



Global integration success - A China perspective

By Harvey Xiao & Keat Lee

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Executive summary

In a world of increasingly larger cross-border M&A integrations, China often sits at the center of attention due to scale, potential, and operational complexity.

To achieve integration success within China, and globally requires deliberate collaboration with the global team,

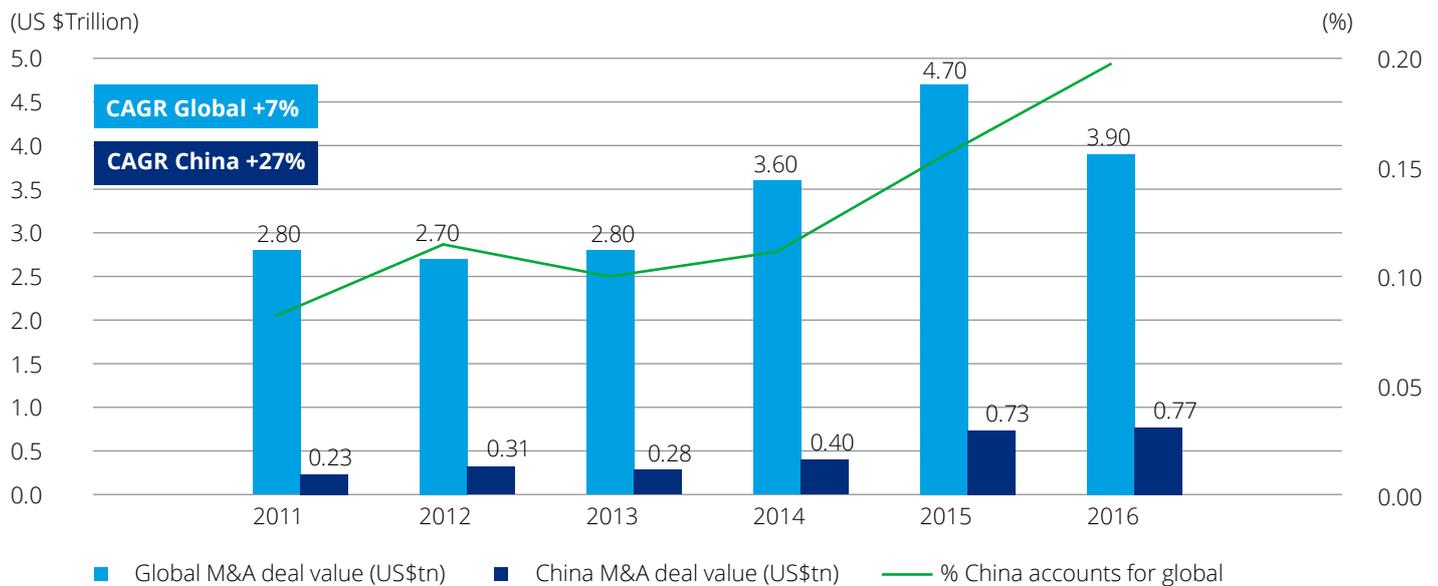
selective identification of in-country stakeholders, a disciplined reporting and governance cadence, and emphasis on employee morale.



Introduction

In an environment of growing M&A activity, China is often the center of attention due to its scale of impact and complexity

Consistently high and steadily increasing M&A activity in recent years
China M&A deals grew rapidly at 4x the global CAGR, and now account for >15% of total global deal value



Sources: J.P. Morgan, Dealogic and IMF GDP forecasts as of January 10, 2017, THOMSON REUTERS, CVSource, Deloitte Analysis
 Note: M&A as a % of GDP is rounded to the nearest decimal

Rising global M&A activity translates to significant implications for our clients in China. The increase in not only volume, but also value of M&A transactions means that deals are becoming increasingly complex and likely include cross-border

integration activities. This complexity is further emphasized by issues commonly seen in China such as **cultural differences, operating model discrepancies, regulatory environment complexities and varying perspectives toward**

shared services. More so than ever, China sits at the center of the M&A story – either as the country of deal origination or as a target growth region.

Top 10 Global M&A Transactions in 2016

All of these deals were over 30B USD in value. 4 were over 50B. China originated deals are already penetrating the top global deals list

Target	Acquiror	Deal Value (\$bn)
Time Warner	AT&T	107.9
Monsanto	Bayer	66.3
Reynolds American (57.8%)	British American Tobacco – BAT	58.1
Energy Transfer Partners	Sunoco Logistics Partners	51.5
NXP Semiconductors	Qualcomm	47.0
Syngenta	ChemChina	46.9
Spectra Energy	Enbridge	43.0
Linde AG	Praxair	42.5
Level 3 communications	CenturyLink	33.7
Baker Hughes	General Electric	32.2

Sources: Dealogic M&A Review Jan 2017

However, while China continues to grow in importance, it rarely serves as the headquarters in complex global integrations, but rather acts as a regional integration center. China integration scope and timelines in global projects are often driven by a global integration team. This is often due to the scarcity of experienced, global-minded talent. However, global clients often lack experience understanding the unique complexities of China. This lack of experience, compounded by cultural and communication challenges results in a **lack of trust between global**

and local China integration teams.

Based on our experience serving several recent global M&A deals, we found that it is crucial for the China team to actively provide input and influence global integration decisions while building a strong rapport with global team members.

Successful integration projects in China require a strong foundation consisting of:

- Comprehensive understanding and alignment on scope
- Clearly defined integration team structure and escalation paths

- Disciplined cadence of integration activities, meetings, and workshops
- Implementation of appropriate proof of concept / trial runs for complex processes
- Proactive identification of synergy opportunities to realize quick-wins to boost profits and morale

This rationally structured approach not only breeds success in China integration, but also caters to the attainment of the project's global integration goals.

Scope

Clearly defined integration scope and parameters with proper alignment among stakeholders are critical for global integration success

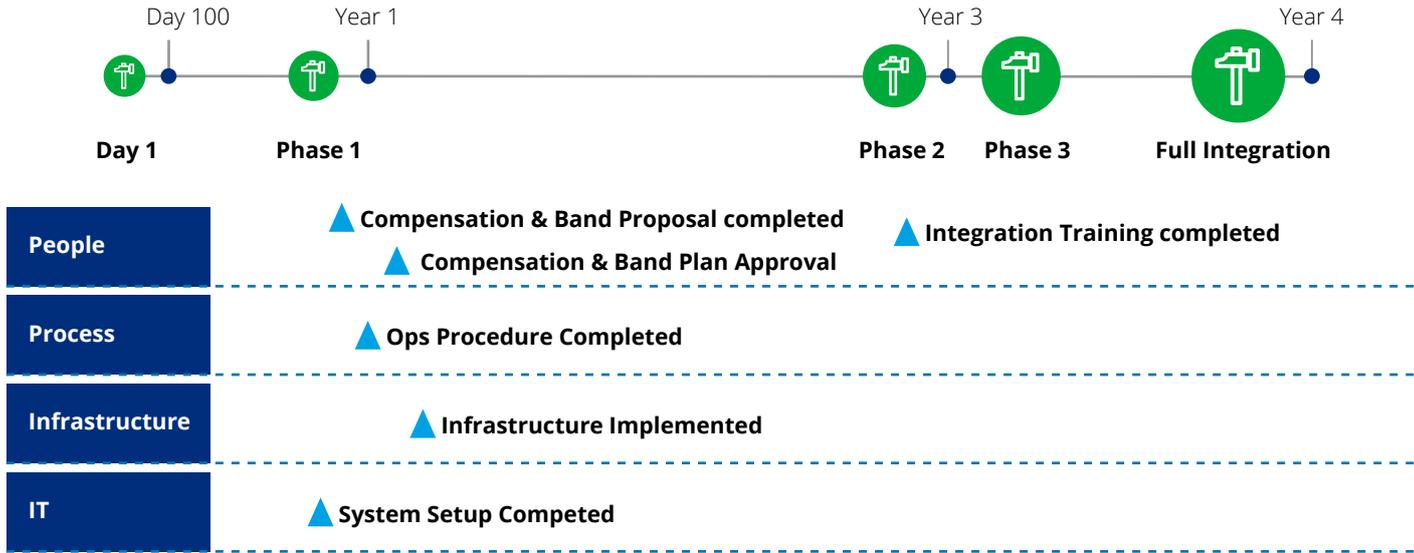
Prior to forming appropriate integration teams and defining activity cadences, it's critical that the global and country integration leads are aligned in terms of high-level integration scope as well as work stream level decision rights. Making sure all stakeholders are aware of overall integration strategy and timeline along with whether key function level decisions will be made at a country or global level eliminates unnecessary confusion and frustration down the line. While seemingly a trivial point, it is one that is often not given enough emphasis

in the frantic and often disorganized early days of planning a global integration.

During a recent global engagement, we worked together with our clients to design a **multi-phased integration approach** due to operational complexities and required system lead times. In this merger of two similar sized global companies, three intermediate phases were identified on the path toward full integration. Each phase was defined by a series of people, process, infrastructure, and IT milestones that brought the merging companies closer to operating globally as one. This multi-phased strategy is increasingly common in complex global integrations.

Due to **reliance on global systems, ties with global operations**, and multiple other dependencies, it was necessary for stakeholders within countries to be clear on scope and timeline for each intermediate phase. This clear understanding and alignment at the country level was required to make sure functions within each country would be operationally ready for the global system, process, and other changes represented by each phase of the program.

3 Potential Phases on Path Toward Full Integration



Sources: Deloitte Analysis
 Note: Illustrative purposes only – does not reflect actual data

This level of alignment and clarity is also required at the function level to understand work stream level responsibilities and decision rights. Each functional lead needs to understand which integration related decisions need to be made at the country level as well as the timeline and impact of decisions and process changes that trickle down from the global team. Typically, shared-service related functions such as IT, legal, marketing etc. have centralized planning while operations, HR, finance, sales etc. have greater country-level scope given their greater country specific considerations.

In our experience, the alignment between operations and commercial functions is especially important for two main reasons: First, decision rights for commercial related integration activities are often made at the global level whereas operations planning is often done at the country level. Second, stakeholders from **commercial and operations teams often have conflicting incentives. Through integration activities**, commercial leaders look toward opportunities for growth while protecting customer experience, whereas operations leaders often seek to capture efficiency synergies

and cost-reductions from combining operations. Managing these conflicting pressures and facilitating alignment between operations and commercial functions early on are critical to avoiding an over-emphasis on operational efficiency at the expense of customer experience.

Global team

China can drive or influence global integration projects and priorities through a dedicated global task force

As mentioned earlier, several aspects of a global integration are typically decided at a global level. The output of these decisions drive several aspects of scope and timelines within countries. Given the importance of these global activities along with the growing importance of China in recent integration projects, it is important that China provides influential input into global integration decisions. In one of our recent engagements, input from the China team regarding the complicated labor and tax regulations within the country helped the global team structure intermediate integration phases in a manner that minimized risk to China operations.

In addition to defining global timelines, global resources are often needed to facilitate rollout of integration related changes. From experience, these activities can range from IT / system related updates to distribution of new equipment to training of employees on new processes. Depending on country level requirements and environment, it can be beneficial to have these global resources earlier or later. For example, we recently worked with a country Integration Management Office (IMO) team to lobby the global IT team to prioritize China in distribution of a new software that allows for facility integration. In this case, the China team could realize significant savings from ability to integrate its facilities. Presenting these synergies to the global team helped influence the sequence of IT distribution.

In an effort to have a continuous voice in global integration decisions as well as a dedicated channel of communication between global and country teams, we recommend permanent resources from larger countries to join the global planning committee. In recent engagements, we typically placed two resources from China to provide input and perspective to the global IMO. It works best when these resources are Subject Matter Experts (SMEs) in their respective fields. When IT is a large portion of the global shared services, as it typically is, we advocate that one of these resources have both strong knowledge and influence with the China IT team.

Resources from China Provide Input and Perspective to Global IMO



Sources: Deloitte Analysis
 Note: Illustrative purposes only – does not reflect actual data

Another major responsibility of these country SME resources is to provide status updates as well as potential risks and obstacles to the global IMO. Overlooked risks and issues from China can have major implications to an integration program. Following

the established global IMO cadence, representatives from the China team should highlight key milestones and escalate issues as appropriate so that the global IMO can make effective integration decisions and adjustments as required.

China IMO

A tailored China IMO structure is essential to establishing accurate dependency-linked milestones and to effectively driving integration progress

Like the global IMO, the China integration team also relies on an effective program structure and disciplined cadence to help define and execute against its integration activities. Once the scope of the global and country-level integration responsibilities is clear, the China integration leader / sponsor should kick off the country level integration with the relevant functional stakeholders. Typically, each globally recognized function, such as HR, Marketing, and Finance will serve as a

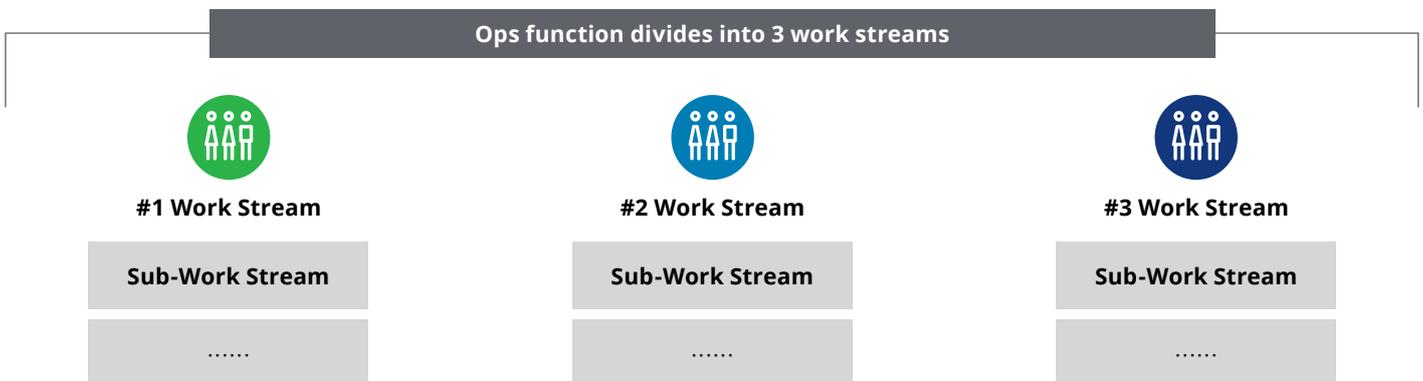
work stream in the integration effort. China's integration lead will work with each work stream lead to guide them in establishing an appropriately detailed set of milestones that represent the integration effort.

One important step for the China integration lead is to determine whether additional work streams should be included at the country level. In China, typical areas of complication include regulatory, tax, commercial, and labor considerations.

We have typically advised our clients to include these work streams separately or in combination to the globally recognized functions (e.g. HR, Marketing, Finance etc.) based on the potential impact issues in these areas can cause.

Each Function Represented by Separate Work Streams

Dedicated leads within each work stream drive integration activities



Sources: Deloitte Analysis

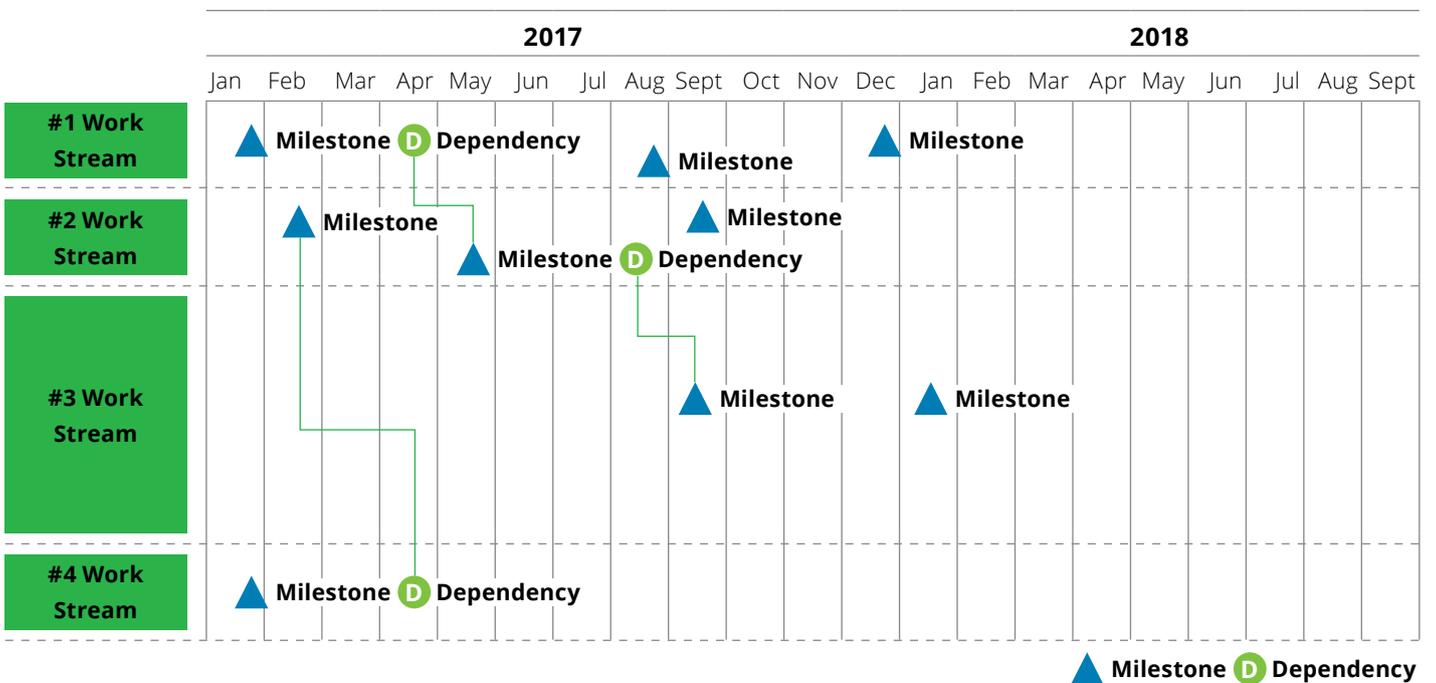
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Once appropriate milestones are established and reviewed for appropriate detail, the China IMO is responsible for facilitating the identification of dependencies each work stream has with one another as

well as with global teams. Only when these dependencies are appropriately marked and aligned can an accurate illustration of integration timeline be established. In addition, appropriately **sequencing these milestones**

based on dependencies will allow for easy assessment of impact across work streams when a milestone needs to be modified.

Milestones with Dependencies Appropriately Mapped and Sequenced



Sources: Deloitte Analysis
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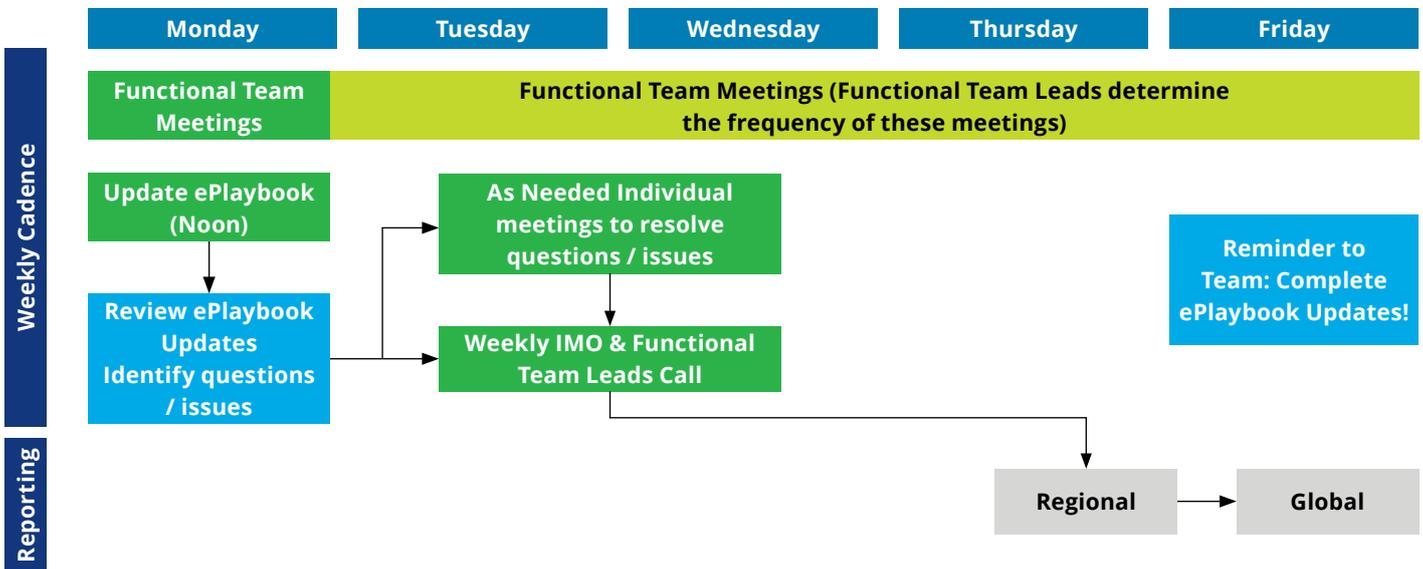
Upon completion of an established work plan with dependency-linked milestones, the role of the country IMO shifts from activity planning to **status tracking and issue identification / resolution**. Specifically, status tracking is an area that is often underappreciated and insufficiently emphasized due to its

seeming simplicity. Effective status tracking requires comprehensive appreciation of milestones with each work stream and consistent discipline. Through frequent (usually weekly) meetings with each work stream lead, the China IMO will remain up-to-date with the happenings within each pillar of the integration. Over time,

this structure will train an intuition to ask the appropriate questions and choose the relevant issues / updates to escalate up to overall country or global level meetings. **This structure allows for swift, informed decision making that is key to preventing costly delays.**

IMO Status Tracking and Issue Identification / Resolution

Weekly Meeting and Reporting Cadence



Sources: Deloitte Analysis

Note: Illustrative purposes only – does not reflect actual data

In addition to work stream meetings, **a cross-functional meeting cadence is critical to avoid each function working in a silo.** This platform, chaired by the IMO, gives each work stream lead time to provide a brief integration update to their peers. More importantly, escalation

issues previously identified during work stream level meetings can be presented and discussed. Often times, milestones adjustments or cross-functional support can be granted within this session. Even if not immediately addressed, this platform allows for follow-up conversations

with appropriate stakeholders to be scheduled. The combination of selecting the appropriate stakeholders, implementing an effective reporting cadence, and enforcing a disciplined IMO cadence provides the foundation for successful country integration.

Weekly Cross-Functional Meeting

Each functional lead provides integration update and escalates key issues. Special topics requiring cross-functional attention are presented and discussed

0	Executive Summary / Overall Timeline	Speaker	Duration
1	Work Stream Leads Updates		
	#1 Work Stream Updates		30 mins
	#2 Work Stream Updates		30 mins
	#3 Work Stream Updates		30 mins
	#4 Work Stream updates		30 mins
	Break		15 mins
2	Special Topic		60 mins
3	Special Topic		60 mins

Sources: Deloitte Analysis

Note: Illustrative purposes only – does not reflect actual data

Proof of concept phase

Period to test operational complexities in environment with limited impact to verify readiness of systems and processes required to realize longer-term integration benefits

As alluded to previously, integrations in China face several unique challenges. Complex regulations around operating permits, tax districts, and labor laws among other areas present significant risks and

challenges to a global integration agenda. An approach we've guided clients through to mitigate these risks in China is to leverage a proof of concept phase. The idea is to select a small, but operationally complex

portion of the Chinese business to integrate first in an effort to test people, systems, and processes. Proof of concept candidates can include smaller business units, product lines, or operating locations.

Proof of Concept Phase Tests Complex Regulatory & Operational Processes

Regulatory, HR, and operational processes often need to be piloted prior to full integration



China Regulations

Customs Rules – First ever integrated process in China – enable Customs supervision by conducting trials upon receipt of approvals

Regulatory environment - Need to gauge government reaction to integrated processes due to complexities



Identify and mitigate regulatory issues in Proof of Concept environment



Compensation & Band Concerns

Variable Pay Design – Mechanisms / rules differ between both sides

Compensation & Band, System Testing – Employee reactions to integrated Compensation & Band will be observed for future phases. Variable pay system will be tested



Proactive actions to minimize customer & employee impacts from integration



Market / Operations

Integration – Allow ability to test / learn from integration activities

Market & Customer Reaction – Proof of Concept phase allows us to observe customer reaction and minimize impact in future integration phases

Sources: Deloitte Analysis

Note: Illustrative purposes only – does not reflect actual data

In a recent engagement, we helped our client identify 5 smaller cities with complex operations to include in their proof of concept phase. Even though these cities represented less than 5% of our client's China revenue, they represented a complex series of operational and

regulatory changes. We structured the integration timeline to integrate these 5 cities 4 months ahead of the general integration date. This extra time allowed our client to adjust certain operational assumptions and resolve several process issues in a relatively insignificant environment.

The lessons learned during this period were extremely useful to achieving a smooth general integration months later. In most integrations, having a low risk trial run period with a representative business segment is a worthwhile investment.

Proof of Concept Selection

Selected pilot region covered 5 cities representing ~5% of revenue.
Separate customer relations teams maintained during POC period

Proof of Concept phase includes: 5 smaller cities



Customer impact

5% of China revenue
Dedicated teams in work streams to serve customers to minimize impact

Employee impact

8% of total employees
Operations only – no other functions



2 Separate teams

Further guarantees customer experience
Creates seamless transition

Driving toward launching mitigation plan

Sources: Deloitte Analysis

Note: Illustrative purposes only – does not reflect actual data

Quick wins

Often not complex to achieve but critical to building morale among integration and leadership teams and instilling confidence with stakeholders and investors

Synergy opportunities and quick wins are frequently mentioned by management but often poorly executed. A structured plan with clearly articulated individual accountability is necessary for synergy realization. In the drive to reach aggressive milestones and fire-fight an array of issues, opportunities for to demonstrate quick integration synergies are passed over. However, these quick wins are important for several reasons. **From a China perception perspective, demonstrating some P&L or operational wins from integration activities, however small, show well to the global team as well as to the market.** The willingness to capture these synergies along the way exhibits a dedication to integration efforts and proves favorable when asking for global resources or funding.

Also, even small synergies can serve as major morale boosters to both sides of an integration team. In every integration, there exists more than a fair share of naysayers and skeptics. Quick wins are a great way to combat negative opinions and gain momentum. In addition to the operational or monetary benefits, quick-wins give stakeholders topics to highlight during internal and external events without disturbing integration activities or dependencies.

In a mature market, people redundancies are often the largest component of integration synergies. **However, with the growth potential in China, redundancies are typically not part of the integration plan.** Several other areas within a business likely contain quick win opportunities from integration

such as sourcing / procurement and facility utilization improvement. From a procurement perspective, the combined purchasing power of the integrated organization often allows for greater bargaining and larger discount rates. From a facility perspective, it's often possible to combine workspaces or other assets without combining processes or systems.

Beyond cost savings, integration projects in China often are candidates for quick revenue synergies through:

- Cross selling
- Product bundling
- Value-added services through value chain extension

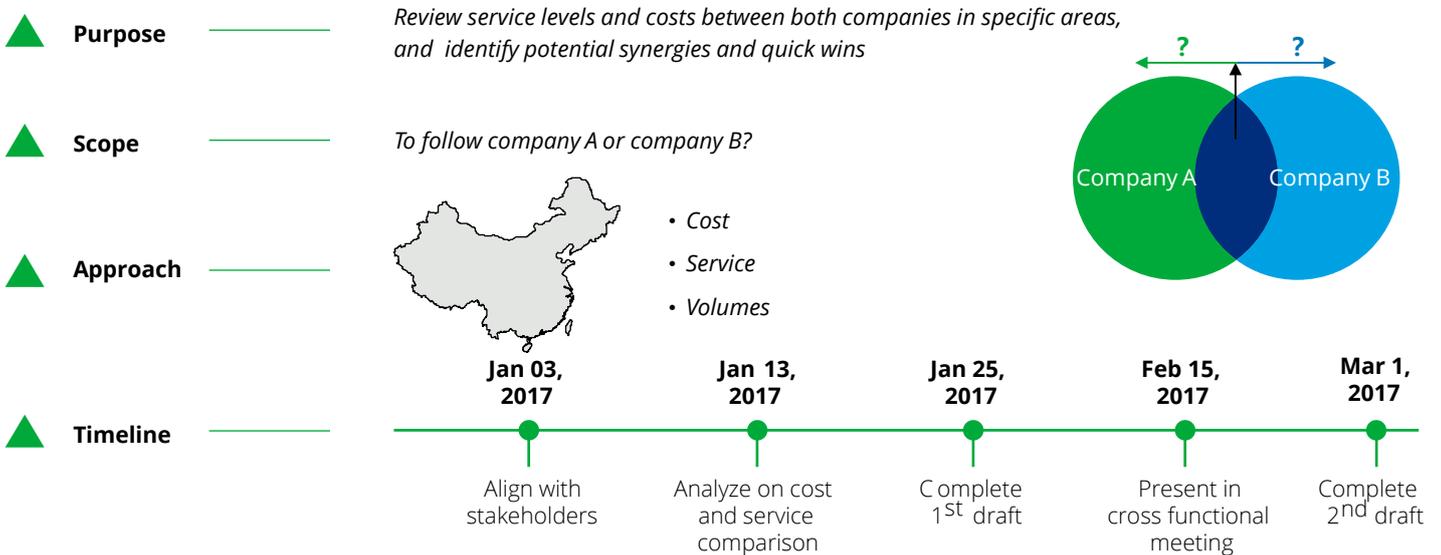
The combined capabilities of integrating firms allow increased revenue opportunities that didn't exist

prior to joining operations. While each individual quick win may be relatively small, the combined number is often significant. Also, the morale and

perception boosting effects are alone worth the time and effort required to achieve them.

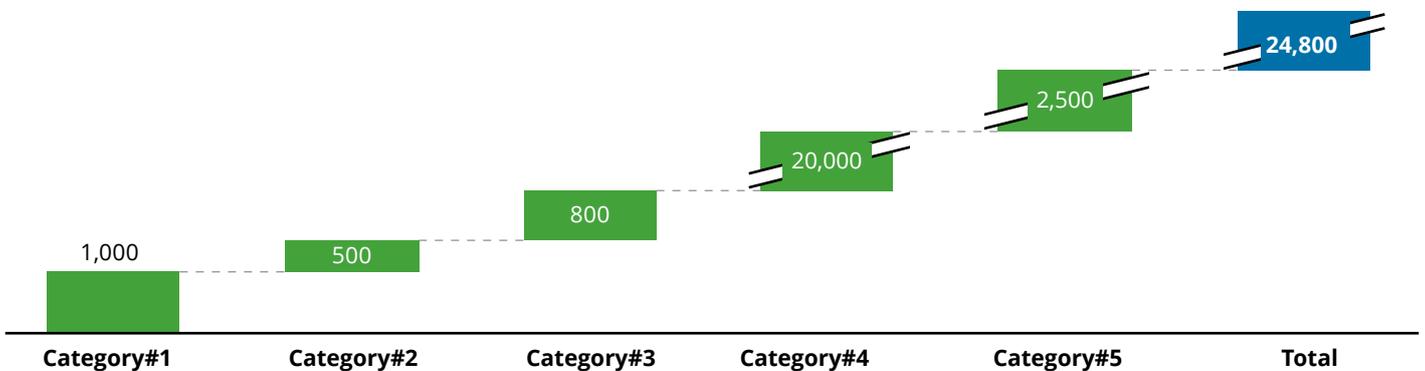
Quick Wins / Synergy Analysis

From a procurement perspective



Sources: Deloitte Analysis
 Note: Illustrative purposes only – does not reflect actual data

Synergy consolidation from multiple sources can add to significant savings, resulting in increased profitability



Sources: Deloitte Analysis
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Conclusion

In recent years, more and more companies rely on global mergers & acquisitions to expand their scope and bring more value to stakeholders. Within these M&A integration activities, China is often the center of attention due to its undeniable opportunities regardless of whether it serves as the origination country. However, unique regulatory and operational challenges in the country make for a difficult integration environment. Through meaningful collaboration with the global team, appropriate selection of local stakeholders, and disciplined planning, governance and reporting cadence, the integration team can build the

foundation for a successful engagement. This structure along with a proactive emphasis on testing assumptions and motivating employee morale combine for an effective integration approach.



Authors and contributors



Keat Lee
Managing Partner
M&A Consultative Services
Email: klee@deloitte.com.cn



Harvey Xiao
Manager
Monitor Deloitte – M&A
Email: harxiao@deloitte.com.cn

Special thanks to our contributors:



Steve Cheng
Associate Director
Monitor Deloitte – M&A
Email: scheng@deloitte.com.cn



Pan Hu
Manager
Monitor Deloitte Strategy
Email: phu@deloitte.com.cn



Cindy Shen
Monitor Deloitte Strategy
Email: cinshen@deloitte.com.cn

Office locations

Beijing

8/F Tower W2
The Towers, Beijing Oriental Plaza
1 East Chang An Avenue
Beijing 100738, PRC
Tel: +86 10 8520 7788
Fax: +86 10 8518 1218

Changsha

20/F Tower 3, HC International Plaza
No. 109 Furong Road North
Kaifu District
Changsha 410008, PRC
Tel: +86 731 8522 8790
Fax: +86 731 8522 8230

Chengdu

Unit 3406, 34/F
Yanlord Landmark Office Tower
No. 1 Section 2, Renmin South Road
Chengdu 610016, PRC
Tel: +86 28 6789 8188
Fax: +86 28 6500 5161

Chongqing

36/F Deloitte Tower
8 Corporate Avenue, 10 Ruitian Road
Yuzhong District
Chongqing 400043, PRC
Tel: +86 23 8823 1888
Fax: +86 23 8859 9188

Dalian

15/F Senmao Building
147 Zhongshan Road
Dalian 116011, PRC
Tel: +86 411 8371 2888
Fax: +86 411 8360 3297

Guangzhou

26/F Yuexiu Financial Tower
28 Pearl River East Road
Guangzhou 510623, PRC
Tel: +86 20 8396 9228
Fax: +86 20 3888 0121

Hangzhou

Room 1206-1210
East Building, Central Plaza
No.9 Feiyunjiang Road
Shangcheng District
Hangzhou 310008, PRC
Tel: +86 571 8972 7688
Fax: +86 571 8779 7915 / 8779 7916

Harbin

Room 1618, Development Zone Mansion
368 Changjiang Road
Nangang District
Harbin 150090, PRC
Tel: +86 451 8586 0060
Fax: +86 451 8586 0056

Hefei

Room 1201 Tower A
Hua Bang ICC Building
No.190 Qian Shan Road
Government and Cultural
New Development District
Hefei 230601, PRC
Tel: +86 551 6585 5927
Fax: +86 551 6585 5687

Hong Kong

35/F One Pacific Place
88 Queensway
Hong Kong
Tel: +852 2852 1600
Fax: +852 2541 1911

Jinan

Units 2802-2804, 28/F
China Overseas Plaza Office
No. 6636, 2nd Ring South Road
Shizhong District
Jinan 250000, PRC
Tel: +86 531 8973 5800
Fax: +86 531 8973 5811

Macau

19/F The Macau Square Apartment H-N
43-53A Av. do Infante D. Henrique
Macau
Tel: +853 2871 2998
Fax: +853 2871 3033

Mongolia

15/F, ICC Tower, Jamiyan-Gun Street
1st Khoroo, Sukhbaatar District, 14240-0025
Ulaanbaatar, Mongolia
Tel: +976 7010 0450
Fax: +976 7013 0450

Nanjing

6/F Asia Pacific Tower
2 Hanzhong Road
Xinjiekou Square
Nanjing 210005, PRC
Tel: +86 25 5790 8880
Fax: +86 25 8691 8776

Shanghai

30/F Bund Center
222 Yan An Road East
Shanghai 200002, PRC
Tel: +86 21 6141 8888
Fax: +86 21 6335 0003

Shenyang

Unit 3605-3606, Forum 66 Office Tower 1
No. 1-1 Qingnian Avenue
Shenhe District
Shenyang 110063, PRC
Tel: +86 24 6785 4068
Fax: +86 24 6785 4067

Shenzhen

13/F China Resources Building
5001 Shennan Road East
Shenzhen 518010, PRC
Tel: +86 755 8246 3255
Fax: +86 755 8246 3186

Suzhou

23/F Building 1
Global Wealth Square
88 Su Hui Road, Industrial Park
Suzhou 215021, PRC
Tel: +86 512 6289 1238
Fax: +86 512 6762 3338 / 3318

Tianjin

45/F Metropolitan Tower
183 Nanjing Road
Heping District
Tianjin 300051, PRC
Tel: +86 22 2320 6688
Fax: +86 22 8312 6099

Wuhan

Unit 1, 49/F
New World International Trade Tower
568 Jianshe Avenue
Wuhan 430000, PRC
Tel: +86 27 8526 6618
Fax: +86 27 8526 7032

Xiamen

Unit E, 26/F International Plaza
8 Lujiang Road, Siming District
Xiamen 361001, PRC
Tel: +86 592 2107 298
Fax: +86 592 2107 259

Xi'an

Room 5104A, 51F Block A
Greenland Center
9 Jinye Road, High-tech Zone
Xi'an 710065, PRC
Tel: +86 29 8114 0201
Fax: +86 29 8114 0205

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