Venturing Abroad
Chinese Banks and Cross-Border M&A
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Note to the Reader

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China's banking industry has gained impressive momentum. Over the past few years, public listings have catapulted several Chinese banks into the ranks of the global titans. In 2007 three of the four largest listed banks in the world were Chinese, and the market capitalization of China's banking industry increased by 79 percent.

Along with banks’ swelling market values have come both greater ambitions and the wherewithal to act on them. Over the last two years, Chinese banks have substantially increased the size and number of cross-border M&A deals, expanding into markets such as Hong Kong, Indonesia, Singapore, South Africa, and the United States.

Banks’ enthusiasm for cross-border acquisitions has been met with skepticism on the part of some investors and analysts. M&A deals, in general, are notorious for falling well short of value creation expectations. According to a recent BCG report, *The Return of the Strategist: Creating Value with M&A in Downturns*, only about 40 percent of public-to-public M&A transactions produced positive shareholder returns (compared with the market) for the acquirer on announcement of the deal. Moreover, cross-border M&A deals tend to pose greater challenges than domestic deals, and Chinese banks are relatively less experienced in both M&A deals and foreign markets.

The clash between banks’ overseas aspirations and the views of skeptical investors and analysts raises important questions. First and foremost, does it make sense for Chinese banks to pursue cross-border M&A deals? Their size—coupled with their strong, profitable growth—gives them the capital and currency to venture abroad. But are they following a compelling strategic rationale or merely a tradition of well-funded banks looking for overseas acquisitions? Do they have the skills and resources to become global challengers, using M&A deals to penetrate and thrive in new markets? Or would they be better off playing the role of local dynamos, mastering China’s booming domestic market? Can they do both?

The answers to those questions have implications for banks both inside and outside China. Over the long term, some of the larger Chinese banks will come to play a more prominent role on the global stage, challenging the titans in cross-border markets. In the near term, banks outside China, particularly those that have been affected by the ongoing financial crisis, may look to Chinese banks for infusions of capital. Others might seek to partner with Chinese banks as a way of unlocking opportunities in China or to serve Chinese companies that are venturing abroad.

Our report, the result of an in-depth study of Chinese banks’ cross-border M&A activity, presents a clear picture of the pros and cons for cross-border deals. The study, which took place in late 2007 and early 2008, involved extensive interviews with leading Chinese banks and regulatory officials—along with financial investors, investment banks, and other market participants, both inside and outside China.

By weighing the benefits and risks of cross-border deals, some Chinese banks will be able to establish a clear case for pursuing selective, well-planned investments. For them, we hope this report provides a practical path forward. Other banks may instead choose not to pursue international M&A in favor of strengthening their domestic businesses. The report also examines the implications of Chinese cross-border M&A for banks around the world.
Chinese banks have recently become bolder in their M&A activities. Since 2006, deals have been announced at a faster pace and have grown in both size and scope—many have involved taking stakes in foreign institutions. For some Chinese banks, cross-border M&A is a cornerstone of their plans to grow and diversify, acquire skills, or access new markets. For others, it is more of an opportunistic tactic, given the recent devaluations of some Western banks.

**Bigger Deals on a Global Stage**

The first wave of cross-border M&A in Chinese banking occurred from 1993 through 2005. During this period, Chinese banks made an average of about one cross-border acquisition per year, but they never ventured too far from home: all of the deals were in Greater China, mainly in Hong Kong. In the second wave—beginning in 2006 and still under way—Chinese financial-services players have so far made 11 cross-border M&A deals, 6 of which have been outside Greater China. (See Exhibit 1.)

The deals have grown more frequent, far-flung, and sizable. During the first wave of cross-border M&A, most deals were valued at under $20 million; only two were valued at more than $100 million. In the second wave, there have so far been five deals of at least $1 billion each. The largest, between ICBC and Standard Bank Group, was valued at $5.5 billion. (See Exhibit 2.)

Although cross-border deals have become larger, they have not necessarily led to more control. Prior to 2006, most deals involved majority stakes. Since then, cross-border deals have involved mainly minority stakes, for two reasons. First, more Chinese banks have been pursuing larger cross-border deals for the first time, and they want to start off small (in terms of control). Second, banks that are more experienced in M&A have been pursuing larger acquisitions, where investments that run into the billions of dollars still buy just a fraction of an institution. Only two of the eight deals in 2007, along with one in the first half of 2008, involved a controlling stake.

The increase in cross-border M&A activity may be more a trend than an anomaly. To begin with, the market values of Chinese banks are rising steadily. In 2007 China claimed 5 of the 30 largest banks in the world measured by market capitalization—more than any country aside from the United States, which had 7 banks in the top 30. In addition, the current financial crisis has created a performance divide favoring banks in emerging markets such as China. In 2007 the average total shareholder return (TSR) of North American banks, many of which were at the epicenter of the crisis, was about −17 percent. Western European banks, also exposed to the crisis, posted an average TSR of about −3 percent. By comparison, the leading banks in the BRIC countries—Brazil, Russia, India, and China—posted an average TSR of 50 percent.

Chinese banks are just beginning to use cross-border M&A to grow. They own about $273 billion in foreign banking assets. As a percentage of total banking assets, this is relatively low. To equal the proportion of foreign banking assets held by banks in developed markets, Chinese banks would need to triple their foreign banking assets, to nearly $900 billion. (See Exhibit 3.)

**The Case for Going Overseas**

The pursuit of growth is the common denominator for cross-border M&A activity—it is part of every bank’s ra-

China’s cross-border financial-services M&A deals, 1993–2008

First wave (1993–2005)
Most deals were in Greater China, mainly in Hong Kong

Second wave (2006 to present)
Most deals have been outside Greater China

Exhibit 2. Since 2006, Cross-Border M&A Deals Have Become Much Larger

Value of China’s cross-border financial-services M&A deals, 1993–2008 ($billions)

The five largest deals have occurred since 2006

Sources: Thomson Reuters; BCG analysis.
Note: Data include transactions in foreign markets, including Hong Kong and Macau, made by a Chinese financial-services company; acquirers include companies that have a Chinese parent company.

1Reflects data as of June 30, 2008.
The importance, however, varies among banks. ICBC, for example, has adopted a proactive international M&A strategy, having pegged inorganic growth as a viable option for overseas expansion. To date, M&A deals have contributed 71 percent of the bank’s overseas assets and 87 percent of its overseas profits.

Other Chinese banks view overseas M&A as a way to complement organic growth strategies—a tool to be used on a case-by-case basis, not the centerpiece of an expansion strategy. China Construction Bank has opened offices in Sydney and the Middle East, and has approval to open branches in the United States. It has said it will consider appropriate targets in some markets, but M&A deals will not be its primary entry approach.

Chinese banks have turned to cross-border M&A to tap a range of strategic opportunities beyond growth: deploying excess funding, going global, acquiring capabilities, and diversifying the business.

Deploying Excess Funding. Deploying excess funding was the reason for pursuing cross-border M&A mentioned most frequently in our study. (See Exhibit 4.) Over the past five years, Chinese banks have taken in far more money than they have disbursed through loans. From 2003 through 2007, deposits grew at a CAGR of 16 percent, to about RMB 40 trillion. Over the same period, loans grew by an average of 13 percent per year, to about RMB 28 trillion. (See Exhibit 5.) In 2007 total deposits were 30 percent higher than total loans, or double the reserve requirement of 15 percent. Inorganic growth strategies give banks an opportunity to put this excess funding to work and have become even more relevant since the People’s Bank of China imposed restrictive loan quotas to cool down economic growth.

As an added benefit, Chinese banks may be able to take advantage of valuation arbitrage when deploying excess funding. Chinese banks have price-to-earnings (P/E) multiples that are significantly above average, making banks in the rest of the world appear relatively cheap. (See Exhibit 6.)

Going Global. Many large Chinese banks aspire to become global players—and not simply as a matter of prestige. Chinese companies in a range of industries are increasingly active in foreign markets—they are becoming...
### Exhibit 4. Chinese Banks Cited Nine Reasons for Pursuing Cross-Border Deals

<table>
<thead>
<tr>
<th>Strategic rationale for cross-border M&amp;A deals</th>
<th>Low</th>
<th>Frequency mentioned&lt;sup&gt;1&lt;/sup&gt;</th>
<th>High</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deploy excess funding</td>
<td></td>
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<td></td>
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<tr>
<td>Follow customers overseas</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Become a global company</td>
<td></td>
<td></td>
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<tr>
<td>Adhere to national directives</td>
<td></td>
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<tr>
<td>Extend product and service offerings</td>
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<tr>
<td>Import skills into China</td>
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<td></td>
<td></td>
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<tr>
<td>Diversify the bank’s business and risks</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Increase scale and lower costs</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Leverage capabilities abroad</td>
<td></td>
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</tbody>
</table>

Source: BCG interviews and research.

<sup>1</sup>Refers to the number of times a factor was cited in interviews with banks, analysts, authorities, and M&A experts. Factors on the “low” end of the spectrum were cited only once. Factors on the “high” end were cited at least ten times.

### Exhibit 5. With Deposits Outpacing Loans, Chinese Banks Have Accumulated Significant Excess Funding

**Total deposits and loans 2003–2007**

- (RMB billions)
- **CAGR (%)**

- **Deposits**
- **Loans**

**Excess funding<sup>1</sup> 2003–2007**

- (RMB billions)

**Sources:** People’s Bank of China; BCG analysis.

<sup>1</sup>Difference between total loans and deposits.
serious global challengers. A recent BCG report, *The 2008 BCG 100 New Global Challengers: How Top Companies from Rapidly Developing Economies Are Changing the World*, found that China was home to 41 of the top 100 companies from rapidly developing economies (RDEs). By comparison, India had the second highest number of top 100 companies, at 20. Many of China’s global challengers have conducted M&A activities in both emerging and mature markets; others have rolled out their own business models to pursue growth. Naturally, Chinese banks want to continue working with Chinese companies that are venturing into new markets. Following customers overseas and becoming a global institution were the second and third most commonly cited reasons in our study for cross-border M&A.

China’s trade and banking authorities are strong proponents of the international expansion of banks. The Ministry of Commerce is promoting a national policy of “going global” as way to strengthen the economy. Banks themselves are an integral part of the expansion of Chinese businesses, according to the Ministry of Commerce: “Appreciation of the Chinese yuan, increasing forms of liquidity, such as available bank facilities, and greater government support are giving many more companies the flexibility and encouragement to venture overseas.”

Chinese authorities, however, are not blindly supporting cross-border M&A; rather, they are cautiously supportive of Chinese banks’ making foreign investments. The China Banking Regulatory Commission (CBRC) recognizes that international expansion is important to the banking sector’s development and competitiveness, but it also acknowledges that this path is complicated and risky. CBRC has provided guidelines for Chinese banks considering international investments and has cautioned banks about going overseas too quickly. CBRC vice chairman Jiang Dingzhi wants banks to learn how to walk before they run. His restraint reflects the realities of expanding abroad.

**Exhibit 6. Valuation Arbitrage Favors Chinese Banks**

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>China Merchants Bank</td>
<td>35.5</td>
</tr>
<tr>
<td>Bank of Communications</td>
<td>30.9</td>
</tr>
<tr>
<td>ICBC</td>
<td>21.5</td>
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<tr>
<td>China Construction Bank</td>
<td>18.2</td>
</tr>
<tr>
<td>Bank of China</td>
<td>13.0</td>
</tr>
<tr>
<td>American Express Company</td>
<td>12.5</td>
</tr>
<tr>
<td>Wells Fargo</td>
<td>11.1</td>
</tr>
<tr>
<td>HSBC</td>
<td>10.4</td>
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<tr>
<td>BBVA</td>
<td>10.3</td>
</tr>
<tr>
<td>Bank of America</td>
<td>10.2</td>
</tr>
<tr>
<td>UniCredit</td>
<td>10.2</td>
</tr>
<tr>
<td>Citigroup</td>
<td>10.1</td>
</tr>
<tr>
<td>Wachovia</td>
<td>9.6</td>
</tr>
<tr>
<td>Banco Santander</td>
<td>9.0</td>
</tr>
<tr>
<td>JPMorgan Chase</td>
<td>8.6</td>
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<tr>
<td>UBS</td>
<td>8.3</td>
</tr>
<tr>
<td>Credit Suisse</td>
<td>7.5</td>
</tr>
<tr>
<td>BNP Paribas</td>
<td>6.6</td>
</tr>
<tr>
<td>Barclays Bank</td>
<td>6.0</td>
</tr>
<tr>
<td>RBS</td>
<td>5.0</td>
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</tbody>
</table>

**Sources:** Thomson Reuters; Standard & Poor’s Compustat; BCG ValueScience Center.

**Note:** Chinese banks’ P/E multiples are based on Hong Kong shares; for all other banks, P/E multiples are based on local currency. Earnings per share (EPS) used to calculate P/E multiples is diluted EPS before extraordinary items. Trailing 12-month EPS and forward 12-month earnings estimates are from Reuters and are as of October 18, 2007. P/E multiples are based on prices as of October 18 and 19, 2007.

**Acquiring Capabilities.** Some Chinese banks pursue cross-border M&A deals primarily to gain or enhance skills—and thus become more competitive, both at home and abroad. These deals provide a shortcut for building capabilities, allowing banks to acquire expertise rather than develop it organically. “Chinese banks need to import skills and know-how from developed markets,” said an executive at a state-owned Chinese bank, who cited
management, IT, and product-development capabilities as areas where domestic banks can benefit from the experience of foreign players. Foreign banks can also provide firsthand insights into their home market’s competitive and regulatory landscape.

Skills transfer can be as much about changing a bank’s image as it is about changing its chemistry. “Eventually, investors need to see demonstrated capability exchange,” said a fund manager from a global asset-management firm, who noted that the exchange should be a two-way street, with the overseas bank and the Chinese bank each imparting lessons to the other. “It isn’t that Chinese banks have no capabilities,” the fund manager said, “but they have no proven capabilities overseas. Until there is a track record of success, the perception will always be that there are no capabilities [to exchange].”

**Diversifying the Business.** Cross-border deals appeal to Chinese banks that want to diversify what they do and where they do it. Many large Chinese banks rely on basic deposit and lending businesses that target retail and commercial customers. These businesses provide good profitability and stable growth. However, banks’ offerings in areas such as asset and wealth management and investment banking—which provide high profitability, strong growth, better cross-selling opportunities, and fee-based business models—are typically underdeveloped. Likewise, large Chinese banks have good coverage of major domestic regions, but they are looking to diversify into both emerging and developed markets.

In addition to the benefits to revenue streams, growth, and business risk, diversification may also reduce the amount of capital required by Chinese banks. By diversifying balance-sheet risks across countries or regions, banks could lower the internal group-level economic capital, thus freeing up capital that can be directed to other projects.

As the financial crisis continues to spread from Wall Street to Main Street, with its impact evident in economic indicators that extend well beyond banking, Chinese banks may find more reasons to pursue cross-border deals. In 2003 BCG published the report *Winning Through Mergers in Lean Times: The Hidden Power of Mergers and Acquisitions in Periods of Below-Average Economic Growth.* The study examined 277 M&A transactions in the United States from 1985 through 2000 and found that deals struck during periods of below-average economic growth had a higher likelihood of success. Over a two-year period, weak-economy mergers generated 14.5 percent more shareholder value than strong-economy mergers.

The 2008 BCG report *The Return of the Strategist* explored the reasons behind the relative success of weak-economy deals. It found that both upturn and downturn acquisitions tended to trigger negative market reactions when the deals were announced, but downturn transactions created greater value in the long run, on average. The long-term advantage of downturn deals cannot be explained by the “buy low, sell high” rationale. Instead, it suggests that acquirers in difficult economic conditions are better at identifying targets with unrealized potential—possibly because of the disciplining power of downturns.

Although the current financial crisis could improve the odds of success for Chinese banks seeking foreign acquisitions, it should not dampen the sense of caution that normally accompanies M&A activities, nor should it lessen the importance of screening deals or encourage banks to seek out the weakest targets. *The Return of the Strategist* found that healthy targets were more likely than distressed targets to have a positive impact on the acquirer’s share price during a period of below-average economic growth.

Together, these benefits make an enticing case for cross-border M&A. Recent events have given Chinese banks even more reason to pursue foreign deals. The turmoil radiating from the downturn of the U.S. housing market has made capital-rich Chinese banks look especially prosperous, while making distressed banks more receptive to foreign investors. Banks outside China that have been severely affected by the subprime crisis have turned to foreign banks for much-needed capital infusions.
For every reason to pursue cross-border deals, there seems to be a reason that should give banks pause. M&A deals are notorious for destroying shareholder value. Cross-border deals are particularly challenging and have confounded some of the most experienced players in the most developed markets. Chinese banks face even greater challenges, including potentially being out of step with shareholders’ preferences.

The Inherent Challenges of M&A

In BCG’s 2003 study of the impact of M&A on shareholder value, Winning Through Mergers in Lean Times, 64 percent of the deals in the sample destroyed value at the time they were announced, and 56 percent continued to do so two years after the deal. A BCG report on value creation in banking, Managing Shareholder Value in Turbulent Times: Creating Value in Banking 2008, noted that aggressive growth strategies have had a tendency to dampen TSR performance. In some cases, postgrowth TSR either did not match the returns that could have been generated by paying out earnings as dividends or started strong but eventually went downhill. Over the past ten years, the value creation report noted, some of the world’s largest banks have pursued M&A strategies that delivered below-average TSR.

M&A deals are inherently complicated and involve a host of management, regulatory, and operational issues. (See the sidebar “Japanese Banks and Cross-Border M&A.”) Typical management issues include a lack of support from senior executives and conflicts with the target company’s management team. Regulatory issues include abstruse legal frameworks and—in some cases—outright opposition from governments. Operational issues include insufficient or unreliable information to conduct a fair valuation, along with the challenges of extracting cost synergies and integrating operations.

Most companies face an uphill battle as they try to make their M&A deals fulfill expectations for creating shareholder value. For a variety of reasons, Chinese banks face even steeper challenges. Their managers, in general, are less experienced with both M&A deals and overseas markets, and are therefore more likely to be unfamiliar with foreign regulatory and legal environments. This may create skepticism within their own organizations and among deal partners. On the operational side, Chinese cross-border M&A deals may involve more complex cultural differences. In North America and Western Europe, the risks of not being able to transfer best practices are particularly high.

Concerns About Chinese Banks’ Cross-Border Aspirations

The market’s initial reaction to acquisitions is often dismaying but not necessarily unfounded. There are simply too many variables that can compromise a buyer’s ability to make a deal succeed. Chinese banks will face the same kind of skepticism from analysts and investors, along with several concerns that may be particularly acute.

A Costly Distraction. Shareholders of Chinese banks understand the argument for cross-border M&A. It provides an opportunity for banks to leverage their excess liquidity and high valuation multiples, gain valuable expertise, and keep up with Chinese firms that are venturing overseas. At the same time, however, many shareholders have important concerns about Chinese banks’ plans to pursue cross-border M&A.
Twenty years ago, Japanese banks embarked on a campaign of cross-border M&A, focusing on U.S. and Western European markets. The surge of cross-border M&A was short-lived—it lasted from 1988 through 1990—but led to dozens of deals totaling billions of dollars. (See the exhibit below.) Some deals fell short of their strategic value-creation expectations—in part because an economic downturn forced Japanese banks to raise capital by selling foreign assets (even though some transactions were profitable), but also because the deals were made opportunistically rather than as part of an orchestrated plan.

Like Chinese banks, Japanese banks had good reason to go abroad. Most had excess liquidity and were positioning themselves to keep up with their corporate clients, which were moving into foreign markets. Some wanted to gain new capabilities through foreign partnerships, which would make them more competitive at home. A sense of confidence, born of success in the domestic market, also propelled the banks abroad.

In some cases, however, overseas M&A deals lacked both a strategic rationale and a well-defined proposition for creating shareholder value. Wherever banks could not bring much value to the deal, customer confidence typically suffered. With limited alternatives, Japanese companies operating in foreign markets ended up turning to foreign banks for specialist services. Other deals were compromised by the loss of knowledgeable and experienced staff in the target bank or the imposition of restrictive government regulations in foreign markets.

Banks in China should heed one of the defining lessons from the Japanese experience: because cross-border M&A is inherently challenging and carries many risks, banks must approach these deals with a clear rationale, backed by a specific plan for creating value.
To begin with, most shareholders of Chinese banks are understandably preoccupied with domestic growth—annual GDP growth has ranged from 10 to 12 percent in recent years. The economy has been expanding rapidly, fueling a high-performing banking sector. In addition, China’s unmet consumer demand in banking bodes well for the development of new revenue streams. Globally, banking revenues are expected to grow by $1.1 trillion from 2006 through 2015. Banking revenues in China are expected to account for $200 billion, or 18 percent, of this increase.

An opportunity of this size will not go uncontested. In fact, the ongoing deregulation of China’s financial-services industry is certain to bring more foreign participants into the market, upping the ante on the products and services on offer and leading to a more crowded, dynamic environment.

Against the backdrop of an attractive but increasingly competitive domestic market, cross-border M&A is seen by some investors as a costly distraction. Many shareholders would prefer that banks focus on the basics: a solid balance sheet, strong return on equity and net interest margin, more sophisticated capabilities (in areas such as risk management, for example), and the development of an increasingly broad, competitive domestic offering.

Cross-border deals and domestic growth are not necessarily mutually exclusive, but investors are well aware that such deals absorb a substantial amount of management attention and company resources. Can a bank afford to divert capital and talent away from domestic operations and toward international ventures? Do Chinese banks really need to venture abroad in order to succeed?

The Challenge of Extracting Value from Cross-Border Deals. Doubts about the necessity of foreign M&A are compounded by investors’ concerns that Chinese banks may not be able to draw value from these deals. How will these deals contribute to banks’ overall profitability, growth, and TSR? Will banks have an adequate stake that allows them to extract capabilities or wield influence? At a more detailed level, investors have concerns about the ability of banks to execute M&A deals. Do they have the skills and experience to assess the potential value and risks of these deals? Will they be able to identify and address complex integration and cultural issues to pave the way for synergies and the transfer of skills?

The Lack of a Clear Rationale. Because Chinese banks can tap tremendous opportunities for growth without venturing abroad, shareholders need to hear an exceptionally clear strategic rationale for cross-border M&A. They need to be convinced that a bank is pursuing this type of M&A not simply because it can—given excess funding, for example, or the devaluation of Western banks—but because it should.

Shareholders certainly have not closed the door on cross-border M&A. They recognize that growth through such deals can be part of a bank’s long-term success—but only if they are the outcome of clearly defined plans. Shareholders are wary of speculative deals. “We want them to be specific and show a reason for doing it,” remarked a fund manager at an asset management firm, referring to Chinese banks that have foreign M&A plans. “We need to be convinced that this will be good in the long term and want to see synergies and a strong strategic fit with the banks.”
Given the inherent challenges of M&A, together with concerns about Chinese banks’ plans for making cross-border deals, Chinese banks must establish a clear rationale for venturing abroad. If they can build a good case, they must then decide which targets fit their strategy. Finally, they must develop plans for executing the deals. A communications strategy, among other factors, will be critical to success. (See Exhibit 7.)

**Why Pursue Cross-Border M&A?**

The pursuit of cross-border M&A should begin with a clear logic that articulates the role that international expansion will play in the bank’s strategy and vision. There are three ways Chinese banks can build such a case. First, they can show that cross-border M&A will be a good financial investment. It might raise the bank’s TSR, deploy excess domestic funding, or diversify its business. M&A deals, in general, have a checkered past when it comes to value creation. As a result, banks that want to base their strategy on financial gains will need to make a watertight case to withstand scrutiny from investors and analysts.

Second, cross-border deals could be predicated on acquiring capabilities that will make the bank more competitive—at home and abroad. This approach could be persuasive, as many investors immediately associate cross-border deals with building capabilities. “Skills transfer and acquisition of management capabilities is the real target of [cross-border M&A],” said a portfolio manager with a global asset-management firm. “And irrespective of whether you lose money or make a profit, the investment has been a failure if you have not fulfilled your primary goal.”

Third, cross-border M&A could give a bank a global profile, opening up new sources of growth and allowing the bank to follow its local customers overseas. This rationale is consistent with national policies—the government is encouraging companies to venture abroad—and Chinese companies continue to make inroads into foreign markets. Banks will need to underscore their commitment to becoming competitive, and not merely present, in a foreign market. As Chinese companies expand into new markets, they will look for opportunities to continue their relationships with Chinese banks. But if the overseas offerings from Chinese banks are inadequate, these companies will ultimately seek alternatives.

The success of Spanish banks demonstrates the value of defining clear strategies for overseas M&A deals. (See the sidebar “Elements of Success: Spanish Banks’ Strategy for Cross-Border M&A.”)

**Which Institutions Should Banks Target?**

A well-defined strategic rationale should guide banks through the process of screening deals. If a bank’s rationale is to make good financial investments, the targets must have strong historical growth and high returns. (See Exhibit 8.) Chinese banks will have demanding expectations on such performance measures. Their income grew by a CAGR of nearly 30 percent per year from 2001 through 2006, and their return on tangible equity (ROTE) averaged about 13 percent over the same period. Valuation arbitrage opportunities will likely play a role in screening targets in general—but more so when banks are pursuing M&A as a financial investment. Among Chinese banks, trailing P/E multiples averaged about 37 in 2007, almost three times higher than the average for banks outside China.
Exhibit 7. Before Venturing Abroad, Banks Must Delve into the Why, What, and How of Cross-Border M&A

<table>
<thead>
<tr>
<th>Why</th>
<th>What</th>
<th>How</th>
</tr>
</thead>
<tbody>
<tr>
<td>Logic</td>
<td>Screening</td>
<td>Evaluation</td>
</tr>
<tr>
<td>◦ Industry and company assessment</td>
<td>◦ Portfolio of opportunities</td>
<td>◦ Due diligence</td>
</tr>
<tr>
<td>◦ Strategic rationale for M&amp;A</td>
<td>◦ First-cut assessment of value creation potential</td>
<td>◦ Commercial</td>
</tr>
<tr>
<td>– Articulate the role that M&amp;A will play in supporting the bank’s strategy and vision</td>
<td>◦ Identification of targets</td>
<td>◦ Regulatory</td>
</tr>
<tr>
<td>◦ Strategic value</td>
<td>◦ Financial impact</td>
<td>◦ Financial</td>
</tr>
<tr>
<td>◦ Tradeoffs</td>
<td>◦ Valuation refinement</td>
<td>◦ Tax and legal</td>
</tr>
<tr>
<td>◦ Due diligence</td>
<td>◦ Standalone value</td>
<td>◦ Combination synergies</td>
</tr>
<tr>
<td>◦ Portfolio of opportunities</td>
<td>◦ Valuation refinement</td>
<td>◦ Sequence and timing of integration activities</td>
</tr>
<tr>
<td>◦ First-cut assessment of value creation potential</td>
<td>◦ Due diligence</td>
<td>◦ Targets, milestones, and accountabilities</td>
</tr>
</tbody>
</table>

Communication

◦ Public relations plan
  – Position the bank’s strategy as open and transparent
  – Address issues that may give rise to political sensitivities

◦ Communication plan
  – Announce deal bidding and completion
  – Update plans and progress during integration

Source: BCG analysis.
1Bidding is led largely by the bankers, auditors, and lawyers who assist the acquirer.

Exhibit 8. Chinese Banks Should Target Overseas Banks That Have Strong but Undervalued Prospects for Growth

1 Identify banks with strong historical growth and high returns

2 Assess opportunities for valuation arbitrage

Income growth

Average ROTE, 2001–2006 (%)

Average income growth of Chinese banks: 28.6

Average ROTE of Chinese banks: 13.2

Trailing P/E multiple, 2007

Average trailing P/E multiple of Chinese banks: 37

Average trailing P/E multiple of non-Chinese banks: 12.5

United States Europe India and Brazil China

Source: BCG analysis.

Note: The peer group includes the top five U.S. and European banks and the top three Indian and Brazilian banks, measured by market capital; the availability of data for Bank of China, Bank of Communications, China Construction Bank, and ICBC is limited because each bank was publicly listed in either 2002 or 2003.

1 Net income before extraordinary items.
BCG’s most recent report on value creation in banking, *Managing Shareholder Value in Turbulent Times*, found that Spain’s banking sector continued to climb in the performance ranking. Among ten major developed banking sectors, its five-year TSR ranked seventh in 2005, fifth in 2006, and third in 2007. (See the exhibit below.) Its one-year TSR in 2007 ranked second.

The above-average performance of Spain’s banking sector owes much to the successful international-expansion strategies of its largest banks, which have been able to deliver strong overseas return on invested capital, particularly in Latin America and North America. Spanish banks turned their attention to overseas investments for many of the same reasons that Chinese banks are looking abroad. They had excess liquidity because of Spain’s strong GDP growth. Moreover, an increasing number of Spanish companies were heading overseas. In addition, a growing Spanish-speaking population in the United States was creating new opportunities.

Banco Santander started with a clear strategy to create value through foreign acquisitions. It developed a turnaround strategy that focused on banks with high synergy potential in Latin America and the United Kingdom, and zeroed in on opportunities where it could leverage its existing business expertise.

The bank’s strategy had other elements of success, as well. For example, the bank expanded into regions that were inviting because of shared language, other cultural affinities, or close business ties. It also started small and built its foreign expertise incrementally, rather than starting off with megadeals. Finally, the bank utilized local management extensively, either from the acquired companies or from other local organizations.

### Elements of Success: Spanish Banks’ Strategy for Cross-Border M&A

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Chinese banks that are committed to gaining capabilities should focus on multispecialists and full-service players. They are bound to find opportunities to diversify their skills. A typical Chinese bank draws more than 80 percent of its wholesale-banking revenues from loans and financing. A typical full-service wholesale bank, by comparison, generates less than 20 percent of its wholesale revenues from loans and financing. Investment banking, which produces about 2 percent of a Chinese bank’s wholesale revenues, can account for about 48 percent of a full-service bank’s revenues. (See Exhibit 9.)

The third rationale, going global to support Chinese corporate clients, will push banks toward China’s biggest trading partners—particularly ones with high levels of overseas direct investment (ODI) from China. Aside from Hong Kong, these partners include developed economies such as Australia, Germany, Japan, Singapore, and the United States. Chinese banks may also target markets where trading volumes are strong but ODI from China has room to grow. (See Exhibit 10.) These markets include developing economies such as Brazil, Indonesia, and Vietnam.

Regardless of which strategic rationale defines their screening process, Chinese banks will also need to consider regulatory issues. Which markets facilitate foreign investments? Which ones have high barriers? The United States, for example, allows foreign firms to have 100 percent ownership, but big deals require regulatory approval. The political climate also affects the viability of foreign investments. In 2007, as the financial crisis deepened in the United States, several sovereign wealth funds—government-controlled investment pools—provided capital to banks that had suffered losses. It wasn’t long before the involvement of foreign governments in major banks attracted criticism and protectionist rhetoric—in part because some sovereign wealth funds provide few details about their operations or motives.

Chinese banks that are venturing into M&A for the first time may want to add another filter to their screening process: cultural affinity. They can reduce some of the stress and complexity of a foreign deal by focusing on markets that share cultural traits with China.

The screening process should allow banks to narrow their search to a small group of targets in a limited number of markets. As they evaluate potential deals, Chinese banks need to consider more than just what the target company can contribute to the deal. To establish a strong negotiat-

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**Exhibit 9. Traditional Chinese Banks Have Room to Diversify**

<table>
<thead>
<tr>
<th>Example: Traditional Chinese bank</th>
<th>Example: Multispecialist bank</th>
<th>Example: Full-service bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans and financing²</td>
<td>83</td>
<td>2</td>
</tr>
<tr>
<td>Investment banking</td>
<td>4</td>
<td>9</td>
</tr>
<tr>
<td>Transaction banking</td>
<td>11</td>
<td>28</td>
</tr>
<tr>
<td>Loans</td>
<td>35</td>
<td>9</td>
</tr>
<tr>
<td>Other¹</td>
<td>13</td>
<td></td>
</tr>
<tr>
<td>Investments/deposits</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>Transaction banking</td>
<td>15</td>
<td></td>
</tr>
<tr>
<td>ECM³/DCM⁴</td>
<td>11</td>
<td></td>
</tr>
<tr>
<td>Trade services</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>Structured finance</td>
<td>26</td>
<td></td>
</tr>
<tr>
<td>Plain vanilla finance</td>
<td>7</td>
<td></td>
</tr>
<tr>
<td>Loans and financing²</td>
<td>9</td>
<td></td>
</tr>
<tr>
<td>Investment banking</td>
<td>7</td>
<td></td>
</tr>
<tr>
<td>Other¹</td>
<td>2</td>
<td></td>
</tr>
</tbody>
</table>

Sources: BCG Global Corporate Banking Benchmarking database; annual reports from Chinese banks.

Note: Percentages may not total 100 owing to rounding.

¹Includes agency service fees related to mutual fund distribution and wealth management income.

²Includes net interest income from loans to customers.

³Equity capital markets.

⁴Debt capital markets.
ing position, they need to show the value they bring to the deal. The ongoing financial crisis, coupled with the excess liquidity of Chinese banks, has provided a clear premise for foreign investment, particularly in the United States and Western Europe. And Chinese banks are in a position to provide a valuable infusion of capital. But this is more a matter of incident and circumstance than of anything else. It makes for a compelling reason to enter a market, but it is unlikely to lead to sustainable advantage. It should not be the only reason for a deal.

Chinese banks should instead emphasize the longer-term advantages they can provide, such as access to new revenue streams (if the cross-border deal takes the form of a partnership or joint venture, rather than a controlling stake). China’s unrelenting growth has captured the attention of companies around the world. A Chinese bank can open a door for foreign players that are interested in gaining entry into China but lack local expertise. Chinese banks can also provide access to the global challengers springing from different sectors of China’s economy.

During the evaluation, Chinese banks should ensure that the deal structure and degree of integration support their objectives. Some Chinese banks have shaped their cross-border deals in a way that allows them to test the waters and pace their involvement. For example, a deal might provide an option to purchase a larger stake at a later date or give the Chinese bank an important but nonintrusive role in the target company. To ensure their objectives are met, Chinese banks might pursue cross-holding deals, with each bank owning part of the other. This would help both players align their strategic and financial interests and ensure that critical skills are transferred.

The evaluation process will need to include a careful examination of any political and regulatory hurdles. In some countries, there are concerns about the perceived link between the Chinese government and Chinese banks. In highly regulated markets such as the United States, regulatory compliance can be difficult and expensive. How much of a burden will this impose? Will it change the attractiveness of the deal? The regulatory approval process, in particular, must be carefully mapped out, and

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**Exhibit 10. Trading Volumes and Foreign Investments Can Help Chinese Banks Pinpoint Attractive Markets**

**Sources:** National Bureau of Statistics of China; 2006 Statistical Bulletin of China’s Outward Foreign Direct Investment.

**Note:** Data exclude countries with less than $1 million in ODI or less than $1 billion in trade volume.
estimates must be made of its associated investments in both time and cost.

**How Should Banks Execute Deals?**

Rigorous preparation can increase the odds that an M&A deal will eventually create value. Ultimately, however, the success of a deal will be determined during the execution phase. During this critical stage, Chinese banks should focus on three important activities: bidding, postacquisition integration, and communication.

Bidding is a common stumbling block; inexperienced buyers tend to overpay for acquisitions. Chinese banks that lack expertise in valuation methodologies are at risk of paying too much. Banks can improve their position in the bidding process by laying out a clear, compelling case that shows the value they can bring to the deal—for example, by providing an opportunity for a foreign bank to tap the Chinese market. They should also develop due diligence expertise to ensure that they can perform a rigorous valuation. Some banks might consider bringing in an experienced deal partner to estimate deal synergies or provide valuable negotiating skills. An experienced negotiator could help a Chinese bank increase the odds of acquiring certain skills by building explicit requirements into the deal.

The amount of postacquisition integration will vary from deal to deal, but most Chinese banks will pursue limited rather than full integration of foreign targets. The prerequisites for full integration—in which the target company essentially disappears into the acquiring company—are demanding. They include extensive integration experience, a strong understanding of the target’s business, and capabilities that are equal or superior to those of the acquired firm. Chinese banks are more likely to leave the target companies intact. Depending on the deal, they may manage the target at arm’s length, ensure close ties through cooperation agreements, or pursue limited back-office integration. For example, a Chinese bank might use the acquisition of a specialist institution, such as an asset manager, as an opportunity to allow the target’s management to play a valuable role in helping to develop and manage the Chinese bank’s own business.

Banks that are entering foreign markets and looking to acquire new skills must pay close attention to retaining talent. To this end, Chinese banks should be prepared to relinquish some operational control, which can help solidify the relationship and demonstrate senior management’s commitment to a successful merger. During the integration process, Chinese banks should identify top performers and provide incentives for them to stay, perhaps by offering competitive terms and such nonfinancial benefits as international transfers.

Chinese banks will need to develop a comprehensive communication plan that begins well before the execution of a deal. It will be important for these banks to send a clear message—to both investors and foreign markets—that cross-border M&A is part of a strategic plan. Communication will become more critical during integration, particularly as banks try to retain staff in the target company. Chinese banks may also need to debunk myths. In some markets, customers and investors may be concerned that the banks lack transparency or accountability, are bureaucratic and political, and have poor risk-management controls.
O nce a bank understands the essentials of foreign M&A, it may still face a yawning gap between the theory of its strategic rationale and the reality of choosing a specific target. To help bridge this gap, our study set out to find a handful of investment opportunities that are likely to suit Chinese banks. The study also yielded an extensive checklist of issues that are relevant to cross-border M&A. (See the sidebar “Are You Prepared for Cross-Border M&A?”)

Our study identified four potential investment opportunities for Chinese banks, each with different levels of feasibility and strategic impact. (See Exhibit 11.)

**Invest in well-managed banks in high-growth, developing markets.** Chinese banks can take minority stakes in tier-one banks in RDEs as a way to gain a foothold in those markets. They should start with small stakes in national or regional banks that have records of high growth and shareholder returns. They could then draw on their partner’s experience to gain familiarity with overseas market practices, customer preferences, and regulatory frameworks—thus setting the stage for further expansion. Chinese banks should also identify synergies—particularly ones that will boost revenues—to deliver shareholder value. This will help demonstrate the strategic importance of cross-border M&A to investors preoccupied with China’s domestic growth.

**Acquire specialist product firms or product arms.** Chinese banks could acquire a majority shareholding of specialist product firms—such as standalone boutiques—or buy a product arm of a large institution to fill capability gaps and generate traction both in developed banking markets and in China. Chinese banks may initially focus on acquiring product manufacturing capabilities in business lines that are relatively new but growing in China. Such lines include asset management, investment banking, and specialized finance. Banks should consider adopting an arm’s-length management approach or structuring a reverse integration—whereby the expertise of management and product specialists is brought to bear in China—to maintain business continuity and maximize the transfer of capabilities.

Chinese banks should also explore opportunities to acquire specialized product arms from leading banks that might want to exit the business or raise capital. This investment opportunity is suitable for developed markets. Similar to the previous approach, Chinese banks should focus on asset management, investment banking, and specialized finance. This approach enables best-practice transfer of capabilities and may provide brand and channel advantages. However, it may also entail more complex transaction and integration issues.

**Acquire small commercial banks.** In countries or regions where Chinese banks already have a good understanding of markets, customers, and regulatory frameworks, they may seek to acquire majority shares of small commercial banks. They could then use these positions as beachheads to build their business in foreign markets. They should target countries or regions with similar financial-services cultures, comparable customer behaviors, or close business ties with China. Chinese banks should also seek transactions that exploit their product and business line strengths: notably, consumer and commercial banking and private banking.

Foreign banks have been expanding their presence in Indonesia by acquiring small local banks. In 2007 the Com-
monwealth Bank—a subsidiary of Commonwealth Bank of Australia—acquired an 83 percent stake in Bank Arta Niaga Kencana (Bank ANK) in Indonesia. The move, which added 20 branches to Commonwealth Bank’s network, has been instrumental in helping the Australian bank strengthen its market share and build a solid foundation for growth, particularly in East Java. It now operates a network of more than 50 branches in Indonesia, which includes the former Bank ANK branches.

**Invest in attractively valued global banks.** Chinese banks may acquire minority stakes in global banks that are undervalued, perhaps as a result of the ongoing financial crisis. Although this approach has the upside of a “buy low” deal, it is—like other forms of cross-border M&A—beset with strategic, transactional, and integration challenges. Such acquisitions should still be grounded in the acquiring bank’s corporate and international strategy. In addition, Chinese banks will need to demonstrate M&A expertise, negotiate learning initiatives to build specific capabilities, establish control measures—for example, through voting rights, board seats, rotational teams, and cooperative agreements—and develop a comprehensive strategy to deliver shareholder value.

### Exhibit 11. Foreign Markets Present Discrete Investment Opportunities

<table>
<thead>
<tr>
<th>Opportunities</th>
<th>Rationale</th>
<th>Developed market presence</th>
<th>RDE market presence</th>
<th>Ownership</th>
<th>Value-enhancing tactics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Invest in attractively valued global banks</td>
<td>1 2 3</td>
<td>✓</td>
<td>✓</td>
<td>Minority</td>
<td>◊ Implement learning initiatives&lt;br&gt;◊ Ensure involvement through voting rights, board seats, rotational teams, and cooperative agreements</td>
</tr>
<tr>
<td>Acquire specialist product firms or product arms</td>
<td>1 2</td>
<td>✓</td>
<td>✗</td>
<td>Majority</td>
<td>◊ Access asset management, investment banking, and specialized finance products&lt;br&gt;◊ Adopt arm’s-length management or structure a reverse integration&lt;br&gt;◊ Leverage revenue synergies&lt;br&gt;◊ Enable capability transfer arrangements</td>
</tr>
<tr>
<td>Acquire small commercial banks</td>
<td>3</td>
<td>✓</td>
<td>✓</td>
<td>Majority</td>
<td>◊ Target business in other countries or regions in complementary business lines: consumer and commercial banking and private banking</td>
</tr>
<tr>
<td>Invest in well-managed banks in high-growth, developing markets</td>
<td>1 3 ✗</td>
<td>✓</td>
<td></td>
<td>Minority</td>
<td>◊ Gain market and regulatory familiarity&lt;br&gt;◊ Prepare for future entry and expansion&lt;br&gt;◊ Leverage revenue synergies</td>
</tr>
</tbody>
</table>

Source: BCG analysis.
Are You Prepared for Cross-Border M&A?

On the basis of our extensive interviews with participants in China’s banking sector, as well as our experience with both M&A activities in general and Chinese banks in particular, we have developed a list of questions that banks can ask to gauge their preparedness for foreign deals.

Define your strategy

☐ Is your corporate strategy clearly defined?
  ✓ Do you have a clear picture of the industry landscape and your relative position?
  ✓ Have you defined customer segments and identified which ones to target?
  ✓ Do you have an aspiration for your current and future portfolio of products and services for each customer segment?
  ✓ Have you set targets for your overall financial performance and will your current plans achieve these targets?
  ✓ Have you defined a clear brand that reinforces and reflects your corporate strategy?
  ✓ Have you broken down your strategy into annual targets for business units and branches?

☐ Have you identified your sources of future growth?
  ✓ Have you identified which businesses to grow and which to maintain?
  ✓ Do you know which businesses need to be fixed before you expand them and which you should divest?
  ✓ Do you have a clear understanding of how much growth should come from M&A?

☐ Do you have a clear international strategy?
  ✓ Do you have a vision of your future international footprint?
  ✓ Have you thought through and calculated the opportunity costs of pursuing international expansion?

✓ Do you have a competitive advantage in the international market segment you are targeting?
✓ Do you have a clear direction for your international expansion? For example, are your plans predicated on targeting specific regions, client segments, and products?

☐ Does your cross-border M&A strategy reflect your overall strategy?
  ✓ Do you have a clearly defined rationale for the transaction?
  ✓ Does the rationale align with your corporate and international strategies?

Assess your capabilities and internal appetite for foreign M&A

☐ Have you identified the internal capabilities you have (and those you need)?
  ✓ Have you catalogued existing capabilities and leading proprietary capabilities?
  ✓ Have you identified capability gaps and the effort required to close them?
  ✓ Do you know which proprietary or specialized capabilities you are willing to share?

☐ Do you have M&A-related experience and expertise to carry out or support all of the activities associated with target screening, due diligence, negotiations, and integration?

☐ Do you know what resources are available for overseas investments?
  ✓ Have you identified the attractiveness and availability of capital?
  ✓ Is the "right" capital available—will you use cash or equity?
  ✓ Do you know the impact of a transaction on your debt capacity and credit rating?
## Are You Prepared for Cross-Border M&A? (continued)

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do you have the necessary level of internal support?</td>
<td>✓ Have you identified available partners?</td>
</tr>
<tr>
<td>✓ Do you have the support of management, business units, and regional teams?</td>
<td>✓ Have you identified affordable partners?</td>
</tr>
<tr>
<td>✓ Does your board support you?</td>
<td>✓ Have you found partners with a strong “fit”?</td>
</tr>
<tr>
<td>✓ Do you have the support of a transaction team (for example, to carry out due diligence and integration activities)?</td>
<td></td>
</tr>
<tr>
<td>Do you have the necessary level of external support?</td>
<td>Do you know how you will create synergies?</td>
</tr>
<tr>
<td>✓ Do you have sufficient regulatory support (in China and overseas)?</td>
<td>✓ Have you identified revenue synergies?</td>
</tr>
<tr>
<td>✓ Do you have enough shareholder support?</td>
<td>✓ Have you calculated cost synergies (ongoing and one-time)?</td>
</tr>
<tr>
<td>Have you identified a reasonable time frame or window of opportunity?</td>
<td>Have you gauged the ease of execution relative to your experience?</td>
</tr>
<tr>
<td>✓ Will critical capabilities be ready when you need them?</td>
<td>✓ Have you identified the competitiveness of the target company?</td>
</tr>
<tr>
<td>✓ Will financial resources be available for the transaction?</td>
<td>✓ Have you assessed your level of M&amp;A expertise?</td>
</tr>
<tr>
<td>✓ Do you know how long your internal and external support will last?</td>
<td>✓ Do you know your target’s and competitors’ level of M&amp;A expertise?</td>
</tr>
</tbody>
</table>

### Evaluate investment opportunities

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do robust target selection criteria exist?</td>
<td>✓ Have you identified the experience and expertise of your due-diligence team—both absolutely and relative to your peers?</td>
</tr>
<tr>
<td>✓ Have you defined reasonable growth targets?</td>
<td>✓ Can you gauge the accuracy of targets’ forecasts?</td>
</tr>
<tr>
<td>✓ Have you identified the right customer segments?</td>
<td></td>
</tr>
<tr>
<td>✓ Do you know what distribution capabilities you need to reach the right customer segments?</td>
<td></td>
</tr>
<tr>
<td>✓ Have you prioritized regions or countries?</td>
<td></td>
</tr>
<tr>
<td>✓ Do you know what product and service capabilities are needed?</td>
<td></td>
</tr>
<tr>
<td>✓ Have you established a process to filter opportunities along a set of key dimensions?</td>
<td></td>
</tr>
</tbody>
</table>

### Assess the financial and economic implications

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do you have a process for conducting due diligence to avoid bad deals?</td>
<td>Do you have a process for conducting due diligence to avoid bad deals?</td>
</tr>
<tr>
<td>✓ Have you identified the experience and expertise of your due-diligence team—both absolutely and relative to your peers?</td>
<td></td>
</tr>
<tr>
<td>✓ Can you gauge the accuracy of targets’ forecasts?</td>
<td></td>
</tr>
<tr>
<td>Are you confident that you can conduct due diligence to avoid overpaying?</td>
<td>Has your due-diligence team defined comparable multiples to appropriately value the target?</td>
</tr>
<tr>
<td>✓ Has your due-diligence team defined comparable multiples to appropriately value the target?</td>
<td></td>
</tr>
<tr>
<td>✓ Are the synergy expectations identified by your due-diligence team reasonable?</td>
<td></td>
</tr>
<tr>
<td>✓ Does your due-diligence team have a track record of achieving valuations that both secure the deal and add shareholder value?</td>
<td></td>
</tr>
</tbody>
</table>
Have you identified shareholder and investment structures to maximize value?

- Do you know whether a minority or majority stake will maximize value?
- Do you know whether a cash or equity investment will maximize value?

Do you know the financial impact of the transaction on your company?

- Have you estimated the ROE of the transaction?
- Have you calculated the TSR of the transaction?
- Have you determined the impact on publicly traded shares?
- Have you identified the impact on debt capacity and credit rating?
- Can you convince shareholders of the necessity or benefit of your cross-border M&A plans?

Select and execute the deal

Do you know how you will negotiate favorable terms?

- Have you identified potential terms for a better negotiating position?
- How will you maintain the support of the target company throughout the negotiation and transaction of the deal?
- Do you have a contingency plan if the deal falls through?

How will you communicate with key stakeholders to secure their support?

- Have you created a strategy to communicate the deal’s benefits?
- Have you identified the key shareholders of your company and do you believe you have their support for the deal?

Have you identified all of the key external stakeholders and created a process to secure the necessary support?

- Have you identified what needs to be prepared for the transaction?
- Have you prepared a 100-day integration plan?
- Have you identified and filled new roles and identified an agreeable division of functions?

Do you know how the acquisition will be managed and measured?

- Have you created a strategy for growing or maintaining the core business?
- Have you identified a capabilities transfer team with representation and engagement from both parties?

Have you created a process to manage organizational change?

- Have you created a pre- and postacquisition communication strategy?
- Have you developed a strategy for retaining employees?
- Do you know how you will manage cross-pollination between the target and your company?
- Have you identified potential cultural-assimilation hurdles and developed a process to overcome them?
Despite the challenges of international M&A, Chinese banks are moving inexorably toward a more international profile. At present, they may not be giants by any measure—apart from their outsized market capitalizations—but they are certain to play an increasingly relevant role in global financial-services markets.

The long-term consequences of outward-bound Chinese banks could be dramatic. Their size alone makes them capable of influencing even the largest markets—particularly if they can harness the momentum of China’s global challengers, tap the enormous pool of Chinese wealth and assets, and extend their corporate relationships beyond China’s borders.

For a variety of reasons, however, Chinese banks cannot expect success at home to translate into immediate success abroad. They still need to develop or acquire core skills and capabilities to succeed in foreign markets. They also need to build strong reputations and navigate complex legal and regulatory frameworks. As a result, the surge of cross-border M&A by Chinese banks is likely to be more of an opportunity than a threat to foreign banks—at least in the near term.

This surge has both short- and long-term implications for banks outside China, which need to develop an active (and potentially reactive) strategy to address Chinese banks’ cross-border growth. We have identified four ways that banks outside China could capitalize on the international expansion of Chinese banks.

**Utilize Chinese banks as a new source of capital.** Cash-rich Chinese banks can help foreign banks weather the current downturn. Several Western banks have already successfully courted foreign investors. Citigroup, the biggest U.S. bank by assets, received a massive cash infusion from Abu Dhabi after record mortgage losses slashed its market value. Barclays Bank agreed to sell 6.7 percent of its shares to China Development Bank in July 2007. The state-owned Dubai International Financial Centre bought 2.2 percent of Deutsche Bank in May and said it is seeking acquisitions in the United States, given the weakening dollar and the turmoil created by the sub-prime crisis.

Many Chinese banks, however, want true partnerships. They are not just looking for ways to spend their capital. They’re searching for opportunities to acquire new capabilities, enhance their offerings both inside and outside China, and leverage their emerging-markets capabilities. To this end, Chinese banks will seek meaningful business alliances.

**Create local and bilateral cooperation opportunities.** Foreign banks should look for opportunities to provide Chinese banks with the presence and capabilities to serve their globalizing customer base. Such benefits were an important factor in ICBC’s $5.5 billion purchase of 20 percent of Standard Bank Group. ICBC’s chairman, Jiang Jianqing, stated, “From a strategic perspective, ICBC has been seeking opportunities to expand its international business, in particular in Africa, given strong trade linkages and the close and long-standing friendship between China and South Africa. As many of our large clients seek investments in Africa, the demand for cross-border financial services is accelerating. Standard Bank, with its market-leading position in South Africa and a true pan-African footprint, represents the best organization with which ICBC can partner.”
The mutual benefits of the deal were underscored by the group CEO of Standard Bank, John “Jacko” Maree: “A partnership between Standard Bank and ICBC is attractive as each party brings numerous complementary benefits to the relationship. Both banks can benefit through the creation of new revenue streams, access to the new partners’ expertise, and sharing distinctive local-market knowledge and expertise. By partnering with Standard Bank, the largest bank in Africa, ICBC will be able to enhance its service to its domestic customers seeking to do business in Africa.”

Offer divestiture opportunities. Banks may find opportunities to free up capital and refocus on core objectives by selling business lines. Chinese banks have both the capital and the incentive to make such purchases—this is a way to fast-track the acquisition of capabilities and market presence. Moreover, Chinese banks are not direct competitors—at least not yet—and therefore present a more attractive option for banks seeking to divest business lines.

The mutual benefits of such deals, in general, are clear. After General Electric Company bought CitiCapital, CitiGroup’s North American commercial lending and leasing business, in April 2008, GE vice chairman Michael A. Neal stated, “This acquisition represents another significant growth opportunity for GE—one that helps us offer more to customers.” The CEO of Citibank North America, Peter Knitzer, was equally impressed with the deal: “This transaction allows Citigroup to release capital from noncore areas and redistribute that capital to areas with the greatest opportunities for profitable growth.”

Conduct reverse M&A. There may be an opportunity, albeit remote, to create a global leader by merging a first- or second-tier Chinese commercial bank and an international bank. The Chinese bank would need to grant substantial management control to the foreign bank and would face a range of risks including managerial, cultural, and operational differences. Moreover, it is unclear to what extent Chinese banks would be willing to share control with a foreign management team.
For Further Reading

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**“The Next Billion Banking Consumers”**
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