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M&A Today

Competing Through Globalization

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INTRODUCTION

New American Partners (NAP) is a private equity firm that was launched in 2003 and now has $100 million assets under management. It invests in small and medium-sized companies in the U.S. and China where the firm can add value through globalization. NAP provides capital and advice to their portfolio companies in order for them to gain significant competitive advantages such as relocating production and developing global markets.

Of NAP's three investments in China, one is Asimco Technologies, the largest independent diversified auto parts manufacturer in China. The other two investments are Wuxi PharmaTech, a $33 million pharma outsourcing company, and Zencheng Power Corporation, an electrical power company.

THE CHINESE DIFFERENCES

Tom Farb stated that most businessmen in this country are vaguely familiar with the characteristics of China such as the following:

- large population of 1.5 billion people

- second largest country in land size

- second lowest cost production (see chart on wage rates)

- over 9% economic growth rate

- undervalued yuan compared to the dollar

- educated work force with an emphasis on engineering at the college level. For example, a comparison of college degrees in engineering are 5% in US, 25% in Russia and 46% in China.

Tom Farb stated that what many businessmen in this country are not familiar with are other characteristics of China – such as the following:

- China is not monolithic in that there are substantial variations in language and customs. The vast majority speaks Mandarin, but there are many regional languages.

- China is boldly initiating major infrastructure projects. The Three Georges Dam project is the largest engineering project in the world, far exceeding Boston's Big Dig and the former is far closer to budget and designated schedule than the latter. China is terrific in organizing large projects such as the 2008 Olympics and the 2010 World's Fair.

- China has a huge pollution problem with 16 out of 20 of the worst polluted cities in the world.

- China's government is a benign dictatorship with some corruption and without the advantages of a free press.

- China's capital gains tax is about 17% or half of Mexico's, for example.

- China, despite its high growth rate, has a large population of unemployed.

- Intellectual property protection in China remains weak. "China pirates 95% of the DVDs and other recorded entertainment sold there, the highest rate in the world. Some estimates are that as much as one-third of the economy is dependent on counterfeit goods," according to *Fortune*.

THE CHINESE NUANCES

According to Farb, the cultural nuances between our country and China are vast. In China, business generally flows from personal friendships while in the U.S. personal friendships often flow from business. The social pressure prevails over business pressure. For example, if there is a contractual dispute in China, the two parties try to come to a decision through mediation. If one of the parties does not abide by the decision, then their personal reputation is damaged. In a business deal, the contract is valid "at least for now," but if material circumstances change, then the contract will be renegotiated. The deal and/or the relationship must be good for both parties. Negotiating a deal takes much longer in China, maybe one and half years with an emphasis on the long term. Chinese are excellent negotiators and might purposely leave an important document on the table when they momentarily leave the room hoping you will peak at it.

Almost all deals in China are done through a joint venture or foreign entity such as a Chinese holding company. While the Chinese personally like Americans, they hate our government, principally because of our support to Taiwan. The Chinese are obsessed with the use of cell phones and will take any call, anytime, regardless of how important the meeting.

CONCLUSION

The China factories are not necessarily a panacea for off-shoring. In a recent *Business Week* article entitled: The Downside to China's Giant Buildup, the authors state: "If the country's economy slows, factory overcapacity could crunch profits. Runaway investment in China is creating surpluses in a range of industries, i.e., semi-conductors, petrochemicals, steel, autos, etc.

New America Partners also has an investment banking component, so it behooves a potential investor in China to contact Tom Farb. Among his many previous business engagements, he was also General Partner and Chief Financial Officer of Summit Partners, one of the largest equity firms with over $5 billion of committed capital under management in more than 255 businesses.