

Control right arrangement in the transactions of merge and acquisition——a case study of the acquisition of Shenzhen V&T Technologies Co. , Ltd.

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Abstract: In recent years, the narrowing of corporate financing channels has a sharp impact on the willingness and success rate of mergers and acquisitions (M&A)[https://en.wikipedia.org/wiki/Mergers_and_acquisitions]. In this context, the final success of M&A largely depends on the design of M&A scheme. Taking the merge transaction of Yunnan Yunnei Power Group Co. , Ltd. as an example, this paper analyzes how Yunnan Yunnei Power Group Co. , Ltd. can control an A—share listed company through small acquisition cost employing diversified control right arrangement strategy and gives the practical summary.

Keywords: control right, merge and acquisition, development strategy of corporation

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1. Introduction

Since the introduction of reform and opening up, the development of China's M&A has experienced the stages of germination, start, and rapid development. As an effective way for companies to expand and optimize resource allocation, M&A has been favored by many enterprises. With the rise of China's economy, the scale of M&A of Chinese enterprises accounts for an increasing proportion in the global M&A scale, and the wave of global M&A will usher in the era of M&A in China. According to the report of PricewaterhouseCoopers, the total number of M&A transactions of Chinese enterprises in 2015 totaled 9419, with a total value of US \$ 855.9 billion. However, with the increasing uncertainty of the market and the domestic deleveraging process restricting the financing channels, China's M&A transactions have declined. In the whole year of 2019, the number of M&A transactions of Chinese enterprises totaled 9483, with a total US \$ 558.7 billion. Under the background of "difficult financing" and of the huge cost of M&A, the success rate of M&A is directly related to the control strategy adopted by enterprises in M&A.

In the process of M&A, to control the target enterprise, the acquirer needs to have a certain number of voting rights of the target enterprise. If the merger adopts a single way to realize the control right, it usually needs to pay a lot of transaction consideration to achieve the purpose of the merger and acquisition of the target enterprise. Besides, under the background of "financing difficulties", it is usually challenging to achieve the goal of controlling the target enterprise only by relying on a single arrangement of control rights. Therefore, enterprises should reconsider their reality and adopt diversified control rights arrangement strategy, which can not only reduce the cost of M&A, but also help to improve the success rate of M&A.

In October 2019, Yunnan Yunnei Power Group Co., Ltd. used an innovated way of merge to achieved the goal of M&A of Shenzhen V&T Technologies Co., Ltd., a listed A-share company with an equity valuation of RMB3.036 billion,

with the transaction consideration only of RMB551 million. After the merger and acquisition, it also officially marks that the state-owned enterprise Yunnan Yunnei Power Group Co., Ltd. has formally entered the new energy automobile industry and firmly grasped the initiative of enterprise transformation. How does Yunnan Yunnei Power Group Co., Ltd. realize the control of A-share listed company Shenzhen V&T Technologies Co., Ltd. at a small cost through wise merger and acquisition scheme? This paper will analyze the control right arrangement strategy of enterprises in the process of M&A through this practice case so as to provide guidance and reference for the control right arrangement of Chinese enterprises in the process of M&A in the future.

2. Literature review

Many scholars have made a more in-depth study on the economic benefits of M&A transactions. Feng Genfu and Wu Linjiang (2001) conclude that M&A can improve enterprise performance and enterprise value to a certain extent. The existing literature also points out that reasonable horizontal, vertical or mixed M&A can enhance the competitiveness of M&A enterprises. Therefore, M&A has become one of the expansion ways that enterprises are keen on. In M&A transactions, financing methods and M&A program design and other factors significantly affect the success rate of M&A (Zhao Qing et al., 2018). Jensen and Ruback (1983) and Stulz (1988) believe that a wholly-owned acquisition of a target enterprise usually results in a conflict of interest between the operator of the target enterprise and its owner. Dang and Henry (2016) believe that based on the incentive theory, compared with the holding acquisition, the operator of the enterprise in the wholly-owned acquisition is easier to be replaced.artzell et al. (2004) and Moeller (2005) pointed out that, in addition to the situation that the acquirer promised to retain the position and salary of the enterprise's operator, the enterprise's operator was more reluctant to accept the wholly-owned acquisition than the holding acquisition. Comment and

Schwert (1995) and Bates and Becher (2017) said that operators usually take a series of anti wholly owned acquisition measures to strengthen their discourse power in M&A negotiations, which also increases the M&A cost of M&A parties. Therefore, in the actual M&A, enterprises are more willing to adopt the way of holding acquisition to acquire target enterprises. Based on the company management level, the existing literature shows that reasonable control right arrangement can alleviate the traditional agency problem caused by the separation of ownership and control in joint-stock companies (Wang Qingsong, 2011). Zhao Keyang (2019) also pointed out that corporate control is extremely important for modern corporate governance. On the one hand, it is necessary to ensure the shareholders' right to know and supervise the company; on the other hand, the company's managers should also have sufficient power to implement management planning. However, few scholars have studied how the arrangement of control right will affect the M&A transactions in the process of M&A. Based on the actual cases, this paper analyzes the practical significance of reasonable control rights arrangement in the process of M&A.

3. Control right arrangement in M&A

3.1 Influencing factors of control right arrangement in M&A

Enterprise control right is one of the core issues of corporate governance theory, which means that it has an indirect or direct influence on enterprise decision-making. The arrangement of control rights should be based on the importance of each party to the value creation of the enterprise. This is because the control right of the enterprise determines the resource allocation of the enterprise, and the resource allocation will determine the operation status and efficiency of the enterprise. The transfer of residual control rights by entrepreneurs is affected by the following factors: entrepreneur's unit non-monetary income, entrepreneur's efforts, investor's control implementation cost, and control realization degree (Liu Qigui and Meng Xi, 2010).

Therefore, the influencing factors of control arrangement in M&A can be divided into two categories.

3.1.1 Material resources

Material resources are the material basis provided to the enterprise to help the production and operation of the enterprise. Common material resources such as shareholders' contributions or investors' investment funds. Material resources provide material elements for the operation of the company. If there are no material elements, the operation of the company will lose the material basis. That is, there is no production object and no means of production. The amount of material resources provided to enterprises is one of the important factors determining the proportion of enterprise control rights owned by resource providers.

3.1.2 Nonmaterial resources

Intangible resources refer to the favorable tools that may help enterprises in the future, such as entrepreneurs' human capital, investors' social relations, key technologies mastered by enterprises, etc. Intangible resources play a key role in the process of enterprise development. For example, entrepreneurs' human capital provides a professional helmsman or strategic consultant for the enterprise. The social relationship of the acquirer can not only optimize the upstream and downstream connection of the merged enterprise but also create a joint strategy of strong alliance. Nonmaterial resources also affect the proportion of enterprise control rights owned by resource providers to a great extent.

3.2 Main ways of controlling right arrangement in M&A

In the process of M&A, the M&A parties often consider the problems of capital or supervision to reduce the proportion of equity in the acquisition. To achieve the purpose of controlling the merged enterprise, the merger and acquisition party may adopt the nonsingle control right arrangement mode, and more adopt the "combination fist" control right arrangement mode to achieve its holding purpose. The main ways of control arrangement in

M&A are as follows:

3.2.1 Equity control

According to Article 42 of the company law, the shareholders' meeting shall exercise the voting right according to the proportion of capital contribution, unless otherwise specified in the articles of association. According to the articles of association of the company, the shareholders can be divided into two types: the same share with the same right and the same share with different rights. The acquirer can control the target enterprise by purchasing a certain proportion of shares of the acquired party.

3.2.2 Contract agency control

(1) Concerted action

Concerted action means that two or more actors take concerted action to exercise voting rights or engage in other joint actions that have an impact on the company. According to the contract law, shareholders can unite with other shareholders to become the persons acting in concert and reach the agreement of persons acting in concert to achieve the goal of centralizing the amount of equity and realize the joint control of the company. In the process of M&A, the M&A party can reach the "agreement of persons acting in concert" with the shareholders of the target enterprise to achieve the goal of joint control of the target enterprise.

(2) Proxy and waiver of voting rights

According to the company law, shareholders can exercise their voting rights through authorized agents in writing or promise to give up their voting rights within a certain period of time. In the process of M&A, the M&A party can sign a "voting power agency agreement" with the shareholders of the acquired party to obtain additional voting rights; or the merger party requires the shareholders of the acquired party to sign a "letter of commitment to give up voting rights", so that the shareholders of the acquired party can not exercise their voting rights within a certain period of time to relatively increase the weight of their voting rights and achieve the goal of controlling the target enterprise.

4. Review the M&A case of Shenzhen V&T Technologies Co., Ltd by Yunnan Yunnei Power Group Co., Ltd.

4.1 Background of transaction

4.1.1 A brief introduction of Yunnan Yunnei Power Group Co., Ltd. Yunnan Yunnei Power Group Co., Ltd. is the first state-owned holding listed company in China's multi-cylinder small-bore diesel engine industry. It belongs to Kunming State Owned Assets Supervision and Administration Commission, and is a large-scale national enterprise. It was listed on the Shenzhen Stock Exchange on April 15, 1999. Its main products are vehicle diesel engine, nonroad diesel engine, diesel engine series, and its deformation unit and parts. At present, the company ranks fourth in the domestic vehicle engines; its main products and main market areas form the core competitiveness of sustainable development, and the overall management level is in the upper level of the domestic engine industry.

4.1.2 A brief introduction of Shenzhen V&T Technologies Co., Ltd. Shenzhen V&T Technologies Co., Ltd. is a high-tech enterprise with independent intellectual property rights and specializing in the research, development, manufacturing, and sales of power electronic products. It was successfully listed on the gem on March 22, 2016. The company's main products are electric vehicle motor controllers, medium and low voltage inverter, servo driver, etc. The company has mastered the core control technology of electric drive, and has perfect industrial design and production capacity. The VTS series and V9 series frequency converters and servo drivers introduced by the company can well meet the needs of high, medium and low markets.

4.2 Motivation

The continuous development of the economy and the intensification of competition in the industry have promoted the fifth M&A boom. For individual enterprises, enterprises can adapt to environmental changes more quickly through M&A, especially the strategic restructuring based on the

changes of industry or product life cycle, which can effectively reduce the barriers to enter new industries and new markets and bear relatively small risks, which can be quite beneficial to play a synergistic role. M&A can bring a variety of functions, and different enterprises have different motives for M&A. the motivations of this case mainly include the following aspects:

4.2.1 Acquire core technology and grasp the initiative of transformation

In the long run, the new energy vehicle industry will have a considerable impact on the diesel vehicle market. With the decline of the growth rate of the automobile industry, the business of Yunnan Yunnei Power Group Co., Ltd. also encounters bottlenecks. At the same time, diesel vehicles have a great emission problem, and many developed countries have already introduced a timetable for banning diesel vehicles in the future. Although there is no national-level policy on this aspect in China, many places have implemented the policy of banning diesel vehicles from the road or implementing subsidy measures to guide buyers to scrap diesel vehicles of national three standards. It has become a global trend to phase out polluting diesel and gasoline vehicles and develop environmentally friendly new energy vehicles. The main electric vehicle controller of Shenzhen V&T Technologies Co., Ltd. has advanced electronic control technology. At the same time, electronic control technology is one of the core technologies of new energy vehicles. It can drive and control the motor of an electric vehicle, so that the electric vehicle can run safely, stably, and efficiently. The acquisition of Shenzhen V&T Technologies Co., Ltd. marks an important step for Yunnan Yunnei Power Group Co., Ltd. to enter the new energy automobile industry, and firmly holds the initiative to transform to the new energy automobile industry.

4.2.2 Respond to the call of the transformation of state-owned enterprises

The reform of state-owned enterprises is an important strategic step for the central government to implement the policy of becoming bigger and

stronger. Promoting the transformation and upgrading of state-owned enterprises under the new normal is conducive to maintaining and increasing the value of state-owned capital and improving the competitiveness of the state-owned economy. Yunnan Yunnei Power Group Co., Ltd. is a listed state-owned enterprise under Kunming SASAC. The acquisition of Shenzhen V&T Technologies Co., Ltd. responded to the call of the transformation of state-owned enterprises, complied with the development situation of the market, formulated targeted development strategies, helped enterprises develop and expand, and improved the competitiveness of the state-owned economy.

4.2.3 Use the advantages of both sides to form a business synergy effect

Before the merger and acquisition, Yunnan Yunnei Power Group Co., Ltd.'s main products were vehicle diesel engines and nonroad diesel engines. At the same time, Yunnan Yunnei Power Group Co., Ltd. was also in a leading position in the domestic market, occupying a large market share, which has formed a particular scale effect. After the merger and acquisition of Shenzhen V&T Technologies Co., Ltd., the company entered the electrical and electronic control industry, complemented the company's business weakness in the new energy automobile industry, formed a business system of selling engines to fuel vehicle enterprises and electronic control systems to new energy vehicle enterprises, making full use of the advantages of both sides and forming business synergy effect.

4.2.4 Improve the technical level of industrial electronic products and expand the application fields, and consolidate the existing competitiveness

As a "national high-tech enterprise", Shenzhen V&T Technologies Co., Ltd. has won the honors of "the most competitive independent brand" and "technological innovation award". It has advanced industrial-level electronic product research and development technology. Its products meet the international standards and meet the application requirements of China's application environment and different industries. The reliability of the product

and the applicability of the environment are further strengthened. After acquiring the core products of the company, the company's share of core products in the automotive industry has been enhanced.

4.2.5 The new energy automobile industry is in a low ebb period, so as to improve the voice of Yunnan Yunnei Power Group Co., Ltd. in M&A

With the notice on adjusting and improving the financial subsidy policy for the promotion and application of new energy vehicles issued by four ministries and commissions in February 2018, subsidies for new energy vehicles continued to decline, which also exacerbated the financial crisis of the new energy vehicle industry. Further cost control by downstream vehicle manufacturers led to the situation that the upstream enterprises in the new energy vehicle industry chain were facing continuous decline in product prices. As a result, the performance of Shenzhen V&T Technologies Co., Ltd. in 2018 dropped dramatically. Compared with 2017, the operating income decreased by 31%, and the gross profit margin continued to decline. At the same time, the cash flow of downstream new energy vehicle manufacturers was poor, which also led to the tension of the cash flow of the company. In 2018, the net operating cash flow was -06 million yuan, and the turnover rate of receivables and inventory decreased to 20 from 1.72 times and 2.94 times in 2015, respectively 74 times and 1.65 times in 18 years. The new energy vehicle industry has fallen into the industry trough period, and the industry competition is intensifying, which makes blue ocean proton urgently need to introduce strategic investors with capital and background, which is also the main reason why Shenzhen V&T Technologies Co., Ltd. is willing to accept this control right arrangement. Yunnan Yunnei Power Group Co., Ltd. chooses to take M&A transaction at this time, which not only does not need to pay a large amount of premium as in the past years but also can improve the discourse power in M&A, reduce the proportion of equity acquisition, and greatly reduce the cost of M&A of cloud power to achieve the control of the target enterprise at a

small economic cost.

4.3 Control arrangement in the case

4.3.1 Merger plan

Yunnan Yunnei Power Group Co., Ltd. signed an equity transfer agreement with Qiu Wenyuan and Xu Xuehai, the founders of Shenzhen V&T Technologies Co., Ltd. and purchased 37759400 shares from Qiu Wenyuan and Xu Xuehai at a price of 14.60 yuan per share, a 31% premium over the previous trading day. After the transfer, Yunnan Yunnei Power Group Co., Ltd. held 18.15% of the shares of Shenzhen V&T Technologies Co., Ltd. Meanwhile, the former controlling shareholders Qiu Wenyuan and Xu Xuehai (holding 11.59% and 7.28% respectively and holding 18.87% in total) promised to terminate the relationship of concerted action; the remaining major shareholders promised not to sign a concerted action agreement with other shareholders in the next 24 months, and Xu Xuehai vowed to give up voting rights within 12 months after the completion of the transaction. This series of control rights arrangement measures enable Yunnan Yunnei Power Group Co., Ltd. to control the merged enterprises with only 18.15% shares.

4.3.2 Comparison of voting rights before and after M&A

As shown in Table 1, before the merger and acquisition, V&T's equity was relatively dispersed. The original controlling shareholders Qiu Wenyuan and Xu Xuehai held 15.45% and 9.71% of the shares, respectively, and reached a consensus action relationship, with the cumulative shareholding ratio of 25.16%. After the merger and acquisition, Yunnan Yunnei Power Group Co., Ltd., Qiu Wenyuan, and Xu Xuehai respectively owned 18.15%, 11.59%, and 7.28% shares of V&T. After the control right arrangement of agreement transfer, voting right abandonment and dissolution of the relationship of concerted action, Yunnan Yunnei Power Group Co., Ltd., Qiu Wenyuan and Xu Xuehai respectively owned 18.15%, 11.59% and 0% of the voting rights, and Yunnan Yunnei Power Group Co., Ltd. became the controlling share-

holder of Shenzhen V&T Technologies Co., Ltd.

Shareholders	Number of shares held before share transfer	Shareholding ratio before share transfer	Number of shares held after share transfer	Shareholding ratio after share transfer
Yunnan Yunnei Power Group Co., Ltd.	0	0.00%	37,759,400	18.15%
Qiu Wenyuan	32,131,024	15.45%	24,098,324	11.59%
Xu Xuehai	20,196,648	9.71%	15,147,648	7.28%
Jiang Zhongwen	12,524,472	6.02%	10,829,772	5.21%
Fu Yin	12,236,500	5.88%	10,056,500	4.83%
Shi Renshuai	10,187,508	4.90%	7,997,508	3.84%
Huang Zhuming	3,653,030	1.76%	2,740,030	1.32%
Huateng Capital	13,140,000	6.32%	0	0.00%
Zhongteng Capital	4,560,000	2.19%	0	0.00%
Total	108,629,182	52.23%	108,629,182	52.23%

5. Analysis of control right arrangement in M&A

From the perspective of the M&A party, the control right arrangement of "agreement transfer plus voting right abandonment plus dissolution of concerted action relationship" enables Yunnan Yunnei Power Group Co., Ltd. to reduce the acquisition proportion and spend only 551 million yuan of transaction consideration, which greatly reduces the capital cost of M&A and achieves the effect of controlling Shenzhen V&T Technologies Co., Ltd. The total shares held by the actual former controllers of Shenzhen V&T Technologies Co., Ltd. reached 33.67%. It is estimated that the transaction consideration of RMB1.022 billion will be spent if all shares of the actual original controller are to be acquired, and Yunnan Yunnei Power Group Co., Ltd. will trigger a comprehensive mandatory offer obligation. By reducing the proportion of acquisitions, cloud power no longer faces this problem. Finally, Yunnan Yunnei Power Group Co., Ltd. realized an A-share listed company with 551 million capital holding transaction value of 3.036 billion yuan, and successfully achieved the purpose of M&A with a small economic cost.

From the perspective of the acquired party, the M&A transaction successfully introduces strong state-owned enterprises, improves the competitiveness of enterprises, and enables the enterprises to smoothly pass the trough period of the

new energy automobile industry. The ingenious arrangement of control rights in M&A broadly retains the residual claim rights of the original founder team to the enterprise, which also enables the original founder team to enjoy the benefits brought by the growth of the enterprise to a large extent, stimulate the enthusiasm of the original managers and achieve a win-win situation.

A common feature of M&A transactions of Chinese enterprises is that they need huge capital, especially the acquired party is A-share listed company with the high market valuation. It is often tricky for enterprises to raise a large number of funds for M&A at one time, which is not conducive to market integration and synergy effect. Besides, if the enterprise adopts the conventional way of merger and acquisition, it needs to send a takeover offer to the merged enterprise and submit it to the CSRC for approval. Under this circumstance, the acquirer needs to undertake many obligations of the tender offer. The above problems have been solved skillfully by Yunnan Yunnei Power Group Co., Ltd. when merging Shenzhen V&T Technologies Co., Ltd., which is undoubtedly due to the skillful application of control right arrangement during merger and acquisition.

6. Conclusion

In this paper, from the perspective of reasonable control right arrangement of enterprises in M&A, this paper takes Yunnan Yunnei Power Group Co., Ltd.'s successful acquisition of Shenzhen

V&T Technologies Co., Ltd. with a small amount of funds, and realizes the rare "A—merge—A" M&A transaction as an example. It is found that the key to the successful acquisition of Yunnan Yunnei Power Group Co., Ltd. lies in the reasonable control right arrangement scheme of "agreement transfer plus voting right abandonment plus removal of concerted action relationship" during the acquisition. In the process of M&A, enterprises should pay attention to the rationality of control right arrangement and actively try diversified M&A schemes. A reasonable control right arrangement scheme can not only reduce the capital cost required in M&A, but also flexibly avoid the compulsory full offer obligation to realize the successful M&A; at the same time, under the background of "financing difficulty", this mode can let enterprises obtain more M&A opportunities, which is conducive to the integration of resources and the play of synergy effect. Specifically, the Enlightenment of this case study is as follows:

6.1 Making reasonable control right arrangement scheme to improve the success rate of M&A

According to the administrative measures for the acquisition of listed companies, if a purchaser intends to purchase more than 30% of the shares of a listed company by agreement, the part exceeding 30% shall be transferred to offer. If it has not obtained the exemption from the CSRC and intends to continue to perform its acquisition agreement, or does not apply for exemption, it shall issue a comprehensive offer before performing the acquisition agreement. According to the conventional M&A practice, enterprises will enter the compulsory comprehensive offer procedure. Ingenious use of control right arrangement, such as abandoning voting right and dissolving the relationship of concerted action, can not only reduce the capital cost and time cost of M&A, but also help the enterprise to achieve the purpose of holding shares, and can significantly improve the success rate of M&A. At the same time, some combination methods of control right arrangement can also be used for reference by enterprises, such as "agreement transfer plus partial offer", "agreement transfer plus voting power entrustment plus voting right abandonment", etc. enterprises should

choose suitable merger and acquisition scheme according to their own situation and specific actual cases.

6.2 Formulate reasonable control right arrangement to help enterprise development

In traditional M&A transactions, the arrangement of control right usually relies on a single share transfer. When the original founder team transfers the control right of the enterprise, it also loses the corresponding equity, which means that the original founder team is out of the game to a large extent. The original founder team has deep feelings and understanding of the enterprise, which is a crucial part of the development of the enterprise. Enterprises should reasonably use the control right arrangement strategy in M&A, which not only effectively solves this problem but also can greatly improve the enterprise's anti-risk ability and industry competitiveness by relying on the strength of the merger and acquisition party, help the enterprise overcome the difficulties and help the enterprise to develop. At the same time, the founder team still enjoys the economic benefits brought by the enterprise development. Dadi has retained the enthusiasm of the original managers and achieved a win-win situation.

6.3 Observe the economic trend and formulate organic M&A strategy

According to the data of Qingke research, China has completed about 1 trillion yuan of M&A transactions in 2019. China has strengthened the reform of the capital market, relaxed the conditions for listing and reorganization, and encouraged the merger and reorganization of listed companies. China Securities Regulatory Commission revised the administrative measures for major assets reorganization of listed companies, broadened the recognition standard and calculation period of reorganization and listing, resumed the matching financing for restructuring and listing, and allowed compliance with the requirements. The high-tech industry and strategic emerging industry, which are in line with the national strategy, are listed on the gem, a new development opportunity for Chinese enterprises. At the same time, it also makes the formulation of organic M&A strategy a critical link in M&A transactions. Organic M&A strategy

has many advantages, such as expanding the scale of production and operation, reducing costs, increasing market share, obtaining advanced production technology, management experience, and other resources, stepping into new industries through acquisition, implementing diversification strategy, and diversifying investment risks. In this case, Yunnan Yunnei Power Group Co., Ltd. predicts that high pollution diesel vehicles will be phased out in the world in the future and advocates the trend of new energy vehicles. Through the merger and acquisition of Shenzhen V&T Technologies Co., Ltd., which has the core electric motor control, the company realizes the layout in new energy vehicles. According to their actual situation and future development trend, enterprises should formulate an organic M&A strategy suitable for developing enterprises, fully integrate resources and play a synergistic effect, seek new growth points, and realize strategic development of enterprises.

6.4 Grasp the right opportunity of M&A and improve the discourse power in M&A

In this case, with the decline of subsidies for new energy vehicles, the industry competition intensifies, and the new energy vehicle enterprises fall into the dilemma of falling gross profit, tight cash flow, and escalating industry competition. New energy enterprises need to introduce strategic investors who have capital, technology, and background to unite with each other to improve their advantages to stand out. At this time, M&A transactions can not only significantly improve the bargaining power and bargaining power of the M&A parties but also improve the success rate of M&A and realize the strategic layout. For enterprises, it is of great significance for enterprises to choose the right time for merger and acquisition in the stage of development and expansion. In addition to the time of merger and acquisition analyzed in this case, enterprises should also consider the situation of macro-economy, capital market, and enterprise situation to find the right time for merg-

er and acquisition.

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