	29.09757	51.8

Cited from WIND, official website of China National Bureau of Statistics, and data from this survey.

The above data will serve as reference for experts participating in the next round, and also the base for further analyze the key factors.

(3) Group comparison of the 21 M&A Funds Performance

Based on the previous work, we further locked 21 M&A fund companies as the basis for subsequent analysis. The 21 funds we selected are all highly market-oriented funds, that is, their fund-raising mainly relies on market-oriented factors such as team ability, past performance, and not relying on strong large-scale corporate shareholders or government resources. According to survey data, its core management team and investment managers have basically remained stable in recent years. The overall fund-raising situation of these companies is as follows:

Table 2 The Overall Fund-raising Situations

time	Amount of fund-raising	fund-raising scale growth rate
2019	63	0.96875
2018	32	-0.30435
2017	46	-0.79825
2016	228	0.490196
2015	153	0.429907
2014	107	0.35443
2013	79	0.462963
2012	54	0.038462
2011	52	0.333333
2010	39	2.25
2009	12	3

In this chapter, our main research goal is to determine the impact of external factors on the performance of private equity funds. Therefore, we need to eliminate the influence of internal factors of private equity funds. In following research, we designed a set of comparative data for observation and analysis of the 21 issued products of these 21 fund companies. The specific methods are:

We ask them to provide basic data (in different years) of a set of products with the highest and lowest yields of the company during the relatively stable years of the company, including the product's establishment date, end date, scale, net worth performance, etc. At the same time, experts are required to judge and analyze the external factors that lead to the difference in investment returns of these products. The specific reasons are selected from the eight indicators we provided in the previous section.

According to experts' feedback, we have obtained the following statistics from the analysis of the external factors affecting the investment return gap of the 21 fund companies with the highest and lowest relative returns in recent years (42 fund products in total):

Table 3 The External Factors

	Total times of Attribution
GDP growth	5
M2 growth	12
Personal wealth	11
Corporate profit	14
RMB exchange rate	5
Financing cost	3
Secondary market valuation	10
policy prosperity	15

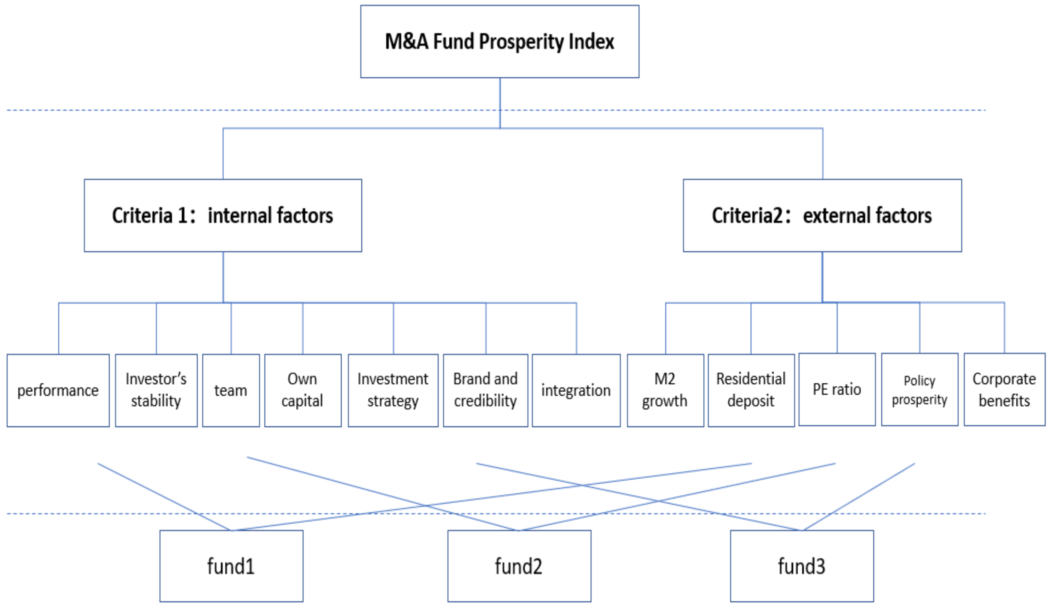
Based on this situation, we selected five factors, including policy factors, corporate profits, national monetary policy (M2 growth), personal wealth level, and secondary market valuation as key external factors for follow-up research.

4.3 Apply AHP method to determine the weight of each element

4.3.1 Construct a hierarchical structure model

According to various criteria determined by the afore-mentioned research, we can construct an analytic hierarchical structure as follows:

Figure 11 The Analytic Hierarchical Structure



The specific index system and its code are as follows:

Table 4 Index Table

target	criteria	sub-criteria
A:M&A fund prosperity index	B1:internal factors	C1:historical performance
		C2:stable fund investor
		C3:team strength
		C4:own funds
		C5:investment strategy
		C6:brand and credibility
		C7:resource integration capability
	B2:external factors	C8: M2 growth
		C9: personal wealth
		C10: secondary market valuation
		C11: policy prosperity
		C12: corporate profit

In this structural model, the criteria level is divided into two levels, the first level of criteria is divided into internal and external factors, among which, a number of sub-criteria were determined respectively.

4.3.2 Construct Judgment Matrix and Determine Criterion Weight

To reasonably determine the weight of each criterion and given the cumbersomeness of the AHP method, we selected 12 experts from the afore-mentioned surveyed to form an expert group, six of whom are familiar with micro-fields, and focus on the weights of the seven sub-criteria under the internal elements of criterion B1. The other

6 are familiar with the macro field and focus on the weights of the five sub-criteria under the external elements of criterion B2.

Table 5 AHP Criteria Table

Classification of Experts	Main Target	Criteria Target Scope
experts on the micro level	management of PE fund companies, PE managers, investment managers, etc.	weight criteriaB1、B2 sub-criteria C1-C7weight
experts on the macro level	Management of PE fund companies, macro-economy scholars	weight criteriaB1、B2 weight sub-criteria C8-C12

4.3.3 Weight Calculation Method

Following the below processes we calculate each index’s weight, in sub-points (1), (2) and (3) of this section, the calculation of the weights of the seven sub-criteria of “B1: internal elements” is used as an example, and sub-point (4) of this section introduces the calculation of the weights of the sub-criteria of ”B2: external elements”, as well as the calculation of the relative weights of the criteria B1 and B2. The calculation of the relative weights of the two criteria B1 and B2. Sub-point (5) of this section explains how to calculate the combined weights of the bottom 12 sub-criteria (relative to the top-level objective A: M&A fund prospect indicators of the assessment framework) based on the relative weights of B1 and B2 and the relative weights of the sub-criteria included in B1 and B2.

（1） Construct judgement matrix

We take criterion B1: internal elements as an example to introduce the weight calculation process of the sub-criteria of C1-C7.

We invite all micro-level experts to score the importance of sub-criteria C1-C7, and construct the following calculation matrix based on the scoring results:

Table 6 Scoring Results

	C1	**C2**	**C3**	**C4**	**C5**	**C6**	**C7**
C1	b11	b12	b13	b14	b15	b16	b17
C2	b21	b22	b23	b24	b25	b26	b27
C3	b31	b32	b33	b34	b35	b36	b37

C4	b41	b42	b43	b44	b45	b46	b47
C5	b51	b52	b53	b54	b55	b56	b57
C6	b61	b62	b63	b64	b65	b66	b67
C7	b71	b72	b73	b74	b75	b76	b77

Among which bij, i.e., stands for the significance relevance between sub-criterion Ci and sub-criterion Cj (compared with upper level criteria, i.e. “B1: internal factors”), whose value follows the rules below:

Table 7 Value Definition And Remarks

Bij value	Value definition and remarks
1	2 sub-criteria of equal importance of the upper criteria
3	1 sub-criterion is of slight importance than the other sub-criterion
5	1 sub-criterion is of obvious importance than the other sub-criterion
7	1 sub-criterion is of greater importance than the other sub-criterion
9	1 sub-criterion is of extreme importance than the other sub-criterion
2,4,6,8	compromised value of the above-mentioned values
1/bji	Bij and bji, the two being reciprocals

At the same time, we notice that the diagonal of the judgment matrix (bii) is all 1, and bij should be equal to 1/bji.

（2）Count the result of one expert

After each expert score, we obtain a judgment matrix. By processing the judgment matrix, we can get the index weight evaluated by this expert.

First, transform the judgment matrix and normalize each column. Let wi = b1i + b2i + b3i + b4i+b5i+b6i+b7i. Generate the following matrix:

Table 8 Calculating Matrix

	C1	**C2**	**C3**	**C4**	**C5**	**C6**	**C7**
C1	b11/w1	b12/w2	b13/w3	b14/w4	b15/w5	b16/w6	b17/w7
C2	b21/w1	b22/w2	b23/w3	b24/w4	b25/w5	b26/w6	b27/w7
C3	b31/w1	b32/w2	b33/w3	b34/w4	b35/w5	b36/w6	b37/w7
C4	b41/w1	b42/w2	b43/w3	b44/w4	b45/w5	b46/w6	b47/w7
C5	b51/w1	b52/w2	b53/w3	b54/w4	b55/w5	b56/w6	b57/w7
C6	b61/w1	b62/w2	b63/w3	b64/w4	b65/w5	b66/w6	b67/w7
C7	b71/w1	b72/w2	b73/w3	b74/w4	b75/w5	b76/w6	b77/w7

Then sum the rows:

Let b = b1 + b2 + b3 + b4 + b5 + b6 + b7，then the normalized scores of the evaluation criteria would be, supposedly that the number of the expert is m, Wmi being the evaluation weight of the m-th expert on the i-th index, and the score calculation result of the expert is as follows:

[Wm1，Wm2，Wm3，Wm4，Wm5，Wm6，Wm7]

= [b1/b，b2/b，b3/b，b4/b，b5/b，b6/b，b7/b]

(3) Combine multiple results of experts and deduce the weight of each factor

In this calculation, we integrated the scoring results of each expert according to the arithmetic average method. In this way, the final calculated weight of each indicator can be obtained. We set B1W=[B1W1, B1W2, B1W3, B1W4, B1W5, B1W6, B1W7].

(4) Calculate alike the weight coefficients of the B2 sub-criteria and its upper-level criteria

In the same way, we can obtain the index weight of C8-C12 in the same way as:

B2W=[B2W1，B2W2，B2W3，B2W4，B2W5，B2W6，B2W7]

Then calculate the weight coefficient of the upper criterion layer, i.e., the relative weight of the two criteria "B1: internal elements" and "B2: external elements":

AW=[AW1，AW2]

(5) Combining the weights of the criteria and sub-criteria to calculate the comprehensive weight of each underlying index

After we have obtained the criterion-level weight vector AW and the sub-criteria-level weight vectors B1W and B2W, by multiplying the two-level weights, the following comprehensive weight coefficient table can be constructed:

Table 9 Weight Coefficient Table

target	**criteria**	**sub-criteria**	**comprehensive weight**
A: M&A fund prosperity index	B1:internal factor (weight: AW1)	C1:historical performance(weight:B1W1)	W1=AW1*B1W1
		C2:stable fund investor(weight:B1W2)	W2=AW1*B1W2
		C3:team strength(weight:B1W3)	W3=AW1*B1W3
		C4:own funds(weight:B1W4)	W4=AW1*B1W4

		C5:investment strategy(weight:B1W5)	W5=AW1*B1W5
		C6:brand and credibility(weight:B1W6)	W6=AW1*B1W6
		C7:resource integration capabilities (weight:B1W7)	W7=AW1*B1W7
	B2:external factor (weight: AW2)	C8:M2 growth(weight:B2W8)	W8=AW2*B1W8
		C9:personal wealth(weight:B2W9)	W9=AW2*B1W9
		C10:secondary market valuation(weight:B2W10)	W10=AW2*B1W10
		C11:policy prosperity(weight:B2W11)	W11=AW2*B1W11
		C12:corporate profit(weight:B2W12)	W12=AW2*B1W12

4.3.4 Calculation Results

This time we invited 12 experts to form an expert group, among whom 6 experts in the micro-level evaluating the seven sub-criteria under the internal elements of criterion B1, while the other 6 macro experts on the five sub-criteria under the external elements of criterion B2. In the evaluation of the relative weights of the criterion level (B1 and B2), 12 experts jointly scored. Based on the scoring of various experts, we obtained the indicator weights as follows:

Table 10 The Indicator Weights Table

Target	**comprehensive weight**	**criteria**	**Criteria weight**	**sub-criteria**	**sub-criteria weight**	**comprehensive weight**
A	100%	B1	64.31%	C1	19.33%	12.43%
				C2	12.25%	7.88%
				C3	15.77%	10.14%
				C4	10.46%	6.73%
				C5	14.48%	9.31%
				C6	11.16%	7.18%
				C7	16.55%	10.65%
		B2	35.69%	C8	13.79%	4.92%
				C9	20.43%	7.29%
				C10	22.32%	7.97%
				C11	25.04%	8.94%
				C12	18.43%	6.58%

Based on the above weights, we can see that from the perspective of industry experts, the influence of internal factors is greater than that of external factors. Among the internal factors, two indicators have the greatest impact: C1: historical performance and C7: resource integration capabilities. Among the external factors, the one that has a greater impact is C11: policy prosperity. These are some of the more critical internal and external factors obtained by synthesizing expert opinions, which can be seen to play an extremely important role in the development of M&A funds, and we plan to focus our analysis in future studies.

Using the above indicator system, we can quantitatively evaluate and compare the development prospects of different private equity funds at different stages.

It should be noted that we have tried to differentiate different indicators by refining the definition of indicators in the process of indicator selection, but it is unavoidable that there is still some correlation between some indicators. We will continue to explore the strength of correlations among indicators and the possible effects of such correlations on the evaluation results in depth in our future studies.

CHAPTER 5. CASES STUDY-COMPARISON OF TYPICAL CASES BETWEEN CHINA AND US M&A FUNDS

In this chapter, we will examine and demonstrate the conclusions in the previous two chapters through the analysis of multiple M&A cases in domestic and overseas markets, so as to understand whether the core elements of M&A funds in reality are consistent with our conclusions drawn from our research.

5.1 KKR acquired Reynolds-Nabisco (RJR Nabisco)

5.1.1 Introduction to the Acquisition

The acquisition of RJR Nabisco in the US, known as the "Grand Acquisition of the Century," was shocking the world with a purchase price of $25 billion and became the largest leveraged buyout in history, dwarfing all acquisitions afterward.

This acquisition war took place mainly between the senior managers of RJR Nabisco and the well-known acquisition company KKR (Kohlberg Kravis Roberts & Co.). However, many giant investment banks and financial institutions, such as Morgan Stanley and the First Boston were directly or indirectly involved in the play due to its vast scale. The initiator of the "war" was by senior executives of RJR Nabisco, headed by Ross Johnson, who believed that the company's stock price was grossly undervalued. In October 1988, Johnson offered the board of directors a buyout at $75 a share for a total of $17.6 billion, above the market value of $53 per share at the time. However, the company's shareholders were not satisfied. Soon, KKR, the "king of acquisitions" on Wall Street, swooped in, sparking a bidding war. After six weeks of competing, KKR finally won the acquisition, paying US$109 per share for a total of $25 billion. KKR itself used only $15 million, and the remaining 99.94% was raised by junk bonds issued by Michael Milken, who was known as the "king of junk bonds."

5.1.2 Introduction to Reynolds-Nabisco (RJR Nabisco)

Reynolds-Nabisco, an American conglomerate formed by the merger of the established American food manufacturers Standard Brands, Nabisco, and RJR, one of the two major tobacco companies in the United States (Manufacturer of Winston, Salem, and Camel cigarette), was the largest food and tobacco manufacturer, and the 19th biggest industrial company in the US. With 140,000 employees and wide-ranged products, including Oreos, Lucy Cookies, Winston and Salem cigarettes, and Life Savers candy, the company was selling its products in every retail store in the country. Although RJR Nabisco's food business has expanded rapidly since the merger, about 58% of the main business was still from its highly profitable tobacco business.

During Johnson's two-year tenure, RJR Nabisco achieved a profit increase of 50%. However, with the stock market crash on October 19, 1987, its stock price plummeted from a peak of $70. Although the company bought heavily in the spring, the price still fell to $40. In December, although the company's profits increased by 25% and other food stocks in the market were rising, RJR's stock value remained down, affected by the tobacco industry, and 60% of its sales came from Nabisco and Del Monte Foods. The company tried to merge the tobacco and food business, but failed, together with the decentralized operation.

5.1.3 Acquisition Process

In October 1988, the management team led by Johnson, CEO of RJR Nabisco, proposed to the board of directors the acquisition of company's equity. The MBO proposal included the sale of the food business after the acquisition and the retention of only the tobacco business. Johnson developed the strategy on the basis that the market had not correctly estimated the sufficient cash flow generated from the tobacco industry and that neither had fully appreciated the value of a mixed food and tobacco. It was believed that with such restructuring, the company would eliminate unfavorable factors and obtain huge profits from the market.

Ross Johnson and the Hilson company agreed on the leveraged buyout plan immediately. Both parties believed that RJR Nabisco's stock should trade at around $75 per share, above the market transaction price of around $71, bringing the total transaction price to $17.6 billion. Since they wanted to complete the transaction independently, Hilson Company didn't adopt junk bonds in the transaction. Instead, the entire $15 billion needed would come from commercial bank loans. Bankers Trust seized the opportunity to finance leveraged buyouts of blue-chip companies, raising $16 billion worldwide, which, according to Hilson's calculations, was only $15.5 billion.

Bankers in Wall Street thought the offer was too cheap. KKR immediately bid to participate in, right as Johnson and Hilson were still making their wishful calculations. In contrast to the spin-off plan by Ross Johnson, KKR planned to retain all tobacco business and most of the food business. What was more, KKR offered a price of $90 per share, touching off a bidding war between Hilson and KKR.

Despite the fact that Hilson chose Salomon to raise funds, it could not compete with KKR either on strategies or financing. KKR hired Drexel and Merrill Lynch as consultants and offered to pay $11 a share for preferred stock at US$11 per share, totaling nearly $2.5 billion. Taking advantage of growing international demand for PIK stock, KKR quickly converted it into junk bonds, raising $2.5 billion.

However, the exposure of the "Johnson Governance Agreement" and the "Golden Parachute Project" irritated the shareholders and employees. The package of 525,600 restricted stock plans worth nearly $50 million, generous consulting contracts, and 1,500 restricted stocks received by each person seemed to keep Johnson intact regardless of any outcome of the acquisition eventually. Johnson's greedy approach stunned the management team, and he soon lost the support from employees. In the end, KKR won the battle at $109 a share for a total offering of $25 billion.

In the final round of bidding, Hilson offered $108 per share, just $1 shy of KKR. However, it was not the purchase price that ultimately drove RJR Nabisco shareholders to make their final decision, but a dozen other disappointments they named. For example, KKR guaranteed shareholders 25% of the shares, while Hilson only promised 15%; KKR planned to sell only a small part of Nabisco’s business, while Hilson intended to sell it all. Besides, Hilson failed to demonstrate the soundness of its securities and employee benefits through restructuring. All these caused the shareholders to ultimately chose KKR.

The acquisition deal was US$25 billion, of which $14.5 billion was a syndicated loan, and $5 billion was a bridging loan by Dechon and Merrill Lynch, which would be paid off by issuing bonds. KKR provided $2 billion (of which US$1.5 billion was company equity), $4.1 billion as preferred stock, $1.8 billion as convertible bonds, and $4.8 billion in debt owed by RJR.

The acquisition was signed on February 9, 1989, witnessed by more than 200 lawyers and bankers who attended the meeting. Hannover Trust and Investment Corporation raised $11.9 billion from banks around the world, together with $18.9 billion from KKR, fulfilling the cash commitment.

The entire transaction cost is reported to be $32 billion (assuming the cost of capital is included). Dechung, famous for its junk bonds to back leveraged buyouts, charged more than $200 million, Merrill Lynch charged more than $100 million, and the syndicated financing fee was more than $ 300 million. Agency fees billed to KKR amounted to US$1 billion.

5.1.4 Post-investment Management

After the acquisition, Louis Gerstner, who became the new CEO of RJR Nabisco, overhauled the company and sold off a large number of luxurious facilities. In 1989, the company reported a net loss of $1.15 billion after paying off $3.34 billion in debt and a loss of $330 million in the first half of 1990. But the operation of the company was smooth in terms of cash flow.

Both Nabisco's profit and cash flow increased by 3.5 times in 1989, but Reynolds Tobacco was still in a fight mode. In March 1989, RJR discontinued production of Prime Brand cigarettes and reduced its workforce to 2,300. Under the new leadership, the company managed to improve equipment, increase production efficiency, and slash costs, resulting in a 46% increase in the tobacco profits in the first half of 1990. However, when the cash from tobacco was used to pay off junk bonds, Reynolds' rival Philip Morris increased sales and lowered tobacco prices. As a result, according to analysis, the Reynolds tobacco market shrank by 7%-8% in 1989.

In addition to the low return on capital, the more severe problems caused by KKR was the unsuitable leadership they introduced. Neither Lou Gerstner (Lou Gerstner) from American Express, nor Charles Harper (Charles Harper) from ConAgra, had even the slightest experience in the tobacco industry, not to mention their lack of passion for this business. As the market performance continued to descend, KKR had no choice but to divest the remaining equity of Reynolds Nabisco in early 1995. Reynolds Tobacco Holding Company became independent again, and Nabisco also became an independent food company, meaning both companies were back to square one. In the first half of 2003, Reynolds reported an 18% drop in sales to just $2.6 billion, while operating profit fell 59% to $275 million.

5.1.5 Sources of Funds

Phase 1: Complete the fixed-price purchase of 75% of RJR's outstanding shares by February 9, 1989

Apart from the US$1.5 billion equity investment provided by the KKR Equity Fund, $5 billion incremental interest rate notes, and the newly issued $500 million bonds, the rest were bridge loans provided by various financial institutions (mainly commercial banks).

The loan of more than $11 billion was mainly composed of "asset sale bridge loan" (to be fully paid off by August 1991), "refinancing bridge loan" (to be fully paid off by 1991), a loan extension, and term loans (all extended loans converted to term loans in February 1991), and so on.

Phase 2: Pay off the bridge loan by follow-up financing before April 1989

Acquired the "shell company", RJR Acquisition Corporation, and merged it with RJR Nabisco, Using RJR Nabisco real financing capabilities, the company managed to raise $25 billion in cash and securities, thus continuously repaying bridge loans and reducing financing costs through the sale of assets and bond restructuring, etc.

Throughout the process, the company issued a large number of junk bonds to finance and promised to repay debts by selling assets of the acquired company in the future. Therefore, although the acquisition capital needed to reach US$25 billion, KKR merely paid $15 million in cash despite the $25 billion needed by the acquisition capital, with the remaining 94% coming from the junk bonds issued by Michael Milken, the "junk bond king".

5.2 Greatwalle Acquired Yaxing Chemical

5.2.1 Introduction to Yaxing Chemistry

Yaxing Chemical, almost as well-known as Weichai Power, was a very famous enterprise in Weifang around 2000, mainly producing chlorinated polyethylene, caustic soda, hydrazine hydrate, foaming agent, and other chemical products, among which, the main product CPE ranked second in the world in the mid-1990s.

When listed on the Shanghai Stock Exchange in 2001, Yaxing Chemical's annual net profit exceeded CNY 60 million, and remained relatively stable at about CNY 40-50 million in the following years. However, the company's performance declined significantly since 2007 with several years of significant losses starting in 2011. At the end of 2015, the cumulative net loss widened to CNY 1.2 billion, and the cumulative loss was close to CNY1.4 billion.

Since 2011, given that Yaxing Chemical was a state-owned enterprise under Weifang City, the Municipal Government took various measures to rescue it, including capital injection and the introduction of cooperation from Shandong Salt Industry Group, but all failed. The collaboration with Salt Industry Group broke down in 2014 due to internal management and other conflicts.

5.2.2 Introduction to Yaxing Chemical's M&A case

In desperation, Yaxing Group, the largest shareholder of Yaxing Chemical and a subsidiary of Weifang State-owned Assets Supervision and Administration Commission, tried to save itself by transferring controlling rights and introducing private shareholders with comprehensive strength. On July 31st, 2015, Yaxing issued an announcement stating that the largest shareholder Yaxing Group and Beijing Glorious Oriental Commercial Management Co., Ltd. (hereinafter referred to as "Glorious Oriental") signed an agreement. Based on the agreement, 40 million shares of Yaxing Chemical (accounting for 12.67% of the total shares) would be transferred to Glorious Oriental at a total price of CNY 375.68 million.

After the transfer, Glorious Oriental held 40 million shares, becoming the largest shareholder. The proportion of listed shares held by Yaxing Group dropped to less than 5%. It was the first time that Yaxing became a privately held listed company since being founded decades ago. Li Guibin, the actual controller of Glorious Oriental, tried to inject assets from its affiliated companies into listed companies since 2015. However, due to limited strength, and the existence of multiple problems the injection of assets, all his proposals were rejected by the shareholders' general meeting successively.

At the same time, Glorious Oriental began to suffer from its capital shortage. In April 2016, Yaxing Chemical announced its first-quarter financial report, with a loss of CNY33.39 million. After two consecutive years of losses in 2014 and 2015, Shanghai Stock Exchange flagged the company as particularly risky and changed its abbreviation to "ST Yaxing". Therefore, under stock exchange rules, the company will be suspended from listing if losses continued in 2016. Based on the market prices, industry trends, assets and liabilities of Yaxing Chemical’s main products in the first quarter of 2016, under normal circumstances, there was no silver lining for a turnaround in their net profits in 2016, unless someone took special measures.

Although Yaxing Chemicals was facing unprecedented risks in early 2016, Great Walle, after sufficient research and investigations, believed that Yaxing Chemical could be quickly revitalized through the power of M&A funds and had a large room for improvement. GreatWalle made such prediction based on the following factors: Firstly, the company’s main product CPE production capacity reached 170,000 tons, accounting for more than 20% of the national production capacity, and there were no strong competitors in the industry. As a leading company, Yaxing's price for CPE 5%-10% higher than that of its competitors. The company’s losses was mainly due to historical burdens and poor management, rather than the products. Secondly, while Yaxing Chemical’s debts were up to 2.3 billion, some of the liabilities and losses were formed by subsidiaries' mergers. The level of debt and loss of the parent company was relatively low. Thirdly, Yaxing Chemical possessed a factory area of 948 acres, which was located in the center of the newly-planned CBD, adjacent to the Weifang High-speed Railway North Station, which, as one of the Beijing-Shanghai High-speed Railway Second Line hub stations, was just 1500 meters to the northeast, so there would be massive potential for land appreciation.

Beginning in April 2016, GreatWalle continuously bought in shares of Yaxing Chemicals in the secondary market through its multiple M&A funds. As of July 2016, Great Walle had acquired a total of 74,476,681 shares of the listed companies at an average price of about CNY9.5 per share, accounting for 23.60% of the total share capital. Great Walle became the controlling shareholder of Yaxing Chemical, surpassing Glorious Oriental's shareholding ratio by 10 points.

After negotiation and coordination with Yaxing Chemical's original major shareholder Yaxing Group, Glorious Dongfang, and Weifang Municipal government, Great Walle took over Yaxing Chemical and successfully reorganized the board of directors.

5.2.3 Post-investment Management

When acquired by Greatwalle, the market value of Yaxing Chemical had a market capitalization of only about 2.7 billion, making it one of the companies with the lowest market value at that period. From 2008 to the first half of 2016, Yaxing Chemical had an average annual loss of more than CNY 100 million, and a cumulative loss of CNY 1.4 billion. The company had been seriously insolvent, with a net asset of about CNY 200 million and total corporate debt of more than CNY 2.3 billion. The company faced the risk of delisting and the challenge of local financial crisis caused by the chain reaction of debt explosion. More than 2,000 employees were also at risk of unemployment and instability. Therefore, how to reduce the liabilities of listed companies and reverse the situation of corporate losses in a short period, was the main task facing Greatwalle.

After reorganizing its board of directors, Greatwalle formulated a two-step strategy to solve the problematic situation of the listed company:

(1) The first step was to reduce the level of debts and make the company profitable, so as to eliminate the risk of listing suspension; the second step was to further promote the strategic adjustment of the company to restore the hematopoietic function of the company, aiming to generate operating profits, and gradually optimize the business blocks.

Considering Yaxing Chemical must meet the two financial indicators of both positive net assets and net profits in 2016. Greatwalle took several measures: the first is to divest non-operating assets, which could not only generate cash flow for the listed company but also increase the profit from asset sales; the second is to directly inject CNY 135 million of cash into the listed company to reverse the net assets to positive; the third is to sell out continuously loss-making subsidiaries, to reduce the losses and liabilities formed by the consolidation of corporate statements through accounting treatment; the forth is to provide a series of guarantees for listed companies to resolve the debt crisis: and the fifth is to actively coordinate with the local government to strive for financial incentives, which further increased listed companies' net profit. Through the above measures, the company turned returned to profit in 2016. It restored its net assets to positive, and significantly reduced liabilities, laying a solid foundation for moving forward.

(2) Significantly improved the operating efficiency, cut costs, and reduced personnel wages, production expense, procurement costs, sales costs, and other expenditures.

(3) By implementing the above measures, by the end of 2017, the debt level of the

listed company was successfully reduced from 2.3 billion to 1.5 billion, and net assets rise from -250 million to 33 million. This was the first time in the past nine years that the company’s main business was profitable, with the net profit after extraordinary gains and losses attributable to equity holders reached RMB 26.8 million.

In order to further enhance the value of the company and enable the company to enter a sound development track, following measures were taken:

(1) At the beginning of the acquisition, Greatwalle formulated a plan to integrate companies from the same industry and inject high-quality assets. However, since mid-2016, drastic changes in domestic financial and capital market environment created significant obstacles to the implementation of the two programs.

(2) In 2017, in response to further tightening of China's financial market policies and capital market policies, Greatwalle quickly developed e a strategy to sell controlling shares to companies in the same industry to optimize listed companies' operations. In October 2017, Greatwalle signed a contract with Chengtai Holdings, a local company in Weifang, to sell 42 million shares to Chengtai Holdings at a price of CNY20 per share, recouping most of the investment costs and retaining 32 million shares in hand.

(3) After becoming the largest shareholder of the listed company, with Great Walle's support, Chengtai Holdings reorganized the board of directors and appointed new managers to take over the daily operations of Yaxing Chemical. When taking control of the company, Great Walle managed the listed company from the board of directors’ level and maintained friendly relations with the second and the third largest shareholder, as well as the original management of the listed company. However, after Chengtai Holdings took over, its relationship with the second largest shareholder Beijing Glorious Oriental, the fourth largest shareholder Yaxing Group, and the company's original management deteriorated rapidly, causing serious internal friction.

Simultaneously, China's capital market began to decline sharply, and the financial crisis spread rapidly since the beginning of 2018. As Chengtai Holdings quickly encountered a financial crisis in such a backdrop, causing that the original plan for asset injection and industrial coordination with the listed company could not be implemented.

(4) In 2019, due to its inability to repay corporate debts, Chengtai Holdings transferred its holding of Yaxing Chemical to Weifang Yuyao in debt repayment, which made Weifang Yuyao the largest shareholder of the company. Nevertheless, due to the poor relationship with Chengtai Holdings, and the low shareholding ratio of only 13%, Weifang was struggling to advance, facing restrictions from the second-largest shareholder Beijing Glorious Oriental, the fourth largest shareholder Yaxing Group and the original management.

(5) In order to bring Yaxing Chemicals into a virtuous circle, and considering that Chengtai Holdings acquired the shares of the listed company held by Great Walle at a premium of 100%, Great Walle chose to support Weifang Yuyao to consolidate the control of Weifang Yuyao, which successfully eliminated the most significant uncertainty in the follow-up operations of listed companies.

(6) In the second half of 2019, Yaxing Chemical launched a relocation for optimizing industrial resources and land resources, which entitled the factory to receive subsidies of more than RMB 1.4 billion from the government. At the same time, it announced the 100% acquisition of Shandong Hongjitang Pharmaceutical Group Co. Ltd by issuing shares. After completing the acquisition, the listed company's net profit was expected to exceed 300 million yuan in the next three years.

5.2.4 Sources of Funds

This acquisition funds were all from the M&A funds managed by GreatWalle, which were raised mainly from three channels: GreatWalle's own funds, financial investors, and strategic investors.

Among them, the financial support from strategic investors was considered critical. Such investors aimed to obtain financial investment returns and integrate with the listed company to fulfill their industrial purpose. Also, the amount of funds was relatively large, and the support for M&A projects was also relatively adequate.

5.2.5 Enlightenment from Yaxing Chemical's M&A case

(1) The manifestation of the value of Chinese listed companies is different from that of developed markets

In corporate mergers and acquisitions, capital value, asset value, and industrial value are the three core elements to evaluate an enterprise. Capital value, also called financial value, is the market's valuation of the excess of its net assets. Asset value is assets outside corporate statements, including land premium, brand, network, patents, and other intangible assets. Industrial value refers to the ability of an enterprise's main business to create cash profits in the future.

Asset value and industrial value in China are not much different from those of developed countries. However, no matter in which market, the manifestation of capital value requires several key elements: a sophisticated direct financing system, a sound multi-level capital market, and a smooth listing and delisting mechanism, stable policies, etc. Due to the absence of the elements mentioned above in China markets, the listed companies on Shanghai Stock Exchange and Shenzhen Stock Exchange tend to be overpriced. As a result, China’s listed companies appear to be much more expensive than those in developed capital markets. Therefore, those listed companies are enjoying an additional value called "shell value", or "capital license value", which is the additional pricing of the company as a listed company. The shell value is the simulated market value after all the assets and liabilities are deducted. In the mergers and acquisitions of listed companies in China market, since 2015, the "shell value" has been priced at about 3 billion, 6 billion, 8 billion, 4 billion, 3.7 billion, and 3 billion, respectively. (This data is the empirical data accumulated by the author of this paper from recent working experience)

In the case of Yaxing Chemicals, GreatWalle used "capital value" as a crucial indicator in the valuation model. Based on the price of the acquisition of Yaxing Chemicals by GreatWalle, the listed company's total market value was only 2.7 billion yuan, well lower than the market average for the same period. In October 2017, when Chengtai Holdings acquired Yaxing Chemical's shares from GreatWalle, the listed company's total market value was CNY 6.3 billion, still lower than other listed companies.

(2) Chinese Characteristics of Internal Management

Yaxing Chemical is located in Weifang, operating for many years. Even though the management team was not the company's shareholders, they still possessed great influence within the company, which is a vast difference between the China market and developed capital markets. Therefore, it is difficult for Chinese listed companies with large-scale operating assets and employees to restructure the company by changing management.

(3) The Relationship between Listed Companies and Local Governments is Relatively Close

Chinese listed companies, especially in second-and third-tier cities, often have profitable local operations and many assets and jobs. Local governments would attach great importance to listed companies as the number of listed companies was one of their performance evaluation factors due to the scarcity of listed companies. The interdependence of listed companies and local governments can be a double-edged sword. If the relationship was handled well, it will get twice the result and achieve a win-win situation, and otherwise, many affairs will be challenging to advance. Therefore, whether M&A funds can handle various relationships and adequately balance all parties' interests is particularly important.

(4) Lacking Long-term Stable Financial Resources, Chinese M&A Funds Often Adjusted Investment Strategies

At the time of its acquisition of Yaxing Chemicals, GreatWalle was funded mainly by private equity funds with an issue period of just 2.5 years and by strategic investors with a longer time. However, when GreatWalle completed the first phase of transformation and planned to move forward to the second phase, drastic changes in policies occur, making it impossible to continue raising funds such circumstances. With the original asset restructuring plan interrupted, GreatWalle decided to change strategies and quickly sell all of its shares. In the process of Chengtai Holdings' acquisition of Yaxing Chemical, the fact that most of the funds was from debt also contributed to the rapid loss of controlling rights during the 2018 financial crisis.

The lack of long-term financial support for M&A funds will cause M&A funds to focus on rapid changes in capital value in the process of restructuring, instead of achieving asset value and industrial value enhancement through industrial restructuring and asset reorganization.

Overall, the case is more consistent with the findings in Part III and IV of this paper.

(1) External Factors

The operation of M&A funds is highly dependent on the policy environment. In 2016, the fund acquired a controlling stake in Yaxing Chemical under a relatively more fund-like policy environment and implemented a series of restructuring measures, which the M&A fund chose to withdraw from in the face of a huge macro policy turn at the end of 2017. The entire industry subsequently fell into a downturn as well.

(2) Internal Factors

The M&A fund successfully completed the acquisition and restructuring of Yaxing Chemical, mainly due to the historical performance of the M&A fund, which quickly organized the fund and gained recognition from the regulatory authorities, within the company, and the local government; also due to the team's ability to integrate resources. Before the acquisition, Yaxing Chemical had high asset and liability ratios, heavy personnel baggage, serious insider control, sustained operating losses, and high dependence on the local government, and the fund team fully mobilized all resources to ensure the smooth implementation of the M&A and restructuring, which was the most critical element of the project in terms of the M&A fund's ability to exit profitably.

5.3 NVC Equity Rivalry

5.3.1 Introduction to NVC Lighting

At the end of 1998, Wu Changjiang, Hu Yonghong, and Du Gang invested CNY 1 million to establish NVC Lighting in Huizhou, Guangdong. Wu Changjiang invested 450,000 and became the single major shareholder with 45% shareholding. The main business of NVC Lighting was to provide lighting solutions for construction, transportation, urban lighting, supermarkets, hotels, office, homes, industry, and other facilities.

On May 20, 2010, NVC Lighting was listed on the Hong Kong Stock Exchange (stock code: 02222HK), becoming the most influential and leading enterprise in China's lighting industry.

5.3.2 Introduction to the NVC Equity Rivalry

NVC Lighting was quite successful since its establishment, with sales reaching RMB 30 million in the first year of establishment and an annual growth rate of nearly 100% for the following consecutive years. After reaching a certain scale, the three founders' business philosophy diverged, resulting in a tripartite conflict. In 2005, seeing the conflict could not be reconciled, Wu Changjiang prevailed with dealers' support. Hu Yonghong and Du Jiang left the company after receiving tens of millions of compensation, and NVC Lighting became an enterprise wholly controlled by Wu Changjiang, ending NVC's first equity dispute.

However, the huge payouts dragged the company into a serious funding squeeze. After obtaining several small investments, in August 2006, NVC accepted a $22 million investment from SoftBank SAIF, representing 35.71% of NVC's equity. Coupled with some of the investments previously obtained, NVC obtained more than CNY 260 million funds. After solving the problems of entrepreneurial shareholders and funding, NVC embarked on a path of steady expansion.

This financing also planted hidden threats for NVC's future. Softbank Saifu had more than 35% of the shares, which was very close to being the largest shareholder. In the reorganized board of directors, Yan Yan controlled 3seats while Wu Changjiang controlled only two, which meant Yan Yan and Softbank SAIF Fund also had veto power over major issues.

In order to obtain funds and restrict Yan Yan, NVC Lighting introduced strategic shareholder Goldman Sachs, who invested $ 36.55 million and held 9.39% of the shares. Softbank SAIF, with anti-dilution clauses, promptly followed up with $ 10 million and maintained its shareholding ratio at 36.05%, becoming the company's largest shareholder. Nevertheless, Wu Changjiang did not have the funds to follow up, and the shares were diluted to 34.4%, becoming the second-largest shareholder. Goldman Sachs was the third-largest shareholder with an 11.02% shareholding ratio.

On May 20, 2010, NVC Lighting was listed on the Hong Kong Stock Exchange, raising HK $1.5 billion. Based on the IPO price, SoftBank SAIF's investment won 5 times return.

On July 21, 2011, NVC Lighting introduced Schneider Electric as a strategic shareholder. Six major shareholders, including SoftBank SAIF, Goldman Sachs, and Wu Changjiang, transferred 288 million shares to Schneider. Schneider invested HK $1.275 billion, accounting for 9.22% of the shares, and became the third-largest shareholder with SAIF holding about 18%, and Wu Changjiang personally holding about 15%. Following the closing of the transaction, Schneider and NVC signed a ten-year "sales network strategic cooperation agreement" to share distribution channels and business opportunities.

In 2012, due to severe internal conflicts between Wu Changjiang and other shareholders, Yan Yan succeeded Wu Changjiang as chairman. At this point, Softbank SAIF, Goldman Sachs, and Schneider were regarded as concerted action, and the power ratio of founders and investors on the board of directors became 2:4.

To counterattack, Wu Changjiang began to leverage NVC shares in the secondary market, once again becoming the largest shareholder, with a shareholding ratio exceeding 19% as of May 15, 2012. Ten days later, however, as soon as Wu Changjiang's "resignation" announcement was released, NVC's stock price plummeted 30%. Brokers had to forcibly liquidate Wu Changjiang's stock, robbing Wu Changjiang of his wealth and his position as the largest shareholder again.

Then Wu Changjiang again used the dealer system as a means of checks and balances. Beginning with the strike led by NVC dealers on July 13, 2012, the core supplier of

NVC Lighting stopped supplying one month later, and several executives resigned. The conflict lasted off and on for a whole year. In June 2013, NVC Lighting announced that its founder and CEO, Wu Changjiang, was elected executive director at the shareholders meeting held on June 21, 2013, which meant Wu Changjiang would officially return to the board of directors a year later. The success of Wu Changjiang's counterattack cannot be separated from the support from Wang Donglei, a white knight in his distribution system.

In fighting against Yan Yan, Wu Changjiang got acquainted with Wang Donglei of Elec-tech International Company (Elec-Tech), which started with the production of Western-style small home appliances and then moved to LED. At that time, Wang Donglei was looking fo a strong partner with a combination of both products and channels. NVC Lighting happened to be a good option.

Wang Donglei designed a mechanism to bind himself to Wu Changjiang through equity design deeply. By acquiring the 18.6% shares held by Wu Changjiang and part of the shares from the secondary market, Elec-Tech quickly became the largest shareholder of NVC’s with shareholding exceeding 20%. SAIF Asia and Schneider Electric were the second and third largest NVC Lighting shareholders with shareholding ratios of 18.18% and 9.21%, respectively. Wu Changjiang still held 6.79% equity. At the same time, Elec-Tech issued 131 million additional shares to Wu Changjiang, making him the second-largest shareholder of Elec-Tech.

At the shareholders' meeting in April 2013, Yan Yan resigned, and Wu Changjiang was re-appointed as CEO of NVC Lighting. At the same time, Wu Changjiang sold shares to Elec-Tech again. After the transaction, Wu Changjiang's shareholding fell to 2.54%, and Elec-Tech held 27.1%. In June, Wu Changjiang was elected as executive director, officially ending the dispute between Wu Changjiang and Yan Yan.

However, a conflict soon broke out between Wu Changjiang and Wang Donglei over the competition for NVC lighting channels and brands. Wu Changjiang hoped to integrate NVC Lighting's distributor channels into one company, and merged it into the listed company, so as to become a "Greater NVC" with bundled interests. This allowed Wu Changjiang to increase his own shares in listed companies. If Wang Donglei disagreed, the channel would be listed separately. Obviously, it was in conflict with the benefits of Wang Donglei, who began to pay various costs to win over NVC dealers.

In August 2014, NVC Lighting issued a statement announcing the resignation of Wu Changjiang as CEO. On the afternoon of August 8, at the Chongqing headquarter of NVC Lighting, Wang Donglei, as the largest shareholder, requested Wu Changjiang to hand over the company's business license, industrial and commercial information, and financial seal, which led to a severe physical conflict occurring between the two parties.

On August 29, NVC Lighting held an extraordinary general meeting of shareholders, on which Wang Donglei directly pointed out that Wu Changjiang's private grant, transfer of benefits, and illegal guarantees may cause a considerable loss of CNY 173 million to NVC Lighting and voted to dismiss Wu Changjiang from all positions at NVC Lighting. At this time, Wu Changjiang's right to speak in NVC Lighting had dropped to 1.71%, the lowest in history. In addition, 30 of the 37 NVC lighting distributors expressed their support for the board of directors' resolution, meaning Wu Changjiang's loss of support from dealers. In October 2014, Wu Changjiang was investigated by Huizhou Police for suspected misappropriation of funds.

After Wu Changjiang was out, Elec-Tech started to experience a crisis and continued to experience large losses. Wang Donglei himself was troubled by issues such as stock pledges and liquidation.

On December 12, 2019, NVC Lighting announced that KKR completed the acquisition of a majority stake in NVC China with a final value of the cash consideration of $663 million and the share consideration of $131 million, approximately CNY 5.56 billion. After completing the acquisition, KKR held 70% of NVC China shares, while NVC Lighting held the remaining 30%.

5.3.3 Enlightenment of NVC Lighting Case

(1) Legal fairness is one of the main barriers to the development of M&A funds in China

NVC Lighting is a typical case of conflict between management control and shareholder rights in China. Due to China's national conditions, after M&A funds or other financial capital enter a listed company and obtain controlling rights, conflicts between the controlling shareholder and the original shareholders or management are particularly likely to occur, especially when the actual original controller controls the management. This aspect is related to the over-emphasis of Chinese traditional culture on personal and family wealth and the imperfect rule of law and huge loopholes in the supervision and management system.

Such conflicts within Chinese companies are fiercer than in foreign mergers and acquisitions. Resistance is not limited to the framework of laws, regulations, and capital market regulatory policies. Sometimes, there will be violent boycotts, local governments and judicial authorities' involvement, and shareholders' pressure through dealers, management, and the public.

This has also occurred in a number of cases such as the acquisition of Greentown by Sunac and the acquisition of Shanshui Cement.(2) Internal management system as a means of anti-acquisition

An essential feature in this case is that the distribution system was repeatedly used as a means of anti-acquisition. In the three successive contends for control rights, the distribution system had played a vital role.

The distribution channel system was the most critical factor in the success of NVC Lighting. The establishment of the "exclusive store + operation center" allowed NVC to survive in the fierce internal conflicts. Wu Changjiang's strategy was to deeply combine dealers by providing financial support and forcing them to keep large inventories. Stocking tens of millions of inventory in the warehouse, the dealers can only go bankrupt if NVC canceled the agency rights. On the other hand, NVC's brand and products were highly recognized by the market. Wu Changjiang's personal charm as a successful businessman had also benefited him in building relations with dealers beyond simple business partners.

(3) The risk of non-compliance by the investee company is significant and requires strong team skills and resource integration capabilities of the acquirer

Many domestic M&A cases involve this issue. Buyers are often exposed to the risk even if the target of the merger is a listed company. In this case, the actual controller may have problems with benefits transmission, such as directly occupying the funds, using listed company to deal with other companies of the actual controller, and offering a Guarantee to other companies of the actual controller. However, existing regulatory measures can not prevent the emergence of similar incidents, neither could the legal system completely protect listed companies and the majority of small and medium shareholders. Instead, many contradictions were resolved by the acquirers through extreme actions and means.

Being fundamental in China, On the one side, the acquirer needs to have extremely strong team expertise, but also extensive resource integration capabilities so that the acquisition risk is minimised.

5.4 Baoneng acquired Vanke

5.4.1 Background Introduction

Vanke Enterprise Co., Ltd., established in May 1984, is one of the largest professional residential development companies in China and has long been regarded as a benchmark in the real estate industry. In 2019, its annual sales reached about CNY 600 billion. The company entered the real estate industry in 1988 and became the second listed company on the Shenzhen Stock Exchange in 1991. However, for such a leading real estate company, the distribution of equity is quite scattered. Annual Report that year showed that China Resources Co., Ltd., Vanke's largest shareholder, held just 15% of its shares. The heavily undervalued share price leaked other institutions' opportunities to acquire a controlling stake.

Baoneng Group was founded in 1992 with a headquarter in Shenzhen Special Economic Zone. The company took the most important step in capital accumulation by becoming a shareholder of Shenye Logistics. Split in 2006, it obtained the right to use the Shenye Logistics brand. In 2005, Shenzhen Baoneng Taikoo City's success allowed Yao Zhenhua, the head of the Baoneng department, to turn his attention to urban integrated property development. Since 2009, Baoneng had expanded its business nationwide, and integrated property development entered seven key regions. Before acquiring Vanke, Baoneng had entered more than 30 key cities in South China, North China, Northeast China, and Northwest China. According to 2012 data, Baoneng Group's direct and indirect land reserves nationwide have exceeded 20 million square meters. In 2012, Baoneng Group co-sponsored the establishment of Qianhai Life Insurance company, which incorporated finance into its business scope, and became a group company integrating real estate, finance, logistics, medical care, agriculture, and many other industries.

At the time of the acquisition, the overall market value of Baoneng Group was around CNY 50 billion, while that of its target, Vanke, was around CNY 160 billion, which was a "a snake swallowing an elephant" operation.

5.4.2 Introduction to M&A case

On July 10, 2015, Baoneng launched Vanke for the first time. Its subsidiary Qianhai Life bought approximately 552 million Vanke A-shares through the secondary market at the cost of 8 billion yuan, accounting for approximately 5% of Vanke's total A-shares. On July 24, Qianhai Life and its concerted person, Ju Shenghua, raised a placard for Vanke for the second time, holding 1.105 billion Vanke A shares, accounting for about 10% of Vanke's total A-shares. As of August 26, Qianhai Life and Jushenghua further increased their holdings by 5.04% of Vanke. Baoneng Group held 15.04% of Vanke's shares, surrendering China Resources Group, the former largest shareholder of Vanke for the first time. But in the whole process, the attitude of China Resources Group was very vague.

On December 15, Baoneng continued to increase its holdings of Vanke, accumulatively holding 23.52% of Vanke's A shares, becoming the largest shareholder of Vanke, and approaching the red line of 30% of the shareholders of listed companies. On December 17, Vanke's management, represented by Wang Shi expressed in an internal meeting that "Baoneng is not welcome to become a major shareholder of Vanke", thus officially kicking off the "Vanke-Baoneng Controversy". The four reasons given by Wang Shi were: (1) insufficient credit; (2) insufficient capacity; (3) short-term debt and long-term investment, with huge risks; (4) It was vital to keep China Resources as a major shareholder for Vanke's development. This also reflects the unique characteristics of this merger. Surprisingly, China Resources Group, which lost its position as the largest shareholder, expressed no displeasure. Wang Shi, the founder of Vanke, who only held a negligible proportion of Vanke's shares through the employees' platform indirectly, was the most vocal opponent of Baoneng becoming the largest shareholder.

On December 18, Vanke announced a stock trading suspension on the grounds of major asset restructuring and acquisition. On December 23, Vanke and Anbang issued an announcement expressing their intention to form an alliance, and Anbang became Vanke's "white knight".

On March 13, 2016, Vanke announced that it would introduce a CNY 60 billion into the share swap with Shenzhen Metro, which aroused the dissatisfaction from the original largest shareholder, China Resources Group. On March 17, the representative of China Resources Group stated that the cooperation between Vanke and Shenzhen Metro was a decision made by Vanke’s management without board discussion or resolution. China Resources questioned the legality of the proposal and reported relevant opinions to the regulatory authorities, requiring Vanke to operate in compliance with laws and regulations.

On June 18, the official WeChat account "China Resources" publicly questioned the Vanke Board of Directors' restructuring plan, indicating that the Vanke and China Resources camps were broken eventually. On June 23, Baoneng and China Resources issued a statement opposing Vanke's restructuring plan, accusing Vanke of its corporate governance issues, such as insider controlling the company. Since Baoneng and China Resources jointly hold 39.53% of the shares, under the decision-making mechanism of the general meeting of shareholders, the reorganization plan of Vanke and Shenzhen Railway were almost certain to fail.

On June 26, Jushenghua and Qianhai Life Insurance, subsidiaries of Baoneng, jointly proposed to Vanke's board of directors to convene an extraordinary general meeting to review the proposal to remove all directors. On July 1, Vanke's directors convened a meeting, passed the "Objection on the proposal of holding the second extraordinary general meeting of shareholders initiated by Shenzhen Jushenghua and Qianhai Life Insurance company. " With 11 votes in favor, 0 votes against, and 0 abstentions, China Resources also voted against the removal of current directors and supervisors.

On July 5, Jushenghua continued to buy in Vanke’s A-shares. As a result, Jushenghua and its concerted parties held 24.972% of its total share capital.

On August 4, Evergrande announced that Evergrande and its Chairman Xu Jiayin personally had purchased approximately 517 million Vanke A-shares, holding 4.68% of the outstanding shares at a total cost of CNY9.11 billion. Evergrande stated that it acquired Vanke because it is the flagship real estate developer with strong financial performance. On August 21, Vanke disclosed the impact of the equity war: first, from the end of June to the beginning of August, 31 cooperation projects were required to alter terms, postpone advancement or consider terminating the cooperation due to equity issues; second, since the end of June, Vanke's partners, customers, employees, and other small and medium shareholders have become increasingly suspicious and worried about the company's prospects; third, Vanke Property's five negotiated cooperation projects were suspended, changed or considered to terminate: a logistics real estate partner was requested to adjust terms and numbers of overseas funds and banks suspended loans; and finally, the stability of the team has been affected.

On November 29, China Evergrande Group issued an announcement disclosing that it held approximately 1.553 billion Vanke A shares, accounting for approximately 14.07% of the total issued share capital of Vanke. Major shareholders Baoneng Group held 25.40%, and China Resources held 15.31%.

On January 12, 2017, the situation changed drastically. Vanke issued an announcement, saying that China Resources, which had previously staunchly opposed the reorganization of Vanke and Shenzhen Metro, transferred all its shares in Vanke to Shenzhen Railway Group. In June 2017, China Evergrande announced the transfer of its 14.07% stake in Vanke to Shenzhen Railway Group. On July 6, 2017, China Resources Group and China Evergrande completed the transfer. Since then, Shenzhen Metro Group's shareholding ratio reached 29.38%, surpassing Baoneng Group and becoming Vanke's largest shareholder.

Later, as Yao Zhenhua, the actual controller of Baoneng Group, was punished by the China Insurance Regulatory Commission for violating financial regulations, and Baoneng Group successively sold its Vanke equity.

5.4.3 Analysis of Baoneng's funding sources

One of the critical reasons for our analysis of this case is that Baoneng's financial leverage is very typical in China's specific financial environment, which is worthy of serious analysis and exploration. Main strategies include:

(1) Raise its funds required for M&A relying on Qianhai Life Insurance's equity value.

Before this acquisition, Jushenghua, Baoneng's investment platform, was not a large company capable of mobilizing tens of billions of funds. As of June 18, 2014, it received only CNY 1.76 billion in the capital. As of October 2015, its registered capital was 10.4 billion.

From the end of October to the end of November, Jushenghua expanded its registered capital to CNY 16.3 billion with a capital increase mainly from Shenzhen Zheshang Baoneng Industrial Investment Partnership (Limited Partnership) (hereinafter referred to as "Zheshang Baoneng Industry"). It injected 4.89 billion yuan to Jushenghua, accounting for 30% of the shares. It was reported that Zheshang Baoneng Industry raised 20 billion yuan, of which the Baoneng contributed about 6.7 billion as a low-level investment, and the Zheshang Bank invested about 13.3 billion as a priority. The capital increase was a hidden loan from Zheshang to Baoneng. The limited partnership adopted a more complicated layered structure.

Of the mentioned CNY 20 billion funds, 4.89 billion were used to increase the capital of Yu Shenghua, and 4.7 billion was lent to Yu Shenghua for the acquisition of shares in Qianhai Life Insurance. The acquisition of Qianhai Life Insurance for 5.7 billion (1 billion Jushenghua's own funds, plus 4.7 billion debts), raised Jushenghua's equity in Qianhai Life from 20% to 51%. This acquisition was a prelude to the entire Vanke M&A case. It is reported that the counterparty of Jushenghua's acquisition of Qianhai Life's equity may be, in fact, an affiliate of Baoneng. If the report was accurate, the acquisition amount of 5.7 billion, was returned to Baoneng.

According to the analysis of the business characteristics by financial institutions, the remaining funds of more than CNY10 billion of Zheshang Baoneng, with no use path found by the public, was very likely to be used for Vanke acquisition projects as well. Therefore, the actual use could be to inject capital into Jushenghua or other companies in the Baoneng in the form of debt or hidden debt.

To sum up, Zhejiang Baoneng as a separate project (there is a small-scale Shenzhen Baoneng Chuangying Investment Enterprise (Limited Partnership), which is not analyzed in this paper), already brought in about CNY4.89 billion in capital and 5-15 billion in shareholder loans. All the funds can be used as inferior funds to obtain more funds to acquire Vanke.

(2) Further enlarge the financing leverage with multiple financing methods

In the entire acquisition case, relying on the means mentioned above, Baoneng obtained its funds as inferior capital to further expand the financing leverage. Main methods included:

The swap of brokerage rights: This part of financing was used in the early stage of Baoneng's acquisition of Vanke, and the financing leverage could reach 1:1 to 1:3.

Securities margin trading: This is also a financing method in the acquisition, and the financing leverage is 1:1.

Stock pledge: This is one of the main financing instruments after the acquisition. Due to the high degree of recognition of Vanke’s stock, it is generally possible to obtain a pledge ratio of more than 1:1.

Structured hierarchical asset management plan: The main financing model of Baoneng. Seven asset management plans by Jushenghua were disclosed in Vanke’s announcement, all of which were marked “for investing in Vanke’s A-shares” with all voting rights attributable to the clients, with a hierarchical funding structure (priority and inferiority). They were: Guangju No. 1 Asset Management Plan, AXA No. 1, 2 and No. 3 Asset Management Plan under the subsidiary of China Southern Capital, Taixin Value No. 1 Asset Management Plan for Specific Clients and Western Profit Fund Western Lide Baolu No. 1 Asset Management Plan.

Among the seven plans, PingAn Bank, China Guangfa Bank, China Minsheng Bank, and China Construction Bank provided a total of CNY14.5 billion in priority funds, with an interest rate of about 6.4%-7.2%. Jushenghua contributed 7.25 billion as an inferior capital, equivalent to a 1:2 leveraged financing of 21.75 billion.

(3) Coordinate mergers and acquisitions with the funds of Qianhai Life Insurance

Under regulations of the year, for insurance companies, the investment in blue-chip stocks was capped at 40% of the total assets of the previous quarter, and the single equity investment at 10% of the total assets of the previous quarter (previously 5%).

As the total assets of Qianhai Life at the end of September 2015 were CNY 126 billion, this regulation allowed Qianhai Life Insurance to use up to CNY 12.6 billion to increase its holdings of Vanke shares that year.

Qianhai Life used about 10.4 billion premiums to invest in Vanke stocks, including CNY 7.96 billion universal life insurance premiums and CNY 2.462 billion regular life insurance premiums.

As a small-scale life insurance company, the short-term universal insurance product was of great significance to Baoneng. The product has a short duration (usually about one year) and a high expected return rate (about 5%/year), which helped insurance companies like Qianhai Life to obtain a large amount of premium income in a short period. However, the issuance of such short-term universal insurance was subject to strict regulatory restrictions in subsequent years.

(4) Baoneng’s main credit-enhancement assets for financing

Baoneng’s ability to obtain tens of billions of financing is attributed to its complicated financing plan and its fair use of its assets with collateral value to financing institutions.

The first asset was the equity of Qianhai Life. Given that domestic financial licenses were extremely scarce, a life insurance company's equity value was well above its book value. When Zheshang Banking injected more than 13 billion funds before the merger, its primary risk control method was the value of the license of Qianhai Life Insurance (the company’s controlling stake is the primary pledge condition for related investments in Zheshang Baoneng Industry). This liscence solved the most critical financing issue for Baoneng's M&A plan.

The second asset was the value of the subject of acquisition, and in this case, it was the value of Vanke stock. Vanke was the flagship of domestic real estate companies at that time, and its stock price was chronically low. Financial institutions had also well recognized the pledge value of Vanke shares, which guaranteed a higher financing ratio utilizing pledged shares during the acquisition (it reached 1:2 in this case)

(5) Summary of Baoneng M&A financing model and calculation on actual leverage rate

In conclusion, the main reasons why Baoneng was able to integrate tens of billions of funds to initiate a hostile takeover of Vanke within a short period of time are as follows:

a. Based on Qian Hai Life Insurance's equity, it rapidly obtained its own funds by enhancing equity and financing through bank-based wealth management.

b. With hierarchical asset management products as the primary means, it carried out secondary leverage amplification relying on the intrinsic value of Vanke stocks.

c. Through the issuance of a large number of universal insurance products, it obtained premium income to buy in Vanke shares, thus assisting the parent company in achieving the control of Vanke.

Regarding the actual leverage ratio of the Baoneng project, we can make a preliminary calculation based on the above analysis:

Calculations based on the conventional model indicated that the acquisition of Vanke will cost Baoneng a total of about CNY 43 billion. About 10.4 billion was from insurance funds, and the remaining 32.6 billion was collected by leveraging twice: the first leverage was to increase its funds through Zheshang Baoneng, with a leverage ratio of 1:2. Afterward, the second leverage was adopted with priority inferior classification method in the asset management plan, with a leverage ratio of 1:2.

Therefore, a rough estimate of Baoneng's funds proportion was about CNY 6.52 billion. Excluding insurance funds, its acquisition leverage ratio was about 1:4. Taking insurance funds into account, we estimated the acquisition leverage ratio to be about 1:6.6.

According to the extreme model estimation, that is, considering the previous analysis, 5.7 billion of insurance M&A funds provided by Zheshang Baoneng Industry actually entered Baoneng's affiliated company. Since this part of the funds are actually debt-like funds, the actual capital contribution of Baoneng Department during the merger and acquisition is likely to be less than 1 billion. In this case, without considering insurance funds, the acquisition leverage ratio was 1:40. Considering insurance funds, the leverage ratio was approximately 1:52.

5.4.4 Case inspiration

(1) This case is very typical of the impact of China's policy environment on M&A and M&A funds. On the one side, Baoneng took advantage of the policy and formed an M&A fund to acquire Vanke as its largest shareholder by harnessing complex financial instruments from 2015 onwards; on the other side, Baoneng completely stopped its acquisition of Vanke from the second half of 2016 onwards due to changes in the policy environment and triggered a huge adjustment in the policy of the entire industry.

(2) In this case, the majority of the over $40 billion raised by Baoneng came from high-net worth assets of individuals, and basically all of Qianhai Life's insurance funds came from individual investors. The capital management plans issued in banks were off-balance sheet funds of banks, and were also dominated by high-net worth investors, with long-term funds accounting for a relatively small proportion.

(3) In this case, whether the acquirer or the acquiree, the decisive factor in winning was the ability to integrate resources: Vanke's introduction of Shenzhen Metro, which was owned by the Shenzhen government and triggered the intervention of the

regulatory authorities as an integral part of the process, and Baoneng's mobilization of resources to become the largest shareholder of Vanke and its eventual safe withdrawal were all a concentrated expression of the two teams' ability to integrate resources.

5.5 Comparison of Chinese and American Cases

Based on the above 4 cases, we have found major differences in the ecology of M&A funds' ecology between China and the US.

(1) The duration of the fund is different.

KKR's acquisition of Reynolds-Nabisco lasted for six years, which required a longer duration of its fund. In the case of Yaxing Chemical, some funds in GreatWalle was only 2.5 years while in the case of Baoneng's acquisition of Vanke, part of the funds was rolling universal insurance.

This situation is quite common in M&A funds in China and the United States. U.S. M&A funds are generally with longer maturities because their investors are more diversified and some investors can tolerate investment periods of 5 years or even more than 10 years. Meanwhile, few Chinese market-oriented private equity fund investors can afford an investment period of 5 years or above.

The shorter duration of the fund is a major constraint on the operation methods and operating space of M&A funds. Therefore, the profit logic are quite different between Chinese and foreign M&A funds

(2) The types of investors are different

In a developed market like the US, M&A funds are relatively mature, and the financial market is diverse. In addition to high-net-worth individual clients, M&A fund investors also include family funds, charity funds, insurance funds, sovereign funds, institutional funds, and so on.

The domestic financial market could still see a huge development potential, and M&A

funds are not yet familiar to investors. Therefore, the primary resource of investors in M&A funds are mostly high-wealth individuals, and in some cases, government-led industrial investment funds.

Until 2018, financial institutions' funds and wealth management funds can participate in the priority level of structured funds, which was soon restricted by newly launched regulations.

However, with the turmoil in China's financial environment in 2019, the Chinese government has rolled out a series of policies to support the private equity industry, encouraging banks to set up wealth management subsidiaries so as to expand the source of funds for equity funds. China's institutional investor market is still immature, and policy changes are relatively frequent. This is also an important hidden danger that restricts the long-term and stable development of the fund industry.

(3) Leverage level is different

In the case RJR, KKR comprehensively used a complex set of innovative financial instruments, most of which were various types of junk bonds and bank loans, including:

Set-up note: Temporary financing instruments provided by Drexel Burnham Lambert and Merlin through private placement. Interest rates are reset every month. A fixed floating interest rate spread is added to the short-term benchmark floating interest rate, plus an additional interest rate that increases over time. Reimbursement can be made at any time in accordance with parity notice

PIK bond: a bond that allows the debtor to pay interest by paying additional PIK bonds, that is, to offset the cash interest payable by increasing the debt principal.

Moreover, the PIK bonds in this acquisition are used as a payment method for the transaction consideration (the transaction consideration of $109 per share contains

$81 in cash and $28 in PIK bonds). If the market agrees to a price of PIK bonds of $28, the bond's interest rate could be reset to bring its price to $28.

Partnership bonds: a temporary instrument for KKR M&A financing.

General US Dollar bonds

Asst sale bridge loans: bank loans, asset sale as repayment

Refinancing bridge loans: bank loans, swap with other financing instrument.

Renewable loans and fixed loans.

By fully utilizing the above instruments, KKR raised as much as $ 18 billion for the acquisition.

In the case of Greatwalle's acquisition of Yaxing, the only financing instrument applied was a structured fund. Part of the private placement was structured with a priority and inferior ratio at 1:3. The priority portion of funds enjoyed no protection on capital and interest but was preferred over allocated capital with a bottom interest rate of 6%. However, such funds were restricted by regulations since 2018. Other than that, no financial instruments were adopted.

In China, the issuance of bonds is relatively difficult due to its high standard required and the long time needed, so only companies rated AA and above can finance with such methods. On the other hand, bank loans also have specific restrictions such as higher credit rating requirements on financing entities and the request for additional mortgages or guarantees.

Therefore, for M&A funds, types of feasible financial instruments such as bonds and loans have limited availability and are subject to various restrictions on innovation.

(4) The legal environment of the financial market is different

For mergers and acquisitions, especially hostile takeovers, to guarantee the return rate on investment, it is necessary to improve the legal system related to the capital market, and all parties can act in accordance with the law.

An effective strategy with detailed planning in advance is important for proceeding with M& A projects, which requires long-term certainty of policies and regulations. It is assumed that the counterpart of a transaction can influence the policies and laws, or even violate them with impunity. In that case, it will disrupt the overall plan and affect the outcome of the transaction.

In Chinese M&A cases, the acquiring party may encounter unexpected obstacles in obtaining controlling rights, management rights, operating rights, and exiting. Management, original shareholders, and local governments are more accustomed to using their local resources and channels to intervene in regular business practices. Many of them do not abide by laws, regulations, and policies.

(5) The difficulty level of listing is different

In the US, the listing and delisting of companies are relatively standardized, while in China, listing behavior is still subject to regulatory control. With the number of listed companies in China each year ranging from 100 to 400, companies that intend to go IPO are queued up for the review by the China Securities Regulatory Commission. At the same time, regulatory authorities may suspend IPOs due to changes in the economic and financial environment.

Therefore, foreign M&A funds can seek targets widely in the primary and secondary markets, and at the same time, exit flexibly via privatization and IPO. However, in the Chinese market, investors in the primary market face the uncertainty of the exit time, while investors in the secondary market are generally reluctant to implement privatization and other means.

(6) Authenticity of corporate financial data is different

At present, the phenomenon of management irregularities and financial fraud in

China’s companies, and even listed companies, which has created many obstacles to M&A projects, including major shareholders’ appropriation of corporate funds, illegal use of companies to provide guarantees for affiliated companies, and frauds on funds, inventory, sales revenue and other data.

The financial fraud incidents such as Kangdexin and Kangmei Pharmaceutical in the past 2 years are typical cases. For the acquirer, this makes it difficult to assess the real value of the target accurately and leaves many uncertainties after the acquisition.

(7) The management and control of enterprises after M&A is more difficult

For M&A projects in China, the competition for controlling rights is a challenge, followed by the fight to obtain control. The new major shareholder may face confrontation with the original shareholders (as in the case of NVC Lighting) and even the original management (as in the case of the Vanke- Baoneng War). In particular, the original shareholders and management can even impede the company's new shareholders' control through illegal means. In European and American countries, such violations and obstacles can be resolved through legal remedies, but such legal remedies are extremely limited in China.

Therefore, in Chinese M&A cases, to obtain effective control over the M&A targets, both parties of the game need to give full play to the role of laws and regulations, regulatory agencies, social resources, public opinion resources, government resources, and other channels.

5.6 Analysis of the cases

By analyzing and comparing the above four domestic and foreign cases, we can see the key factors in the development process of M&A funds and the critical factors that affect the success probability of M&A fund business, consistent with the previous conclusions obtained in the previous two chapters. Therefore, it can support our research conclusions in the following aspects:

We can see that in the above cases, the fund teams must first determine a more straightforward investment logic (also called an investment strategy) before starting a project. Whatever investment logics different institutions adopt, they all need to adapt to market characteristics and policy environment. The above cases have shown the importance of investment logics. What kind of investment target should we choose? How to acquire and obtain control? How to exit with profit? How to prevent risks? These questions need to be answered in line with the actual situation. An illogical investment may lead to project failures, while a reasonable investment logic can ensure safety and profit. Due to different investment logics of KKR, Baoneng, and GreatWalle Agribusiness, they have great differences in target companies, the sources of funds, and post-investment operations. However, in the end, these projects gain profit, because their investment logic are all consistent with the market characteristics. Another key factor lies in the resolution and handling of various abnormal problems, which corresponds to the team ability and the resource integration ability of fund companies mentioned in the previous chapter. In the process of mergers and acquisitions, many unplanned situations may happen, such as hidden debts, control rights, and legal proceedings, and M&A fund team should solve all these emergencies. Taking the NVC lighting and Vanke projects as a comparison, SoftBank SAIF, who promoted overseas models, and Baoneng, a local organization, were both fiercely resisted by the original management or actual controller and failed in the end, but Baoneng responded to the emergency in a more professional and effective way, which ultimately ensured the investment profit.

The third aspect is the high sensitivity of M&A projects to policies. This is consistent with the indicator of policy prosperity mentioned in the previous chapter. Whether an overseas project or a domestic project, it is necessary to fully consider the current policy restrictions and adjust the project operation plan at any time according to policy changes during the project implementation. From the previous four projects, we can see that policy will profoundly affect the entire process of M&A projects, from equity acquisition methods, fund-raising methods, specific forms of funds, post-investment operations, to exit arrangements. Therefore, it is necessary to understand existing policies in depth, and make reasonable predictions about future policies' possible changes.

Based on the above analysis and the development history of the investment institutions involved, we can further test the scientific validity of research conclusions in the previous chapters. Key elements would be analyzed below one by one.

(1) The impact of fund's historical performance

From the analysis in the previous chapter, we can see that the historical performance of a single M&A fund company can guide the future development trend of the fund. This conclusion is in line with our intuitive judgment.

From the cases we analyzed in this chapter and the several cases involved, it can be seen that KKR and Baoneng develop better after successfully completing major M&A projects: KKR continue to expand management scale, and gain ideal benefits from related M&A projects. After completing the Vanke project, Baoneng successively invested in projects such as Zhongju High-tech, CSG, Nanning Department Store and Shaoneng Co., Ltd., which increased its management scale and efficiency steadily. However, after the setbacks of NVC Lighting, SAIF gradually shrank its M&A business and finally withdrew from this market.

(2) Resource integration capability

According to integration experts, the resource integration capability of M&A fund is the second most important factor affecting its development. This kind of integration involves coordinating and integrating local governments, regulatory agencies, industrial resources, financial institutions, media resources, and other factors, aiming to solve various emergencies in the M&A process and successfully implement M&A projects.

This is also evident in the various cases in this chapter. Baoneng demonstrated its strong resource integration capability in investing the Vanke project. For example, it raised a large number of funds from insurance companies and commercial banks, and continuously received support from the government and supervision in control rights, managed a good control ability over media and public image. Although it failed to gain control in the end, it still ensured a good return on investment in the complex and fierce competition. GreatWalle’s acquisition of Yaxing Chemicals project also demonstrates the importance of resource integration capabilities. The critical aspects, including the introduction of industrial capital, the expropriation of plant land, and strategic cooperation with companies in the same industry, require strong resource integration capabilities. During the struggle for control of NVC lighting, the different capabilities to integrate government resources determined SAIF’s failure and Elec-Tech’s success.

(3) Professionalism of the investment team

The professionalism of the fund investment team, which involves business operations, M&A negotiations, legal issues, and M&A plan design, is also a key factor.

The comparison between domestic and foreign cases shows the gap between domestic M&A funds and international first-tier companies such as KKR in terms of professionalism. An excellent team can significantly reduce the cost of acquisition and the uncertainty in the process of project progress, and at the same time, improve the ability to solve unexpected situations.

(4) Investment strategy

In experts' opinions, the investment strategy is another crucial internal factor. As we can see, investment strategies in the 4 cases are significantly different in terms of selection criteria for the target (different industries, and different business operating conditions), cooperation method with the management (such as the hostile takeover in the KKR project and the cooperation with the management in the Great Walle project), operation method (spin-off, industrial integration, debt restructuring, etc.), and exit method (overall transfer of control rights, exit from the secondary market).

The investment strategy should be chosen according to the local political and economic environment, as well as the professional capabilities and business experience of the M&A fund team itself, thus forming a clear and confirmed direction to give full play to their advantages.

There were changes in the long-term strategic planning of KKR, Baoneng, and GreatWalle. KKR decreased the proportion of malicious M&A and paid more attention to stakeholders' cooperation; Baoneng adjusted its selection criteria for targets, to focus more on medium-sized companies and real estate business. Great Walle gradually shifted from M&A of distressed companies to strategic investment in leading companies in specific industries and introduced state-owned enterprises as strategic shareholders to jointly implement M&A projects. These strategic changes were made according to the ever-changing business environment.

(5) Prosperity of Policies

According to previous research, prosperity of policies is the core element among all external factors for M&A funds. This finding is also verified in the analysis of cases in this chapter.

In the Vanke-Baoneng rivalry, although Baoneng won financially, the early and late stages of the project were affected by different policy environments, which was encouraging and lenient for M&A in the early stage, but resistant and hostile in the later stage. As a result, Baoneng failed to achieve holding as expected. The situation is the same for Great Walle's acquisition of the Yaxing Chemical Project. The overall regulatory environment was favorable from the start of the project to the first transfer of controlling rights, ensuring relatively smooth progress of the M&A project and a higher premium for the first transfer. However, since 2018, the regulatory environment became tightened for years, which continuously increased the difficulty of exiting and thus affected the fund's average return.

(6) Valuation on Stock Market

The stock market's valuation level has an equivalently important influence on the primary market M&A funds and the secondary market M&A funds. In the previous 4 cases, project implementation was affected by the stock market valuation level, and M&A funds tended to initiate projects when the stock market valuation recovered, rose, or maintained a relatively high level. It may be because investors were more willing to invest when the market was highly active, as they believed that M&A projects were easier to exit at a reasonable price. Simultaneously, the high valuation of the stock market at the exit stage has indeed promoted the returns of investment.

In the KKR, GreatWalle, and NVC Lighting cases, the exiting of the projects was based on the securities markets in the United States, Mainland China, and Hong Kong respectively. The market's valuation level (including the increase in transaction volume brought by the high valuation stage) affects the exit amount and time of M&A funds in the later stage.

(7) Wealth Status of Household Sector

The wealth status of the household sector is also an external key factor. Based on our observation, SAIF, GreatWalle, Baoneng, and other projects were more dependent on the fund-raising from high-net-worth clients at the time of the acquisition, which has a lot to do with the wealth status of the household sector.

When the household sector possesses more wealth, more abundant funds can be provided for M&A funds, which contributes to the smooth implementation and promotion of M&A projects.

CHAPTER 6. M&A FUND DEVELOPMENT STRATEGY STUDY RECOMMENDATIONS

6.1 The Important Role of M&A Funds in the Transformation of China's Economic Development

6.1.1 Research on the Economic Impact of M&A Funds based on Overseas Experience

Combined with the international development history, we can see that M&A funds, as an essential financial instrument and financial format, are strongly in synergy with the economy and industry by optimizing the allocation of funds and resources. In the content of China economic development and transformation process, the strategic significance of M&A funds includes:

(1) M&A funds are value discoverers of industrial assets, which can effectively prevent silence and waste of resources

An important role of M&A funds is value discovery. The main characteristics of excellent international and domestic M&A funds are adept at analyzing the capital value, industry value, and asset value of a target. By exploring the underestimated factors and applying them as a foundation for investment and profitability, it could be regarded as a “self-interested” process that results in positive social and economic benefits. Those silent resources and assets could be reactivated to generate new growth point, to drive the economy to a higher level of development, thus benefiting the society comprehensively.

(2) M&A Funds Contribute to Upgrade and Optimize Industrial Development in the Post-investment Stage

Unlike traditional venture capital funds or hedge funds, M&A funds are deeply involved in the operation and strategy of the M&A target, rather than simply providing financial investment.

A corporate merger or acquisition can have a far-reaching influence on a company’s growth prospects and long-term outlook. After investment, the M&A funds will generally contribute to optimize operating efficiency, cost, industrial strategy, investment mergers and acquisitions, internal management, debts, and other business aspects. Through the above measures, the fund is beneficial to establish a more scientific and efficient management system and even helps exploit new markets and new businesses.

This is particularly critical for many state-owned and private enterprises in China. After the rapid development of the past four decades, many companies are gradually starting to encounter development bottlenecks due to market, technology and other constraints. Therefore, rather than seeking for capital, these companies are more eager to introduce advanced management concepts and market-oriented mechanisms and adopt a path for brand and technology upgrading, so as to acquire new growth momentum. M&A funds can play an essential part in this regard.

(3) M&A Funds can Optimize the Allocation of Industrial Resources and Capital

M&A are the process of optimal allocation of resources. M&A funds can achieve the horizontal and vertical integration of the industrial chain based on the company's needs and bring the external capital required for transformation and development. Recently, resource misallocation in the domestic market is rather significant and different companies have shortcomings such as funds, market channels, key patents, and management teams and continuous losses caused by abusive competition. One of the main solutions to these problems is to reorganize resources through mergers and acquisitions.

(4) M&A funds can contribute significantly to an active M&A market

Compared to the vast majority of companies, M&A funds have the advantage of capital, expertise and comprehensive resources, and companies often need the involvement of M&A funds to assist in the implementation of their M&A strategies. At the same time, M&A funds can also play a strategic role, as they can often address the concerns of both the acquirer and the acquiree in acquisitions in the same industry, strategic acquisitions and acquisitions with long decision chains, thus facilitating the successful completion of the acquisition. The combined advantages that exist for M&A funds can contribute significantly to an active market.

6.1.2 The Role of M&A Funds Play in China's Current Economic Transformation

On account of the three characteristics of M&A funds, this paper aims to propose that in the context of China's economic transformation, M&A funds can make a difference in the following perspectives:

(1) Focus on Traditional Industries, Discover and Upgrade the Stock of the Economy

Traditional industries, including traditional manufacturing, consumption, chemicals, health-care, etc, contribute to the majority of GDP and jobs in China's economy, which is an indispensable part of economic transformation. Venture capitals concentrate more on new start-ups, and M&A funds attach more emphasis to traditional industries. M&A funds would help promote the economy to a larger scale and higher stage by upgrading, integrating, and optimizing traditional industries.

(2) Participate in State-owned Enterprise Restructuring and Merges, to Improve the Operation and Output Level of State-owned Assets

The optimization of state-owned enterprises at the capital level and management level is currently an important issue facing China. In recent years, continuous attempts at different levels and fields were conducted. M&A funds can obtain great potential in this sector by providing capital needed for restructuring, applying their operation experience to mix reform plan designing or assisting with the operation of restructured entities.

(3) Assist High quality Enterprise to Achieve External Expansion

After years of hard work, many high-quality state-owned companies, private enterprises and listed companies are attaching more and more attention to mergers and acquisitions, hoping to obtain new development momentum by external expansion. It is believed that the cooperation between M&A funds and such industrial participants would effectively increase the success rate of M&A cases, by taking advantage of the merits of both parties in terms of capital operation, strategy, negotiation ability, assets valuation and credit.

6.2 China's M&A fund development environment over the next decade

Previous studies in this paper have manifested that the external environment significantly affects the M&A funds. Before studying the development strategies for M&A funds in the next decade, we begin by screening for a handful of pivotal risk factors in the external environment.

6.2.1 Overall Development Environment

According to the investigation and analysis, several key trends for China’s development are as follows:

(1) The Probability of China Falling into the Middle-income Trap is Gradually Expanding

The “middle-income trap” is the phenomenon of hitherto fast-growing economies stagnating at middle-income levels and unable to graduate into the ranks of high-income countries because of the operation of several adverse factors. According to the World Bank's data in 2018, low-income countries are those with a per capita income below US$ 995; lower middle-income countries are with a per capita income ranging from US$ 996 to US$ 3895; higher middle-income countries are with a per capita income varying from $ 3896 to $ 12055; countries with a per capita income of more than $12236 are classified as higher-income economies.

Some low-income countries have joined the ranks of middle-income group by attracting FDI, and developing scaled manufacturing industries. With the development of economy, the emergence of series of social problems, including unbalanced structuring, increasing labor cost, enlarging income gap, and deepen social conflicts, have become the obstacles for China's enter to high-income class.

Currently, the GDP per capita of China is roughly US$ 10,000, which belongs to higher middle-income countries, and not far from the standard of high-income countries. What we are concerned is that social problems appeared along with the economic development and the country is witnessing a slowdown in growth rate as a whole. Such problems contain a large gap between rich and poor, rising old-age dependency ratio, increasing labor cost, high dependency on real-estate and infrastructure, and slow technological progress.

In response to this downward trend, China has enacted a series of reform strategies, in the form of policies covering industrial development, capital market, financial market policies, and regional development, nevertheless, in our observation, these policies have not effectively preserved the situation. As a consequence, one of the risks we need to be concerned is that China is at particularly high risk of falling into the middle-income trap in the coming few years.

(2) Reform in Capital Market Has been Continuously Deepened

China's stock markets are relatively young compared with foreign markets. Over the past 20 years of development history, central government and supervision authorities have been adjusting the framework and regulations. Since the second half of 2018, China's stock market entered a new phrase with a remarkable revolution, which has further deepened and has significantly impacted the M&A sector. Main changes took place as below:

The government was determined to construct a multi-tiered and comprehensive framework of the capital market. Current structure consists of Shanghai and Shenzhen Main Board, SME Board and ChiNext Board as the core platform for equity trading, which obviously could not satisfy the requirements of economic development and industrial upgrade. Under such circumstances, China launched the Science and Technology Innovation Board, a new Nasdaq-style tech board, and allowed a company to go public by relying on a registration. Meanwhile, “New Third Board” was reemphasized as a transitional plate where selective companies listed on this board are entitled to be listed on the Shanghai and Shenzhen Stock Exchange. Related laws and regulations have been revised. Such changes of the capital market would significantly make a great difference to the valuation of different sectors and the investment behaviors in the market.

(3) COVID-19’s Continuous Impact on Global Economy and Government Polices

The whole world, including China, is suffering from the economic disruption caused by the COVID-19 pandemic, in the short term, reflecting the reality that the demand side is damaged and the supply side is interrupted. It is foreseeable that the world would experience the impact of COVID-19 pandemic in a relatively long period.

On the other hand, governments around the world would adjust policies in order to tackle this situation. Possible changes are:

Governments worldwide are inclined to tighten global trade policies, and some countries might implement anti-globalization and trade protection policies from the perspective of ensuring the security of the strategic materials, preventing and controlling the epidemic, supporting domestic enterprises, and improving employment rate. This would reduce potential for global economic development and cause serious damage to export-oriented companies.

To protect the financial system from being destroyed by the pandemic, many countries are likely to adopt more aggressive monetary and fiscal policies, which on the other hand would produce more instability and risks to the financial market, leading to a liquidity and valuation change of financial products.

The development of emerging industries and technological progress would be expedited due to the continuous impact the pandemic on economic development, government policies, and citizen living habits. For instance, the government is vigorously developing 5G technology, online promotion and distribution, bio-pharmaceutical and industrial automation, as well as supporting the emerging industries like information technologies, high-end equipment, new energy and new material.

(4) New Infrastructure Investment Will Become the Main Focus of Government Expenditure

The annual Central Economic Work Conference, held in Beijing from 19th Jan to 21st Jan, 2018, defined “new infrastructure construction” as 5G, artificial intelligence, industrial internet, and internet of things. Afterward, “new infrastructure construction” was highlighted in Government Work Reports of 2019.

With its tremendous potential in investment demand, trillions of dollars would be switched to new infrastructure construction, squeezing the market shares of traditional infrastructure, thus changing the structure of government expenditure accordingly.

(5) M&A is Playing A More and More Important Role in the National Economy

Based on existing central policy, M&A is considered as a crucial tool for China's economic transformation and sustainable development. On-going efforts were put by Chinese government to introduce various strategies to promote the development of M&A business.

As analyzed in the previous chapter, it is quite possible that China is trapped in the middle-income dilemma, to escape from this situation and improve the GDP per capita, M&A could serve as an effective method for companies to acquire new technology and encourage market performance, thus to optimize resources allocation and regain productivity growth.

To develop emerging industries, technological companies could take full advantage of M&A to actively acquire technology and innovation and maintain competitiveness.

6.2.2 Changes in Policy Climate

Among the factors in the section 6.2.1, the policy change is vital to the development of M&A fund and thus would be emphasized in the near future. In the late 2018 policies and regulations were released to enhance the development of M&A in the capital market, which can be classified to following categories:

(1) Facilitate the approval procedure of M&A projects

In October 2018, the China Securities Regulatory Commission introduced the "small and fast" mechanism so as to ensure the efficiency of small-scale M&A cases. At the same time, the approval over the different levels of M&A case was also accelerated and further benefit the implementation accordingly to a great extent. Afterward, the "audit separation system" explicitly exempting or accelerating the approval of strategic industries of high-end manufacturing and aerospace technology was soon introduced by China Securities Regulatory Commission.

(2) Introduce the "New Regulations on Refinancing" to fully loosen the regulatory requirements

In February 2020, the implementation of new regulations on refinancing fully loosened the regulatory policies for refinancing instruments such as private placement to specific institutional investors by listed companies, which are mainly related to the conditions and scale of issuance, lock-up period, pricing restrictions, use of funds, etc. These policies have extensively activated the capital market, hence resulting in a bigger increase of fixed-increasing projects by listed companies in the first quarter of 2020 than previous years.

(3) Drive innovation of financial instrument with pledges to stimulate M&A

In November 2018, such innovative financial instruments as targeted convertible bonds were launched to enhance the fund-raising capability of listed companies. Apart from being a predetermined amount of the underlying company's equity, the targeted convertible bonds were permitted by the regulator to be applied to M&A projects.

(4) Reduce the threshold for the issuance of acquisition and reorganization funds

It was obvious that the threshold for the issuance of acquisition funds were loose, and supervision was reduced, thus to encourage funds to flow into the market and accelerate the implementation of M&A projects.

(5) Build a multi-level capital market system

The Launching of Science and Technology Innovation Board (SSE STAR Market) at the Shanghai Stock Exchange was a milestone throughout the development of Chinese capital market. Currently the market consists of traditional platforms (Shanghai and Shenzhen Main Board, SME Board), emerging platforms (Sci-Tech innovation board and ChiNext Board after revolution), selective NEEQ, non-selective NEEQ and regional equity trading markets. Each of them is clearly distinguished from others according to different investors, trading methods and institutional supervisions respectively.

(6) Experiment with the registration-based IPO system

The registration-based IPO system corresponding to Science and Technology Innovation Board was a remarkable institutional innovation that changed the basic logic of domestic capital market. The wider investment landscape and diversified exit mechanism indeed unlocked a broader horizon for equity trading.

The fulfillment of relevant policies mentioned above has shown China's utmost determination to support the development of M&A. Besides, further supporting measures are expected to be launched and implemented continuously. As we can see from the actions taken, it is doubtless that the importance of acquisition and reorganization has been increasingly accepted by the government. M&A will be adopted as an effective instrument to boost market vitality and economic growth.

6.3 Discussion on Strategies for Developing M&A Funds

Based on the analysis of industrial characteristics, market development, economic prosperity, and domestic policies environment, here are seven practical strategies for development of mergers and acquisition funds in China in the coming years.

(1) Upcoming 5 to10 years would be a golden age for M&A Funds

The research herein suggested that government policies, market demand, supply of capital, legal construction, market valuation and market vitality are of positive impact on the development of M&A funds. It is widely believed that all these factors are being improved and optimized gradually in China, in addition, the stock market rebounded from the bottom would directly stimulate the expansion of M&A Funds, increase more channels for financing and the odds of higher investment return.

(2) Focus on controlling acquisitions

Regarding M&A funds, the most crucial factor of satisfying investment performance is determined by smooth implementation of the restructuring plan. In consideration of the short-term credit environment and legal construction throughout the country, the acquirer needs the controlling rights of the target companies. Relying on other parties like management team and other shareholders to finish restructure is on the verge of extreme danger. The control over the acquired companies is firmly believed to be the key factor of fundamental performance improvement and valuation enhancement after project implementation.

(3) Corporate management: focus on projects with less dependency on management

Conflicts between the management team and shareholders are regular in acquisition, especially in China. When companies highly depend on the management team, such essential resources as human resources, distribution channels, and suppliers are completely and tightly held. Shareholders' plans and ideas over company management are often opposed by the management team in case of inconsistent personal interest each other.

With regard to typical scenarios, the M&A fund is characterized by short duration of investment in a company, therefore severe conflict with the management team might disturb the implementation and exiting of the projects. Instead, if companies less dependent on the management team are taken, M&A fund is likely to obtain advantages when competing with the management team. Some extreme cases revealed that the restructure of whole management team without negative effects on the company's business operation is possible.

(4) Industry selection: focus on company with highly independency on technological research and innovation

In reference to industry, the technological company heavily concentrating on research and innovation is not optimal option of M&A funds because of high risk of huge investment in the R&D, uncertain development routes, market acceptance and cost prediction, and high market valuation. These features are not totally compatible with M&A funds' duration of investment, evaluation and team professionalism.

(5) Pay attention to resources reallocation and cross-industry integration

A successful restructure and integration after the acquisition is also regarded as the key to good performance of the M&A funds, and yet many projects hardly live up to expectations due to inadequate effort in the past years. It is now commonly believed that a fruitful outcome of the M&A projects is far away from reality if multiple resources including but not limited to industry resources, capital resources, land resources, and government relations are not integrated in an effective way.

(6) Seek for more stable long-term channels for fund raising

The fund-raising channel of domestic private equity funds mainly banks on high-net-wealth individuals. Ahead of short investment duration and poor risk tolerance, this method largely restricts the operation of M&A funds. Therefore, the access to more stable long term capital is no other than an urgent task.

One of the feasible solutions is to acquire a listed company, through which both investment projects and fund can be achieved by issuing shares or long-period corporate bonds. Compared with fund raising from wealthy individuals, this channel turns out to be more stable and sustainable.

On the other hand, the high quality fund of funds (FOF) or industrial capital, which are initiated or founded by government organizations, state-owned enterprises, and major financial institutions, are absolutely considered to be a good choice as well because they are typically compatible with the LP of M&A funds as regards investment principles and fundraising capability, and bring the M&A team's expertise into full play.

(7) Cross-border asset acquisitions should be emphasized

Recent policies believed that China has made solid efforts to escape the middle-income trap by rapid industrial upgrades and technological breakthroughs. Subsequently, mergers and acquisitions of emerging industries would be encouraged by the government and supervision authorities to further attract government-funded investment platforms.

Such target projects matching the criteria are mostly located overseas, including some foreign companies and well-established Chinese-funded listed companies on foreign markets. As a result, the focus of M&A funds should be shifted gradually from domestic markets to foreign fields accordingly.

Currently a great loss to the international financial industry caused by the Covid-19 pandemic has significantly undervalued some of the high-quality high-tech companies listed or not yet listed. Despite sharp decline, the domestic stock market renders high valuation and multiple exit mechanisms for high-tech companies. By this way, plenty of opportunities are generated for M&A funds. In conclusion, the “bringing in” of quality companies from foreign markets is considered feasible at present and in the future.

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