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The rise of global protectionism will not stymie Chinese deal-making

China ends 2016 as the leading acquirer of foreign companies – the third year in a row that it has topped the outbound M&A league table. Chinese companies collectively spent nearly $200 billion buying their foreign counterparts in the first nine months of 2016, with that number expected to swell further before the year closes.

The country's historical emphasis on resources has been replaced with a desire to diversify its risk and asset base, with a host of deals transacted this year across a multitude of sectors ranging from technology to distribution and agriculture.

China's appetite for deals in the tech space was highlighted recently by Ctrip's £1.5 billion acquisition of the British online travel group, Skyscanner. In the agricultural arena, ChemChina's US$43 billion purchase of Swiss seed and agro-chemicals giant Syngenta, agreed in February of 2016 and expected to close early in 2017, showcases China's interest in the agricultural industry.

But if the critics are to be believed, 2017 is likely to see the end of China's outbound boom with China's investment in foreign companies coming to a juddering halt.

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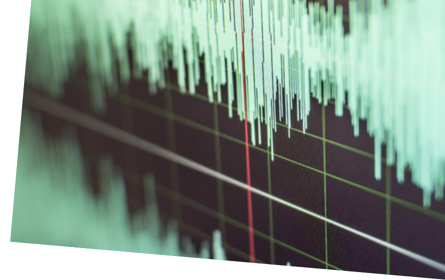

Those critics increasingly point to the seismic shift in global political sentiment as a primary reason for the end of China's overseas acquisition spree. They argue that the surprise November election of Donald Trump and the Brexit vote in the UK in June reflect a rising tide of new protectionism in response to globalisation.

With greater focus on domestic concerns, the critics believe regulators are more likely to raise an increased number of objections to cross-border deals, including those which would have been waved readily through in the recent past. And it is easy to understand why this train of thought is gaining traction.

The decisions by both German regulators and, latterly, US President Obama to block the Fujian Grand Chip Investment Fund's $750 million acquisition of technology group, Aixtron, came as a surprise to many observers. Coming hard on the heels of the re-opening and blocking by the New Zealand government of the previously approved acquisition of a large cattle and sheep operation by Pengxin Group late last year, these decisions represent supposed proof that the starting pistol on a global regulatory crackdown has been fired.

But while politicians talk tough, emphasising the need for early stage assessment by dealmakers of the scope for "public interest" intervention in every relevant jurisdiction, there is little evidence to suggest that western protectionism will stymie the flow of Chinese deal- making beyond a few specific sensitive cases.

Critics pointing to the beginning of the end of the China outbound trend are also quick to cite to tougher Chinese domestic obstacles that corporates need to navigate in order to get cross-border deals sanctioned.

The change in Chinese law that now makes executives in state-owned enterprises liable for some of their decisions for life, is one example often cited. Once again, the impact appears overstated with only the riskiest, most highly speculative, deals, or deals that result in huge losses of state-owned assets, being impacted.

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Similarly, whilst we do see greater uncertainty around the process and timing for transactions involving capital outflows from China, suggestions that the Chinese government's crackdown on capital flight will curb outbound deal-making seem overdone.

In recent years, many of the front line deal monitoring and supervision duties have been delegated to the State Administration of Foreign Exchange (SAFE) which is increasingly focusing on macro supervision - rather than black letter law and rulemaking. Reported internal guidance from the Shanghai branch of

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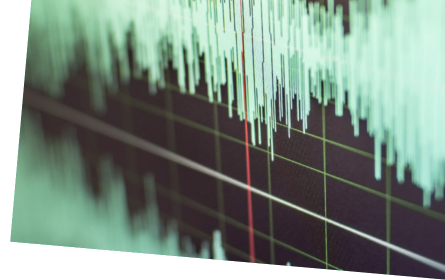

SAFE points to a multi-authority "authenticity and compliance" gating review for transactions involving outflows of US$5m or more in RMB or foreign currency; and review by SAFE at the second threshold of US$50m.

This approach seems to be replicated in other parts of China, although, in the absence of standardized regulation from SAFE, appears in differing forms. Consequently, this increased supervision may slow deal flow, so transaction planners certainly should factor in a potential impact, but does not mean outbound activity will grind to a halt.

While foreign exchange outflows certainly are more closely scrutinised nowadays and may experience delays, meaning deal conditionality and finance requires more attention than ever, Chinese authorities will continue to green flag deals that are genuine and make clear strategic sense. China has, in the last few years, progressively reduced the red tape on approvals for outbound deals to the point where for the vast majority of acquisitions, it is now largely a record filing, rather than approval, driven process.

What is clear is that Chinese officials increasingly want to better understand the specific rationale behind a deal. They want to kick the tyres and make sure that a purchase is being undertaken for legitimate business reasons and not just to shift funds offshore in the absence of a genuine underlying transaction. In my view, the recent tightening is a 'bump in the road' which will not change the overall trend that is to put in place, piece by piece, the building blocks for an eventual transition to liberalization of the capital account.

This transition to liberalization in recent years has helped to diminish, albeit not eliminate, the influence of the historical 'China premium', when sellers would price in the uncertainty of the Chinese approvals process, in terms of money and time when choosing suitors on a deal. The recent crackdown may dent confidence in the short term, particularly in terms of meeting payment deadlines, but this impact will fade over time once the workings of the new reviews become clearer.

I would argue that in many ways today's Chinese corporates are in a much more fortunate position than their predecessors, who had to wade through a formal approval process where timing was indeed uncertain. Outbound investment is becoming a much simpler process to navigate and those pursuing legitimate deals that make sense in non-sensitive countries and sectors have little to fear.

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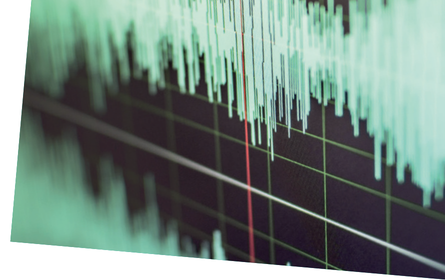

The need for China's leading companies to diversify away from reliance on the domestic market during a period of slower economic growth remains acute. The Peoples' Republic remains underweight in a number of key sectors. Chinese products continue to suffer from a lack of distribution channels and brands in other markets. And for a country that has the second largest global economy, China has surprisingly few globally recognised brands.

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This desire, and need, to diversify, coupled with healthy corporate balance sheets and increasing management sophistication, means that Chinese companies will continue to look outbound in 2017.

Yes, there will be some difficulties, delays and setbacks along the road. Yes, regulatory and administrative processes in both China and "target" countries will need to be looked at even more carefully and factored into deal-making at an ever earlier stage. Yes, some deals may not be as easy to close. But fundamentally the arguments and rationale for China to continue to invest huge sums overseas remain as cogent and compelling as ever.

And in the unlikely event that a door is closed in any given jurisdiction, China will turn its attention elsewhere, or simply bide its time.

Outbound is a long game.

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