Comparison analysis of building a new factory verses acquiring
an existing one for operating in the Chinese market.
ABSTRACT

This thesis is written based on the case of the company Rotork. The case took place at the beginning of 2000. This thesis provides a comparison analysis of which is more beneficial for a globally operating industrial manufacturing company in Chinese market: building of a new factory or acquire the existing one.

The main sources of information and data are interviews of the decision-making personnel of the company and an analysis of existing sources of the related topic such as professional literature and articles. The examination of the topic is provided through different factors and aspects. Analysis of the case from these factors and aspects helped to get a fulfilled answer to the given question in this strategic transaction processes.

After provided research and analysis of the question the following conclusions and recommendation were given. It was clearly identified what was more beneficial for Rotork company in this strategic transaction case and why. In conclusion it was briefly stated the future paths of both companies, which was time proof of the correctly made decision for all the parties.

Keywords

Acquisition, horizontal acquisition, building new manufacturing facility, international company.
CONTENTS

ACKNOWLEDGMENT ............................................................................................................ 1

1 INTRODUCTION ................................................................................................................ 1
   1.1 Purpose of this Thesis ................................................................................................. 1
   1.2 Research Question ................................................................................................. 1
   1.3 Research Objectives ............................................................................................... 1
   1.4 Research Methods .................................................................................................. 2
   1.5 Limitation of the Thesis ......................................................................................... 2

2 CASE STUDY BACKGROUND ............................................................................................ 3
   2.1 About the Case Company: Rotork .......................................................................... 3
   2.2 The Company Business Model ............................................................................. 3
      2.2.1 Technological leadership ................................................................................ 3
      2.2.2 Closer to the Customer ................................................................................... 3
      2.2.3 Enhancing the Product Portfolio .................................................................... 3
      2.2.4 Outsourced Production Model and Supply Chain ..................................... 4
   2.3 Rotork strategy ...................................................................................................... 4
      2.3.1 Profitable sales ............................................................................................... 4
      2.3.2 Acquisition policy ......................................................................................... 4
      2.3.3 Rotork human resources .............................................................................. 4
      2.3.4 New product ranges and modifications ....................................................... 5
      2.3.5 Production process and supply chain ............................................................ 5
      2.3.6 Worldwide presence ...................................................................................... 5
      2.3.7 Employee development and corporate social responsibility (CSR) .......... 5
   2.4 About the case ........................................................................................................ 5

3 THEORY OF ACQUISITION AND CHINESE MARKET ...................................................... 6
   3.1 Current situation in Chinese market ..................................................................... 6
   3.2 Process of Acquisition ........................................................................................ 7
   3.3 Why Companies Make Horizontal Acquisitions ................................................. 8
      3.3.1 To build decision .......................................................................................... 8
      3.3.2 To buy decision ............................................................................................ 9
      3.3.3 Benefits for acquirer .................................................................................... 9
   3.4 Why companies do horizontal acquisitions ....................................................... 11
      3.4.1 Business point of view ................................................................................ 11
      3.4.2 Personal goals point of view ...................................................................... 12
   3.5 Financial statements for investment project analysis ........................................... 12
      3.5.1 Accounting rate of return (ARR) ................................................................. 13
      3.5.2 Payback period ......................................................................................... 13
      3.5.3 Net present value ....................................................................................... 13
      3.5.4 Internal rate of return ................................................................................. 13
      3.5.5 Shareholder value analysis (SVA) ............................................................... 14
      3.5.6 Measure of free cash flow ......................................................................... 14
      3.5.7 Value of a company business and shareholders value ......................... 14
      3.5.8 The implications of SVA .......................................................................... 15
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1 INTRODUCTION

1.1 Purpose of this Thesis

The main goal of this thesis is to make a comparison analysis in order to have a clear understanding of what is more beneficial for the internationally operated company Rotork in the Chinese market: to build the factory by its own or to acquire one.

1.2 Research Question

Thesis is written based on the case of current employer Rotork. Rotork is a globally operating industrial manufacturing company with factories and sales offices all over the world. The company also has factories in China. Company expansion policy is mostly through acquisitions. The topic should clarify when expanding its business to the Chinese market, is it more beneficial for Rotork to build a factory or to acquire one? This research question appeared during author’s staying in China, where he got interested in the acquisition process in Chinese market, and Rotork case kindly provided by Chinese colleagues was from author’s point of view very interesting to investigate and then to analyses in final thesis.

1.3 Research Objectives

Theory objective is covering such aspects as current situation in Chinese market, theoretical background of acquisition process, basic financial statements of investment analysis. Research objective covers current situation of Rotork and acquiring company back to the time when acquisition case took place. Interview of decision-making management and other involved company personal including Chinese colleagues took place in order to gather the data of the case. Further, based on above
explored theory and obtained data analysis of what is more beneficial for Rotork on long-term run, from financial point of view, and also including compliance with company values and standards, global quality management, employee values, intercompany cooperation, etc. was provided. Based on the analysis and conclusions following recommendations for the case were given.

1.4 Research Methods

The research methods which were mainly applied to get the information and necessary data are an interview of decision-making management and other involved company personal including Chinese colleagues, company financial data analysis.

1.5 Limitation of the Thesis

The potential challenges of this work could be total or temporary inaccessibility of top management, along with some data.
2 CASE STUDY BACKGROUND

2.1 About the Case Company: Rotork

Rotork is a manufacturing company and market leader, producing its products for industrial applications for any kind of technological process. The product range covers all the main industries such as oil, gas, mining, nuclear, marine, energy, etc. The company operates globally with 26 manufacturing facilities and over 150 offices all over the world. Rotork is represented in almost 100 countries and has over 3500 employees. The main manufacturing facilities are located in such countries as the United Kingdom, Netherlands, Italy, Germany, China, Spain, the United States, Malaysia, India, Sweden. (Rotork company annual report 2016)

2.2 The Company Business Model

The company business model and its corporate culture are organized in a way to provide the customers with high-quality products and services in whatever place it is needed, in any complex application, it could be all over the world. To achieve, this company needs to conceptualize its business model as follows.

2.2.1 Technological leadership

The company products operate in very different environmental conditions, mostly in very harsh ones (such as nuclear or offshore, or under extreme cold temperatures). These applications require sustainable and uninterruptible operating equipment. This is why Rotork ensures the design and delivery of only reliable and high-quality products. In order to provide the best solution to its customer, Rotork needs to invest a significant amount in Research and Development. All the new designs are tested and checked to obtain modern and reliable solutions.

2.2.2 Closer to the Customer

Rotork provides high quality products and services all over the world. This is why the company is so widely represented in many countries with direct representative offices, logistic and service centers. It aims to be as close to the customer as possible and react to any case as fast as possible.

2.2.3 Enhancing the Product Portfolio

Rotork continues to enhance its product range in order to meet all the possible needs of its clients to have one-stop reliable supplier. This is achieved by a continuous acquisition strategy. During the last years, the
company has acquired several more companies, which in turn helped to enter new markets.

2.2.4 Outsourced Production Model and Supply Chain

Rotork cooperate only with the most reliable suppliers and factories to get the best components for its products. Almost all the company products are produced using outsourced manufacturing model. That means that delivered components are only assembled by company workforce. Rotork has built a global network of reliable suppliers of high-quality components.

2.3 Rotork strategy

Rotork strategy can be shortly described with following statements:

- “To provide high-quality products and services to its customers;
- Meeting customer needs through global expertise delivered locally;
- Achieving consistent, sustainable and profitable growth;
- Being the employee of choice.” (Rotork company annual report 2016)

To achieve this company follows certain strategic ways in different directions.

2.3.1 Profitable sales

Providing profitable sales growing by means of concentrating on the clients, their needs, enhancing international exposure, entering to new markets, continue to acquire new companies to enlarge product portfolio.

2.3.2 Acquisition policy

Acquisitions is one of the most essential parts of the Company growth strategy. Main principles of acquisition policy are that it deliver to Rotork a new product, a new geographical presence or a new market segment. Frequently, the target will meet two or all of these main principles. The Company has got strict and reasonable pricing policy in acquisition issues.

2.3.3 Rotork human resources

Sales support and site service are the directions where Rotork always continue its development in order to achieve the expected level of
providing customer service. Along with production personnel which is also a very valuable asset for the company optimal production assembling.

2.3.4 New product ranges and modifications

Rotork continuously developing its products, hence, regularly market receives new product versions and modifications, which meet modern market requirements. Significant investments in Research and Development ensure the implementation of this strategic direction.

2.3.5 Production process and supply chain

At all times Rotork has been continuing to develop and modernize its production in order to have the best quality output along with lean manufacturing processes. The Company has outsourced business production model. That means that materials costs are the most essential part of direct costs. In order to implement lean-production strategy Rotork uses its global presence and seeks for the best alternative supply chain solutions. In order to decrease pricing the Company negotiate with existing and look for alternative supply channels.

2.3.6 Worldwide presence

In order to deliver its products and services locally Rotork always enhancing its worldwide presence through new representative offices, stock and service centers, and establishing new sales channels all over the world.

2.3.7 Employee development and corporate social responsibility (CSR)

The Company put in effort and encourage its employees for development and improvement for future growth. The Company takes care of health and safety in a very strict and uncompromised manner. Rotork also takes precise care of social, environmental, ethical and other issues. For example the Company support and organize different charity events. (Rotork company support and organize different charity events. (Rotork company annual report 2016)

2.4 About the case

In the middle of 1990’s Rotork entered Chinese market with direct presence there, with production in its European facilities. In early 2000’s Rotork found out that another company (from here on is referred to as Company B) started to make some copy of the core product of Rotork. Then Rotork started investigating this company. Company B used to belong to OEM company, which was on of Rotork clients buying this core product
from Rotork for some oil & gas projects. Later on this OEM company found that this core product manufacturing is a good business in China. After a long time design and copy, this OEM company began to set up a new company called company B to make copy of this Rotork core product. At the first stage, the quality of the copies were very poor. Since the appearance of those copies was quite similar to Rotork core product, many customers came to Rotork office to complain. On the one hand Rotork explained to the customers about this product copy, on the other hand Rotork contacted with company B, pretesting about their irresponsible deed. Rotork planned two ways to react with company B. Action 1: if company B was negotiable, Rotork could acquire their business to stop this copy action. On this foundation, Rotork would start to manufacture locally its core product (which originally was producing in the European facility) to prevent future copy actions. Action 2: if company B was not reasonable, Rotork would file a law suit to them for their infringement. (Interview 1, Man, Rotork, Beijing, July 2017)

3 THEORY OF ACQUISITION AND CHINESE MARKET

3.1 Current situation in Chinese market

Nowadays China continue to be one of the most attractive places in the world for investors. A lot of companies considering and opening new investments into Chinese market. Many of them favorite the merger and acquisition as a way of investing (Metropolitan Corporate Counsel). Merger and Acquisition are the investing principles, where in merger there are two and bigger amount of companies combining with one another to form single legal entity. In acquisition in its turn one of the firm usually having much bigger business, than the one which being acquired (Vernimmen et al., 2009). Nowadays, due to world-wide business internationalization process the term International Merger and Acquisition has become very popular. It means that one of the local firms combining with Foreign Direct Investment (Pan, 2006).

China has become a very attractive country for foreign investments due to many reasons. Some of them are that China is one of the fastest (if not to say the fastest) developing economies in the world with the biggest population and economy reformations. Economy reformations are taken as one of the key factors in order to improve business investing environment in the country. It has started in 1978 by Reform and Open Door Policy. It is also worth mentioning that huge effort was also put into improving the infrastructure, which plays essential role for attracting new businesses as well. Since then Chinese government were implementing action and policies in order to increase attraction of foreign capital inflow. (Xi Chen, 2011)

One of the most significant steps to encourage Chinese private companies for foreign merger and acquisitions was published in 2005 “Several

China for a long time used to be planned economy. Nowadays China still have major amount of assets in State Owned Enterprises (Sun, 2000). Due to not the most efficient way of operation of these State Own Enterprises Chinese government in recent years put essential steps forward reorganizing the way of operation of State Own Enterprises in order to adapt them to market oriented economy and make their operation and assets utilization more efficient (Xi Chen, 2011).

Considering these last changes and reforms along with accessibility to lower labour costs, advancing infrastructure, fast availability of different supplies and components, scale of economy, manufacturing experience and efficiency, China has become one of the most attractive places for foreign investments in the world. Not mentioning that China itself is one of the largest market in the world.

Due to all the above-mentioned reasons many businesses around the world considered to look for the investing opportunities into Chinese market. One of the most attractive way to do it has become the merger and acquisition.

Why? Due to many reasons. For example, to establish your own presence in the country like China without having a proper partner is very hard because of different issues such legal, dealing and way of business behaviour including inter- and cross-cultural struggles. Along with that it will take long time to run from the beginning business in new country, to get experience and to understand lots of things during the way by your own. On the other hand if you do it with existing company it saves you lots of time, management, and capital recourses for faster and easier access to the Chinese market. (Xi Chen, 2011).

In 1995 Chinese government issued policy for protecting assets of State Owned Enterprises (The Central People’s Government of the People’s Republic of China, 1995). In accordance with this law it is prohibited to transit assets of State Owned Enterprises upon foreign investors. After that in 1998 and 2001 (Invest in China, 1998; China Securities Regulatory Commission, 2001) Chinese government issued new rules, which helped to open Chinese market for foreign Merger and Acquisitions. And finally in 2001 China entered the World Trade Organization. This process helped step by step for Chinese companies to integrate into globalization process. After that new rules and laws appeared to decrease limitations of foreign investment into State Owned Enterprises. That means that from now on interests and opportunities in Mergers and Acquisitions with Chinese firms had been dramatically increased for foreign companies (Yao, 2008).

### 3.2 Process of Acquisition

Nowadays acquisition strategy has become one of the most popular to grow a business. In almost all the business cases to acquire or to be
acquired of/by a company might be one of the most significant decision to be made for both sides of the deal. For one it might become an essential opportunity to enhance its presence and shoot ahead on the market. For another one it is mainly a ‘game over’ decision. (M. Frankel, 2005)

What is the process of acquisition? A process of acquisition involves two or several companies, during which one company obtains (acquire) majority or the whole piece of another company and take control of it fully or partly. (Acquisition, A. Roberts, et.al, 2010)

Defines two types of acquisition horizontal and vertical. When a firm or a company acquire another one which produce the same products (or services) in order to get better market or industry position it is called horizontal acquisition. This type of acquisition is implemented when company need to have a growth in profit by enhancing its business. Some times it is also applied in order to kill the competition. On the other hand vertical acquisition is a type of acquisition when one company fulfil its business process with another firm. For example fulfilling some parts of supply chain in order to become full cycle production company. (Ovidijus Jurevicius, 24.03.2013; Vertical integration and horizontal integration, MBA Crystal Ball)

Since the case of this thesis is certainly horizontal acquisition case, let us look at both sides of the deal by answering two questions: Why do companies do a horizontal acquisition and why companies accept a horizontal acquisition, and what they benefit from them.

### 3.3 Why Companies Make Horizontal Acquisitions

When we think of acquisition process we need to consider not only the reasons which are the best for a company, but a personal goals of key players as well. In this case we will mainly analyse acquisition process from the business point of view. However, sometimes we might touch personal interests of key decision makers as well, since some times it might play not the least role in the deal. (E. Miller, 2008)

In vast majority of cases in nowadays practice, there is a choice between to build against to purchase one. The decision is usually about the cost, period of realization (time issue), and reasonability.

#### 3.3.1 To build decision

One of the advantages of this strategic decision is that company can create a facility upon its desires and expectations. Exactly how they planned. Another one is that to build a facility is normally cheaper than acquire similar ones, since you acquire not only a facility but an operating business itself. During the building process company can adjust the process if there is a need providing flexibility advantage over to buy decision, where you certainly lack this advantage. And what is also very important is that construction goes totally under the control of a company.
On the other hand this decision has certain drawbacks. One of them is that one might need to have a certain proficiency in the construction process which it might be lack of. This disadvantage might come from different directions and not only in construction itself, but more often if it is to be done on the territory of the country with different unknown regulation and procedures, different cultural background, etc. Another one is the time issue, since construction process is usually very time consuming process. And during this time a company may lose its potential position on the market. Especially if it requires fast actions to get one. One more to be mentioned here is that facility construction process usually take some time and effort from top management. Basically it distracts them from other possible actions and seeking for new opportunities for a company. (M. Frankel, 2005)

3.3.2 To buy decision

To buy decision looks like an easier way. Since it has normally way much faster than construction one. By acquiring a company one not only gets the facility but also immediately gain a certain competencies in an area. And here, as we mentioned earlier, it can be not only manufacturing skills, but also understanding of country laws and regulations, cultural matching and many others.

On the other side of the coin lays down such drawbacks like cost of acquiring a company. It is normally much more expensive than to construct your own facility. On top of it you also often need to pay a big amount of money straight away, so financing of the deal can be an issue for the company as well. Other issues might come out of integration process such as corporate and cultural mismatching and other disappointed expectations of a buyer. Another disadvantage comes from uncertainty in evaluation process, since acquirer might have some difficulties to obtaining all the needed right and precise information for company evaluation. (Ovidijus Jurevicius, 24.03.2013, M. Frankel, 2005)

3.3.3 Benefits for acquirer

If finally company decided to go with ‘to buy decision’ then what kind of benefits in can reap out of it?

One of them is **higher efficiency** (due to **economy of scale**) of the bigger company, which comes from the combined recourses of two or several companies. It is particularly true in the case if company business highly consists of fixed costs. Then by increasing the market share a company will be able to sell more products and obtain more profit. But this is only true when this new acquired company’s customer base is being served from existing facility of acquirer or vice versa. (Umar Farooq, 04.17.2014; M. Frankel, 2005, E. Miller, 2008)
Another one is frequently named as a **geographical enhancement**. Which often appears when a company enhancing its business in a different territory, mainly in a different country. It comes down to two parts of it: domestic market competencies and local market functioning. By obtaining an operating company in an uncommon domestic market acquirer gets comprehension of business operation issues (e.g. partners, suppliers, etc.), local customer behaviour, along with regulators and its standards, and many other issues which may arise when the one is coming to a new geographical zone. Especially when it differs significantly from the region a company is from itself. (M. Frankel, 2005)

**Clients’ pool – market share**

Clients are often to be considered as one of the most important advantage to do a horizontal acquisition and definitely one of the more frequently mentioned. E.g. acquirer might be looking for another client’s segments or to absorb a new potential key clients of the market. Some times in some local markets key accounts (especially for governmental procurements) might be looking for domestically produced products and equipment. Here acquisition of domestic manufacture can also be a very fast and efficient solution to obtain such orders. Though there might be another side of the coin called degradation, when some clients may abandon acquirer when it gets its local production or associated with particular acquiree. (E. Miller, 2008)

Another significant reason to acquire a company might be its **product/service or/and technology (know-how)**. Whether it is some know-how of product/service or its production process. After a strategic transaction completed acquirer might take advantage of optimizing the process and reducing the costs by, for example, leaving some unnecessary staff out. Usually company will remain only those who are actually possess certain know-how competencies in product or its production process. This also takes advantage over ‘to build decision’ since it saves the time no only for constructing and Research and Development of a product, but also significant time to get this operation and production on a proper level after its start-up. (M. Frankel, 2005)

**Brand** in some cases can be very valuable motive to buy a certain company since it gives a recognition and association to particular customers in particular markets. And sometimes to be associated with certain brand can become very beneficial for some companies. Though many sources tell that this advantage is especially difficult to measure.

**Human resources**

Operating personnel is another good reason to make an acquisition. Since while constructing a new factory company needs to spend significant amount of time to build and to hire the personnel. And in this sense it also needs resources and time to find and hire the personnel (or companies), to build manufacturing facilities as well, not only the staff, which will be working there. And time sometimes may be very crucial factor when
entering specific markets. However, when the personnel of acquired company is essential asset it can be also a great threat to acquirer, since they may decide to get out of the company right or some time after the transaction is completed. Nevertheless, there can be another way, when acquirer can say “good-bye” to some staff of acquired company and leave only the essential one decreasing and optimizing the costs. (M. Frankel, 2005)

**Market position development** is another plus of acquiring strategy. An example here could be obtaining your direct competitor in order to reduce the competition on the market and become a bigger player in the industry. It is also a good advantage over ‘to build decision’ since it is normally very difficult to accomplish significant step forward in a market within short period of time by constructing your own facility. (E. Miller, 2008; Ovidijus Jurevicius, 24.03.2013)

From mentioned above we can conclude that acquiring a company looks like an easier option for the one, since it offers you speed benefit and immediate gaining of competencies, along with other mentioned advantages. However, it has notable drawbacks as it can be very expensive, company may struggle cultural and corporate values mismatching, limitations of company business analysis, which may lead to uncertainties in evaluation. (M. Frankel, 2005, E. Miller, 2008; Ovidijus Jurevicius, 24.03.2013)

### 3.4 Why companies do horizontal acquisitions

General reply to this question might be that companies believe that they can get more money from selling it rather than operating it. However, let us take a closer look to the particular reasons of choosing to sell option, since as was mentioned before for one it can be ‘the game over’ decision. As usual reasons can be out of business and personal ones.

#### 3.4.1 Business point of view

From the business point of view one of the reasons to be acquired can be if the company business has reached *saturation* point or very close to it. Since main idea of business is to increase value of its owners, they might decide to invest this proceeds from selling the company into something more promising in growth rather than existing business.

Another reason from business side may come when company *outgrow its own resources*. In other words existing manufacturing capacity or sales network or supply chain or any other company resources are no longer enough for desirable business growth. In this case company might seek for bigger partner which can provide additional abilities for the business growth.
There are two other reasons that are correlated with **period cycling process of market and industry**. Though sometimes these two ‘definitions’ might be taken as something very similar. It means that sometimes in the industry or in the market, especially after picks, may appear ‘bad times’, when all the companies operating in the industry or in the market can struggle decreasing of sales for different kinds of reasons. These down times might be short and long in a period of time. If, for example, a company operating in such an industry or a market could see this coming, and realize that crisis might take significant time and, hence, business decrease, then it might decide that it is a good time to get acquired and invest money out of the deal into increasing market. (M. Frankel, 2005)

3.4.2 Personal goals point of view

From the personal goals point of view reasons can be quite obvious. For owners it can be receiving significant amount of cash at instant moment. For top management it can be becoming a part and taking control of something bigger than just existing business. (M. Frankel, 2005)

3.5 Financial statements for investment project analysis

Before coming into specifics of investing into Chinese market let us focus on basics of decision making and analysis process from Financial and Accounting point of view in general. What are the key indicators and factors for proper investment decision making. Since the purpose of this thesis is a basic analysis, there is no good reason for us to go very deep into financial tools of investment evaluation analysis. However, since financial analysis is inherent part of this sort of decision making, below we will explore the fundamentals of such financial statements.

The importance of investment decision making lays in the facts that it involves big amount of different kinds of capitals. And it is also often very hard and cost consuming to turn back when the investment has taken place.

Below it is shown and explained four fundamental methods of investment analysis.

- Accounting rate of return (ARR)
- Payback period (PP)
- Net present value (NPV)
- Internal rate of return (IRR)

Some examples shows that it could be applied combinations of these methods, though mainly a firm chose one of the methods to analyse the investments. (Atrill, McLaney, 2007)
3.5.1 Accounting rate of return (ARR)

Accounting rate of return means an average annual profit earned by the investing divided by an average investment to earn that profit. It is measured in percentage. The significant drawbacks of this method might come from the fact that ARR is applying for accounting profitability. Nevertheless, more essential to consider is the cash flow, rather than accounting profit, because the real wealth provided by the investment is actually seen by cash. When accounting profitability is more referring to the period based reports. Also when you comparing investments, which are unalike to each other in means of scale and size, the ARR can have certain disadvantages in the analysis as well. (Atrill, McLaney, 2007)

3.5.2 Payback period

Payback period is a time period which is needed for the investment to be payed back from the cash profit of this particular job. It should be able to take advantage of time issue of ARR method. Successful investment means that profit period of the business itself should be longer than pay back period of an investment. The same way company compares if there are several investing opportunities. As a disadvantage of this method on the contrary to the first one it is visible that it does not take into account the actual cash profit of the investment. That means that actual profitability after the time of paying back the investment is not taken into account.

3.5.3 Net present value

Net present value consists of both analysis of two previously mentioned methods, and gives decision making person understanding of expenses and cash inflow from the different investing projects and the time period when these expenses will be overcome. In other words this one combines advantages of ARR and Payback period methods and eliminate their major drawbacks.

3.5.4 Internal rate of return

Internal rate of return providing understanding of investment return. It is often considered to go along with NPV approach. These two discounting methods are now are widely utilized in the investment analysis practices. Another important fact to consider is risk analysis, because the longer time of investment project the bigger chance to have something goes not in a way it was expected, along with the bigger the project the bigger affect to the business it might have if something goes wrong (Atrill, McLaney, 2007). Also for a long term cost analysis it is essentially important to analyse such things as organizational integration, conflicts of corporate cultures and
brain drain, management conflicts issues, cross-cultural differences in mind-set of employees, communication issues and many others. All these factors must be identified and taken into account as well as financial indicators. Along with the investment analysis itself a company should value the potentially acquired firm.

3.5.5 Shareholder value analysis (SVA)

If net present value of cash income from the investment is on the maximum level it means that the company value (shareholders return) is also on its maximum level. It leads us to the fact that the firm business can be evaluated as an investment opportunity. That means to get shareholders return on a maximum level the equal method can be applied. The method is called Shareholder value analysis (SVA).

3.5.6 Measure of free cash flow

Free cash flow refers to the cash utilized to evaluate the whole business value. It means that it is equal to the net cash from process after paying taxes and extra investing capital.

3.5.7 Value of a company business and shareholders value

Value of a company business and shareholders value does not always mean the same thing. It is represented as: shareholders value equals to the whole business value minus loan capital. Concluding mentioned above about Shareholder value analysis (SVA) it can be seen that SVA can be successfully applied in different matters. Such as acquiring new business or vice versa selling the business; also in advancing new product portfolio or new markets; business reorganization. It is worth to mention that it is essential evaluation method due to taking into consideration all the cases which are determining shareholders value. The Fig. 1. representing obtaining process of the shareholders value.
3.5.8 The implications of SVA

When applying Shareholders value analysis it is worth to mention that there could be several issues arisen. Such as cash flow future forecast still might not be as accurate as it would like to be due to inevitability to implement some assumptions.

3.5.9 Economic value added (EVA)

The economic profit lays down as a basic principle of Economic value added. It means that from economic point of view business can be considered as profitable if creates more profit than needed profit of investors. Because the accounting profit itself does not cover the whole account profit needed for investors. In other words Economic value added equals to needed returns of investors multiplied by capital invested (which are the net assets of the business) to be deducted from net operating profit after tax. Growth of shareholders income means positive value of Economic value added of investment project or business. And this method providing a certain way of proper decision making by controlling of invested capitals. With suitable decrease of business effort into an investment project and more efficient way of utilizing existing resources may help for decision makers to increase income of shareholders. That what Economic value added can be very effective to be applied.
3.5.10 Shareholder value analysis and Economic value added Payback period

The both of these values are quite close to each other and after all should provide the same evaluation of shareholders rate. Figure 2. shows shareholders rate is determined by these two methods.

Fig. 2. Shareholders rate determination by EVA and SVA methods (Atrill, McLaney, 2007)

Though there are some advantages and disadvantages to use each particular method. For example, Economic value added method can be applied over traditional accounting measures, while Shareholder value analysis might require some new approaches. Nevertheless, both of them are existing method to analyse the business value. (Atrill, McLaney, 2007)

3.6 Merger and acquisition specifics in China

Since it is clearly for vast majority of business people that Chinese market is one of the largest and one of the most promising for investors, let us now focus on the certain specifics of merger and acquisition in Chinese market. Chinese market is nowadays still very specific market for western investors, in spite of the huge steps forward made in recent history of new laws and regulations. (Lehman Brown). In case of Rotork, which before coming into Chinese market was mainly operating with European manufacturing facilities, so it was doing its acquisitions mainly on European markets. In order to show the main differences of merger and acquisition practices in China in comparison with European countries further it is presented several specific points for European market (where German market was mainly taken as an example, but it is considered that other European markets have very similar features as well) and Chinese market in terms of merger and acquisition.
3.6.1 Specific points of Merger and Acquisition in European markets

1. The country is really opened for foreign investments. There are not many limitations for merger and acquisition there. Only some of them in some special areas like military industry.
2. Different nationalities are accepted in middle and top management.
3. In most of cases governmental approval is not needed for a company operation, just to follow the normal laws and regulations. Only few areas might need some special license to do the business (such as bank sector or similar).
4. Also in general it is not required any governmental approvals to make merger and acquisition in Europe.
5. Transactions of merger and acquisition in general do not need any approvals from governmental trade or other unions.
6. Tax law of Europe needs precise tax due diligence process, an adapted acquisition arrangement.
7. In time consumption point of view merger and acquisition is simple and easy to be accomplished.
8. Certain differences in real estate rights, they are different from the ones applied in China.

3.6.2 Specific points of Merger and Acquisition in China

1. Overseas investments are also welcomed in China, though the process itself is still being under development from the legal issues points of view.
2. There are Pilot Free Trade Zones (FTZ) launched in such key economic centres of China as Shanghai, Guangdong, Tianjin and Fujian. Purposes of these special zones are the reformation and uncover administrative legislations in order to develop investment and trade climate in Chinese market.
3. Overseas investments in ways of merger and acquisitions with local firms authorizations, inspections and registrations requirements. When such acquisition is applied the transaction processes needs the authorizations from Ministry of Commerce or similar authorities.
4. Overseas investments into Chinese market are matters of “Catalogue of Guidance of Foreign Invested Industries”. The edition of 2015 of this document is aimed to deduct the limitation of industries and any other limitation for investors from foreign countries.
5. License for business operation and other governmental approvals are essential in business arrangement in Chinese market.
6. Antimonopoly regulations are applied in Chinese market. Under this term any merger and acquisition needs to go through Ministry of Commerce.
7. In case of merger and acquisition procedures involving state owned companies it is needed to get approvals from different authorities including State-owned Assets Supervision and Administration Commission of the State Council (SASAC) or similar.
8. Overseas investors are allowed to form merger and acquisition transactions by means of acquisitions of shares or assets. After receiving all the required permissions a local firm which are being acquired by overseas investments by share acquisition is created as a foreign-invested enterprise. If firm is acquired by means of assets acquisition, overseas investors should launch a foreign-invested enterprise to run the acquired assets.

9. A company should consider opened risks in due diligence. For example in such matters as taxes, personnel, mislaid or incomplete authorisations and licences and many others. Thus, it is essential to have a thorough due diligence review.

10. In any kind of merger and acquisition an overseas investors need to provide a payment established by law within a certain period of time. (Germany Trade and Invest, 2015)

3.6.3 Important issues and risks of merger and acquisition practices in Chinese market

Despite significant improvements in ways of liberalization of merger and acquisition with foreign investments involved in Chinese market, there are still certain issues and risks of such deals to be taken into account apart of mentioned above ‘imperfections’, which still presented in legal system. (J. Chapman, Foley & Lardner, Linlin Li, Attorney, 2011)

Some of issues and risks are stated below.

1. Management and control issue
   Certain issues may be arisen in terms of rearranging the control of the acquired company, since the company management might not be willing easily to step aside of main company control.

2. Titling and licensing the assets
   Also rearranging the rights and asset titling might be an issue in Chinese acquisition practices.

3. Overestimation of Chinese firms’ values caused by the rising of Chinese stock market
   It may appear in a sense of that sometimes in Chinese stock market it can be seen a lack of utilization of such aspects like price-earnings ratio, investments returns, discounted cash flow and other firm financial evaluation standards.

4. Unreliable financial items
   Unreliable financial items along with relaxed governing conformities and uncertainty of taxations may lead to mismatching of what purchasers are ready to contribute and selling parties are ready to take.

5. Contractual non-conformances
   Contractual non-conformances may be arisen due to real owners may be other people, often relatives or friends. There are some practices of verbal contracts between a firm owners. Also there may be conflicts in contracts between regulations and firm statements and records. It may lead to extra time and efforts consumption in terms of finance and legal issues solving.
In spite of mentioned above there are certain ways to reduce the issues in acquisition cases in Chinese market.

1. To fail to determine a comprehensive statement and acquisition standards;
2. To fail to make wide and detailed business and legal due diligence along with investigation and examining aiming case;
3. A lack of clear idea of the cross-cultural mismatching by straightforward coping the experience from western business models into Chinese market;
4. Do not over rely on interpersonal relations and trust;
5. Do not “blindly” follow “communal” domestic business experience without comprehending its legal competences;
6. To fail to identify unpredictable regulations’ explanations and rules between different governmental stages (such as local, provincial and central governments);
7. To fail to reveal inappropriate linked parties transactions and payments;
8. To fail to comprehend the boundaries of converting essential licenses.

By taking into consideration these some key points and following updating information and practices it might significantly reduce time, money and effort consumption in a process of acquisition in Chinese market (J. Chapman, Foley & Lardner, Linlin Li, Attorney, 2011).
4 RESEARCH OF ROTORK ACQUISITION CASE

The main idea of this thesis is to understand what was more beneficial for Rotork in Chinese market: to acquire a company or to create its own production. For this purpose mentioned in theoretical section statements were analyzed applicable to Rotork and acquiring company case. After analyzing those statement from both sides points of view and assessing possible criteria of price evaluation for such a deal once again the decision-making personnel of Rotork was being interviewed and consulted in order to get final understanding of possible options of the deal. To make this analysis it is necessary to find out information and methods used in the company for acquisition and factory construction procedures. In order to obtain required data and information interviews of decision-making management and other involved company personal including Chinese colleagues took place. (Interview 2, Man, Shanghai, August 2017). After clarifying all the necessary information and comprehend the nature and final result of the deal we also can observe how this decision influenced both sides in the future.

4.1 Why would Rotork do such acquisition

As we observed in Theoretical section there are many different advantages of acquisition doing. Let us go through them in terms of Rotork.

4.1.1 Higher efficiency

One of them is higher efficiency of the bigger company, which comes from the combined recourses of two companies. It’s particularly true in case if company business highly consists of fixed costs. Then by increasing the market share a company will be able to sell more products and obtain more profit. But this is only true when this new acquired company’s customer base is being served from existing facility of Buyer. In case of Rotork it needs to get its manufacturing facility first.

4.1.2 Brand

Another one could’ve been brand target, but in case of Rotork and Company B it is more of advantage for Company B to be acquired by well-known brand as Rotork is.

4.1.3 Market position

Market position sounds more reasonable for Rotork, since it kills the competition on the one hand and reducing a bad reputation of poorly copied actuators on the other.
Along with market position market share and existing customers’ base (including some key customers, since Company B is connected with OEM manufacture, which was purchasing from Rotork before) is probably even more important advantage to do a horizontal acquisition and definitely one of the more frequently mentioned. Though there might be another side of the coin called degradation, when some clients may abandon Rotork after its acquisition with Company B. This can be explained that for example some clients wants to get actuators from the UK rather than locally produced.

4.1.4 Factory and Human resources

Another significant reason to buy is existing manufacturing facilities and operating personnel. While constructing a new factory company needs to spend significant amount of time to build and to hire the personnel. And in this sense it also needs resources and time to find and hire the personnel, which will build manufacturing facilities as well, not only the staff, which will be working there. And time sometimes may be very crucial factor when entering specific markets. For example, if having its own local production is important for local customers, then competitors, which can organize its factory in China faster than Rotork might take some of customers (including potential ones) out from Rotork. However, when the personnel of acquired company is essential asset it can be also a great threat, since they may decide to get out of the company right or some time after the transaction is completed. Nevertheless, there can be another way, when Buyer can say “good-bye” to some staff of acquired company and leave only the necessary one decreasing and optimizing the costs.

4.1.5 Time issue

Another time consuming issue is that after building and starting new manufacturing facility it is often so, that it takes some time to put it on wheels, to get it work properly.

4.1.6 Supply chain

Continue in this direction it is also worth mentioning that another advantage to acquire a company is that it already has its infrastructure and components’ suppliers. While after building the company, it will also take some time and effort to create it. Legal issues and cooperation with regulators are also solved when the factory which is already built.
4.1.7 Control the building process

When a company decide to build, then it can control and make the facility upon its exact expectations. Also while constructing the one can be very flexible with changes over the construction. And building is often considered as less budget consuming scenario than acquisition. Nevertheless, besides mentioned disadvantages of own construction, which basically goes to time issues, there is another one such as top-management and forces destruction, since these resources should be applied to a factory building process.

4.1.8 In General words

Acquiring a company looks like easier option for the one, since it gives you speed benefit and immediate gaining of expertise, along with other advantages mentioned earlier. However, it has significant drawbacks as it can be very expensive, company may struggle cultural and corporate values mismatching, limitations of company business analysis, which may lead to uncertainties in evaluation.

4.2 Why would acquiring company accept such a proposal

4.2.1 Alternative investment

One of the reasons to sell can be alternative investments from company sold money. But in case of Company B they considered actuator business as a promising one.

4.2.2 Market/Industry down time

Another reason could be a bad times on the market. But again I believe it is not about oil and gas industry, since back to those time it should have shown quite solid and continuing growth. Means not the best time to sell from this point of view as well.

4.2.3 Own resources limitation

On the other side, if Company B could see the limit of the future expanding with their own resources (e.g. sales net work, product range, etc.) it could be a good deal for them to combine their forces with Rotork. Since beyond network and new product ranges (such as RFS products and gearboxes) Rotork could also offer internationalization, which means Company B business would go international. Rotork could also offer its well-organized and tested by time management system to make Company B more efficient business as well.
4.2.4 Personal goals

Along with Rotork great resources it could become beneficial from both company business and personal/private point of views to become a part of a much bigger international company with much more opportunities to grow. And owners of Company B could get some materialistic benefits of the deal as well of course.

4.3 What could be a possible price for such a proposal

As we know any acquisition transaction goes along with valuation of the company. Different sources provide different valuation methods and there comparison analysis for particular cases. As could be seen from the theoretical part one of the most common seems to be discounted cash flow (DCF) method. It evaluates how much money company has out of its activity now and in foreseeable future. In order to get this method done we need the information about the company cash flow: operating, financing and investing. We also need to take into account weight average costs of capital (WACC) and risk component. Risk component is very important one since this valuation is based on company forecasts and different factors, which might influence this forecast (such as trends in the industry, market situation, competition, future technology, financial situation, etc.). The last component in this evaluation is terminal value of the company. There is another similar approach called Economic value added, which equals to needed returns of investors multiplied by capital invested (which is the net assets of the business) to be deducted from net operating profit after tax. And as it’s described those two methods should provide very similar results after all.

Other sources provide other different valuation methods such as combination of revenue with net income, or EBITDA, return on equity method. For example, in MSN money for evaluating company performance they provide following statements: Income statement (Revenue; Net income; Profit margin); Balance Sheet (Total assets; Total liabilities; Debt to assets); Cash flow (Operating; Financing; Investing). When thinking about what price could Rotork pay for Company B a mind-map what Company B consists of and what value it can bring to Rotork was created (see Fig. 1.).
Fig. 3. Mind map

The basic idea was that price could Rotork pay for Company B is the sum of factory construction costs + personnel hiring costs + sales income, which could be made during the time of factory construction and starting its operation on proper level + money inflow out of Company B clients’ pool and other synergies (infrastructure, no need for hiring staff, etc.).

Talking about synergies: they must be evaluated as well since they definitely brings some value to the Buyer of the acquired company. The idea of 1+1=3. Synergies here could be the network, existing infrastructure, staff, warehouse, etc.

5 ANALYSIS OF THE CASE

From the interview with General Manager in China, who is in charge of these kind of cases as well, we will analyse through the following questions. (Interview 3, phone call, Man, Shanghai, October 2017) After that analysis part took place as follows.

5.1 Product and production

Rotork and Company B are like a teacher and a student from product production point of view. Since as it was mentioned in introduction of the case study Company B at the beginning was just poorly coping Rotork’s design. That means from this (product manufacturing) point of view Rotork would have to teach and train Company B staff how to make it on a proper level. And it would definitely take some considerable amount of time.

5.2 Customer pool

From the customer pool point of view there is a very little overlap of Rotork and Company B potential customers since companies are positioning their products in different segments. Since Rotork provide high quality premium price segment products, it’s sales operation goes mainly through design institutes and end-users cooperation. When both of them realize the need in outstanding features of premium product they make valve makers or
OEMs to design their equipment based on the specified Rotork features. Company B on the other hand provides low cost products. Then, when valve makers or OEMs can decide themselves what product to go with they might want to purchase Company B products since the price is less and they can earn more profit.

5.3 **Supply chain**

Considering supply chain possible advantage Company B and Rotork also have major differences here. It goes from the demand to suppliers. Rotork has high demand and Company B for their segment needs to have low demand to the suppliers. That is why if integration would take place Rotork would have to anyway reconsider the existing supply chain of Company B.

5.4 **Human resource**

From human resource point of view it is very similar situation as with supply chain since the personnel is very much associated with the company it works for. It would also take from Rotork time whether to educate and retrain the staff or to change some of them. Either way it will take as well as with supply chain. As for the middle and top management for Rotork it would also be hard to keep them since they represents to different corporate cultures.

5.5 **Market position**

Indeed Rotork and Company B have totally different goals from the very beginning of the case. The main goal of Rotork was to kill Company B in order to reduce the competition and source of bad reputation of poorly copied actuators. Company B to the contrary saw good opportunities in actuator production business and wanted to go on with that.

5.6 **Rotork evaluation**

Out of above mentioned we can see that the only reasonable advantages for Rotork are the fixed assets (which is existing factory itself) and quick setup. That means that Rotork evaluation for the deal, as can be seen, mainly was coming from two points: fixed costs and law case expenses. Since Company B has different value for its business they decline the deal and law case took place after which Company B had to make its own design and invest more money in RnD of its product.
5.7 **Rotork production**

As for the production part Rotork needed to have only the assembly line for its products. It has already a very wide experience of operating and enhancing the production lines over its existing factories over the world. For quick setup of assembly line of electric actuators, it simply needed to rent a building, purchase some assembling equipment (nothing special, just ordinary ones), and hire and train the staff. At the beginning for quick start all the components would go from the suppliers of main factory in the UK. This quick production line setup would take approximately around four months. Fully localized factory with its own local supply chain would take longer time – up to two years. This time would also be spent to find suitable suppliers and to teach and coach them in order to have a proper components for the production.

6 **RECOMMENDATIONS**

After all we can undoubtedly conclude that it was more beneficial for Rotork to create its own production facility with direct foreign investment into Chinese market rather than acquiring existing Company B.

Companies were clearly speaking different languages in almost every aspect of production business. Since Rotork was much more advanced in product and production development than company B as well as in supply chain infrastructure. And as was shown customer pool of company B would not provide any significant bonuses to Rotork as well, since Rotork sales strategy lays down to a premium segment and Company B to low cost segment. Also from operating personnel both of the companies have essential differences in corporate cultures, values and competencies.

For Rotork apart of factory fixed costs and law case expenses another reason to get into the deal could be killing the competition. But in this case Rotork would also not benefit that much since two companies have different segments (above mentioned premium and low cost correspondingly).

From the production setup point of view Rotork could establish new production line in China with quick set up very fast - within four months only. Though, of course Rotork strategic goals were far behind it, and it needed to establish fully localized manufacturing facility to produce not only the core product, but all the product range for local market and some of the products for world wide spread as well. However, it was already out of scope of the this evaluation analysis, since Rotork has got a very wide range of products which were needed to be localized. And that would be the whole different story.
Back to this case – the industry and the market was promising and increasing back to those times and actuator business as well – so no one would willing to give the market up easily.

Last but not least reason for Rotork not to get involved in such a deal could be corellated with foreign capital, with which Rotork could also face some difficulties from legal point of view. Since back to those times it was even harder to make an acquisition in Chinese market from the legal and regulatory points of view.

7 CONCLUSION

In thesis were examined and analyzed different aspects, factors and methods for strategic analysis. By means of them we understand what was more beneficial for internationally operating manufacturing company in Chinese market: to build its own factory or to acquire existing one. In the analysis were also included geographical market specifics like laws and regulations for such deals.

After ten years it can be seen that both companies made the right decision: Rotork is successfully operating with its own factory which totally up to Rotork international values and standards, which producing not only a core product but all the product range of the company, and not only to local market, but with some of the products spread worldwide across Rotork presence. And Company B has designed their actuators and moved a lot into developing it direction. Company B has also become an international company and enhanced their business to such markets as Latin Amerika and Mexico in their segment.

By that we can conclude that above all the mentioned in this work analysis and factors such kind of strategic decision making processes involve long term strategic vision and scenario planning in which both sides of the case had succeeded.
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