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Analysis on Risk of Debt of Leveraged Financing in Cross-border M&A

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Abstract: *The reform and opening up and economic globalization have enabled China's economy to achieve rapid growth, which directly promoted the upgrading of China's national consumption capacity and the modernization transformation of various industries. Under the background of this era, most domestic enterprises have carried out cross-border mergers and acquisitions and made a lot of advanced achievements. Effectively dealing with risk of debt in the process of leveraged financing of cross-border M&A can not only improve the efficiency of cross-border M&A, but also promote the transformation and upgrading of enterprise production and operation activities. Based on the relevant research results and years of practical experience, this paper will discuss the common ways, specific risk influencing factors, main risk of debt and optimization measures of leveraged financing for cross-border mergers and acquisitions from various aspects. Finally, I hope that through the analysis and discussion of this paper, I can provide reference for related enterprises.*

Keywords: *Enterprise; Cross-border mergers and acquisitions; Leveraged financing; The risk of debt*

1. Introduction

In China, the main countries for cross-border M&A of enterprises are developed countries such as Europe, America and Japan, and the fields involved include science and technology, energy and resources. With the development of the times, the scale of cross-border mergers and acquisitions of Chinese enterprises is increasing, which makes the enterprises involved in cross-border mergers and acquisitions face many risks. As one of the main risks of leveraged financing in cross-border M&A, of debt can directly determine the outcome and impact of cross-border M&A. Based on this, managers enterprises need to pay more attention to risk of debt in leveraged financing of cross-border mergers acquisitions, and choose appropriate financing methods according to the actual development of enterprises, so as to effectively enhance the comprehensive competitiveness of enterprises.

2. Common Ways of Leveraged Financing for Cross-border Mergers and Acquisitions of Enterprises

2.1 Internal guarantee and external loan

Domestic insurance and foreign loans are the most important leveraged financing methods for cross-border mergers and acquisitions of enterprises, which can be subdivided into two types: setting SPV and providing special credit lines for enterprises by domestic banks. The former requires to cooperate with domestic banks, set up special SPV in the country where the cross-border M&A enterprises are located, and provide them with financing guarantee or credit certificate. After the relevant procedures, the cooperative bank in the country of the cross-border M&A target enterprise can provide a specified amount of loans to the domestic acquirer enterprise. In the latter case, domestic banks need to be the dominant players to set a special credit line for domestic acquirers or the acquirers can deposit enough deposit in the designated account of the bank, and then the branches of the bank in country where the cross-border M&A target enterprises are located provide special loans for SPV so cross-border M&A can be carried out in an orderly manner[1].

2.2 International syndicated loan

Leveraged financing for cross-border mergers and acquisitions of enterprises will also use international syndicated loans to complete the designated financing objectives and fund preparation,

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making internal funds more flexible. When adopting this model, relevant overseas banks can form a special syndicate to cooperate with domestic acquirers, so that enterprises can set up SPV with the assistance of the syndicate and obtain corresponding foreign currency loans. Foreign currency loans obtained through this model can only be used to acquire overseas target enterprises, that is, the target enterprises of cross-border mergers and acquisitions, and cannot be used for other work. At the same time, domestic enterprises should also provide necessary information and data and assets as collateral for overseas banking institutions in the syndicate to increase their credit, such as the target equity and a certain proportion of assets, so that enterprises can deepen cooperation with overseas syndicates with higher credit index, thus enhancing the effectiveness of leveraged financing for cross-border mergers and acquisitions.

2.3 Issue bond

Domestic acquirers can issue bonds to assist the development of leveraged financing for cross-border mergers and acquisitions, so as to ensure the orderly development of related work. When it is necessary to use the mode of issuing bonds, domestic acquirers should take SPV as the main channel of issuing bonds, so that they can integrate relevant investment banks, investment companies and other professional investment institutions abroad and complete the financing goal in this process. At this time, the domestic acquirer enterprises need to pay attention to the credit enhancement measures proposed by various financial institutions, such as increasing the equity pledge of the M&A target, providing special guarantees and credit enhancement. There are also some domestic acquirers who will add extra clauses to prevent default in the process of issuing bonds. When there is a debt default, the investment institution has the right to transfer the bonds to the acquirer's enterprise, so that the issued bonds can maintain their original value[2].

2.4 Clear shares and real debts

When using the leveraged financing method of cross-border M&A, the acquirer needs to set up SPV which can assist the work abroad and take it as the actual M&A subject. When signing the equity transfer agreement, SPV can carry out necessary cooperation with the seller of the M&A target, and finally achieve the goal of locking the M&A target. Then, domestic acquirers need to cooperate with specialized investment institutions to transfer the equity owned by SPV to the names of these overseas investment institutions. At this time, overseas investment institutions as partners need to provide special M&A funds based on SPV's actual equity, thus completing most of the cross-border M&A leveraged financing work. When entering the final stage, the acquirer enterprise should repurchase the equity of SPV at a premium, so as to complete all acquisitions and mergers and acquisitions of the target enterprise.

2.5 Other non-standardized creditor assets

The acquirer enterprises in China can also use other non-standardized creditor assets to carry out leveraged financing for cross-border mergers and acquisitions. This method requires the acquirer to designate SPV as the financing subject, so that it can carry out financing with overseas trust companies, fund companies and asset management institutions in the process of cross-border M&A leveraged financing. After that, relevant participating institutions need to issue special trust asset management products, so that these products can provide a large amount of M&A funds for domestic acquirers. In addition, the acquirer enterprises should pay attention to the specific implementation plan of non-standardized financing methods, and can flexibly adjust the content according to the actual needs of both enterprises, relevant laws and regulations, and the situation of domestic and international market economy, so as to keep the leverage balance.

3. Main Risks of Leveraged Financing in Cross-border Mergers and Acquisitions of Enterprises

3.1 Policy risk

When carrying out cross-border mergers and acquisitions and related leveraged financing, Chinese enterprises often need to face policy risks. This is because the cross-border M&A work of Chinese enterprises needs to be promoted in order under the supervision and guidance of the higher regulatory authorities. Only with the approval of the local development and reform commission can enterprises

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further carry out cross-border M&A, such as signing legally binding documents and providing filing for local commercial departments. In the process of waiting for approval and filing, the development of the industry may change. At the same time, the changes in the international situation and the domestic and international market economy may also cause the higher authorities in China and the government of the country where the M&A target enterprise is located to impose certain restrictions on cross-border M&A of enterprises, which will make enterprises have to face all kinds of risks arising from policies, and then affect the final effect of cross-border M&A and leveraged financing.

3.2 Credit risk

Enterprises may also be affected by credit risk in the process of cross-border mergers and acquisitions, which may lead to the failure of leveraged financing. Compared with the financing of M&A in China, the main risks of cross-border M&A financing are closely related to the debt-paying cash flow of the target enterprise and the financing principal and interest. When the debt-paying cash flow of the target enterprise is less than the loan principal and interest, it is necessary for the acquirer enterprises in China to use their own comprehensive income to complete the repayment. However, under the influence of the management policies of overseas countries, it is difficult for the funds of domestic enterprises in China to be transferred to the countries where the target enterprises of cross-border mergers and acquisitions are located in large quantities, which will have a negative impact on the debt repayment situation of cross-border mergers and acquisitions. Once an enterprise does not have a stable cash flow, it will not be able to put the necessary funds into relevant work links in time, and the tightening of relevant control policies will eventually lead to credit risk[3].

3.3 The risk of merger integration

After completing the transaction link of cross-border M&A, enterprises may also face the risk of M&A integration. Among the enterprises with such risks, the relevant managers of the target enterprise will be directly incorporated into the management of the acquirer enterprise, and the employees within the target enterprise will be gradually integrated into various business departments of the acquirer enterprise. In the actual production and business activities, the personnel of both companies will carry out relevant communication and exchange work, aiming at docking business and working together. However, the enterprises of the two sides belong to different cultural backgrounds, which may lead to problems that enterprises cannot accurately understand each other’s culture, management system and related laws and regulations after completing cross-border M&A transactions, leading to conflicts in different degrees in their daily management work, further increasing the difficulty of cooperation between the enterprises of the two sides after cross-border M&A, and also enhancing the risk coefficient of cross-border M&A integration.

3.4 Other risks

Besides the basic policy risk, credit risk and integration risk, enterprises may be influenced by other highly uncertain factors in the process of cross-border M&A leveraged financing. Compared with domestic enterprises' M&A, cross-border M&A has the characteristics of long time and many details, which makes it vulnerable to some force majeure factors and causes the progress of cross-border M&A to be less than expected. This type of risk mainly involves war, regime change, serious natural disasters, epidemics, etc., which will seriously hinder the orderly development of cross-border mergers and acquisitions. At the same time, the pressure of public opinion and the strike activities of local workers may also make cross-border mergers and acquisitions have to be terminated at any time. With the passage of time, the managers of the two companies may change, which will easily lead to the direct suspension of cross-border mergers and acquisitions and the direct waste of the invested financing.

4. Risk of Debt of Leveraged Financing in Cross-border Mergers and Acquisitions of Enterprises

4.1 Risks in financing mode of cross-border mergers and acquisitions

The financing mode of cross-border M&A of Chinese enterprises involves equity acquisition and asset acquisition, both of which can provide various assistance for cross-border M&A. Among them, the principle of equity acquisition mode is that the acquirer can transfer its existing equity, or subscribe for the newly added equity in the process of cross-border mergers and acquisitions, so as to obtain the

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management right and management right of the target enterprise. The principle of asset acquisition mode is that the acquirer enterprise will acquire the assets of the target enterprise and bear its debts, so as to complete the enterprise merger or fully manage the assets of the enterprise. Starting from the characteristics of cross-border M&A, the main target of this work is overseas enterprises, which requires domestic enterprises to adopt local official currency for M&A transactions. When the type of financing currency is RMB, enterprises may have to face risks such as exchange rate conversion and a large amount of funds leaving the country, which is especially necessary for enterprises to pay attention to risk of debt[4].

4.2 The use of FCFF model

The full name of FCFF is the concept of free cash flow, which refers to the cash generated before the enterprise pays all the cash operating expenses and taxes. When evaluating the solvency of enterprises, FCFF model can be used to measure it. For enterprises, the debts arising from cross-border mergers and acquisitions are mainly repaid through advanced technology, which requires enterprises to create a large number of free cash flows in the future. When applying FCFF model, more cautious assumptions should be adopted. Once the work in this area is not done well, enterprises cannot accurately predict the possible risks in future development. Under this concept, enterprises need to calculate their actual solvency during the financing period based on the cash flow, financial management and the progress of cross-border mergers and acquisitions this year, and make detailed balance sheets and profit and loss data tables to make the data given by FCFF model more convincing.

5. Optimization Measures of Leveraged Financing for Cross-border Mergers and Acquisitions in Risk of Debt

5.1 Balance the leverage ratio of multiple customers

The survey found that the managers of some enterprises set a high leverage ratio for a single customer when they carry out cross-border M&A financing, which will make some enterprises here face financial risks and debt cost risks, and directly increase the risk of debt and credit risks. For this problem, managers of enterprises need to balance the leverage ratio of multiple customers, which can reduce the original single risk coefficient by syndicated loans, or combine indirect investment with direct investment to sort out the leverage ratio of each customer. When the cross-border M&A financing of an enterprise involves the elements of M&A loans, the manager can underwrite and issue part of the creditor's rights or shares of the M&A enterprise. Through a series of measures, managers of enterprises can further reduce the risk of debt coefficient in cross-border M&A financing, thus effectively avoiding financial risks caused by relevant institutions and improving the quality of cross-border M&A financing[5].

5.2 Do a good job in merger and acquisition integration

Managers of enterprises also need to do a good job in merger and acquisition integration, so that leveraged financing can give full play to its role in cross-border mergers and acquisitions. Leveraged financing in cross-border mergers and acquisitions can improve the valuation and performance of enterprises, use the interest earned for tax deduction, and obtain more legitimate interests in the capital market. Therefore, managers of enterprises need to deeply evaluate leveraged buyouts in the integration of cross-border mergers and acquisitions, and analyze the sources of the benefits generated in the process of mergers and acquisitions, so as to make a highly targeted exit plan while reasonably evaluating the benefits of cross-border mergers and acquisitions. After implementing the relevant work plan, the enterprise can effectively reduce the financial risk coefficient. Once the cross-border M&A fails, the managers of enterprises can also safeguard their legitimate rights and interests through corresponding countermeasures and minimize the credit risk.

5.3 Pay more attention to the repayment path of funds

Managers of enterprises should also pay more attention to the repayment path of funds, so as to solve the potential technical breach of contract in time. In the process of cross-border M&A, most enterprises will set their work goal as to obtain the unique advanced management experience and production technology of the acquirer through cross-border M&A and related financing activities.

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However, the managers of some enterprises ignore the important role of capital repayment path when carrying out cross-border mergers and acquisitions, which is very likely to cause these enterprises to fail to complete the repayment on time according to the existing cash flow when repaying the loan amount, and then lead to technical breach of contract. In this regard, the managers of enterprises need to strictly manage the cash flow and the repayment path of funds, and carry out relevant communication with overseas enterprises in time to ensure that they can have healthy cash flow to cope with repayment, so as to make the quality of cross-border M&A financing of enterprises by going up one flight of stairs.

6. Conclusion

To sum up, the development of China's market economy and the trend of international trade have brought a series of brand-new opportunities and challenges to enterprises in various industries. Only when managers of enterprises have a correct understanding of the risk of debt of leveraged financing in cross-border mergers and acquisitions and the factors that cause risks can they formulate scientific and reasonable countermeasures, and then effectively deal with various risk of debt. In this process, managers of enterprises need to innovate their own management concepts and adopt advanced technology while actively learning advanced management methods. At the same time, all employees of enterprises should constantly improve their professional quality and participate in cross-border mergers and acquisitions with high-level work ability, thus helping the sustainable development of enterprises.

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