

# **Analysis of Legal Risk Identification and Preventive Measures in the Merger and Acquisition**

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**Keywords:** merger and acquisition, legal risk, preventive measure

**Abstract:** In the process of business operation, enterprises often face various risks, especially those in the merger and acquisition. If these risks cannot be solved, it will seriously affect the business situation and future development of enterprises. Recognizing the importance of avoiding the risks in the merger and acquisition, the state has formulated quite a lot of rules to prevent them. However, the current situation is worrying. Therefore, this paper focuses on the analysis of preventive measures of legal risks in the merger and acquisition.

## **1. Introduction**

Nowadays, with the rapid development of national economy and the continuous expansion of enterprise scale, there are more and more mergers and acquisitions, which not only take place among industries, but also enterprises of different industries and countries. Therefore, there will always be many legal risks. In order to reduce legal risks in the merger and acquisition (M&A), the state has formulated many regulations through government supervision. However, in the process of the M&A, legal risks continue to emerge, producing a negative impact on the development of enterprises. Therefore, it is of great necessity to guard against the legal risks in the process of M&A.

## **2. Characteristics of the Domestic Mergers and Acquisitions**

In our country, the M&A started relatively late, and the domestic economic system is still in the transition period. Under this background, there are many problems restricting the M&A, such as the imperfect capital operation system. Different from risks in the M&A in western countries, those in China are relatively greater.

### **2.1 Role of Government in the Merger and Acquisition**

From the perspective of market economy, pursuing the maximization of value and promotion of market mechanism are the motive forces of the M&A. At present, China's economic system is being reformed and its stock assets are being adjusted. In this situation, the motive forces of the M&A mostly comes from the power of government reform. However, the government pursues diversified goals. On the one hand, the development capacity and production capacity of enterprises after M&A should be guaranteed. On the other hand, the factors that affect social stability, such as the settling of personnel, should also be well arranged. However, these goals are often contradictory, which leads to the existence of great risks, high transaction costs and complex relationships in the M&A in China.

### **2.2 Imperfect External Market Environment**

Western countries complete the M&A through capital operation market, especially the stock market, because they have relatively perfect external capital operation market environment. The initiation, execution and generation of M&A has been greatly supported by the capital operation market. However, our domestic capital operation market can not provide strong support for the M&A, because the market environment is not perfect enough. Because of this, the depth and breadth of the M&A of domestic enterprises have been greatly restricted.

### **2.3 Failure to Give Full Play to the Role of Intermediaries**

Intermediaries are indispensable in a perfect M&A market, since they can reduce the costs and coordinate the relationship between all parties. However, in the process of M&A in China, banks and other intermediaries have not really played a role. Usually, the two sides of M&A directly contact with each other.

### **2.4 More Conditions for the Merger and Acquisition of Domestic Enterprises**

Under the great pressure of employment in China, the problem of resettlement of employees has become a capital problem in the process of M&A. Usually, when the acquirer party is willing to accept the employees of original factory, the acquired party will reduce the asset price or even transfer the assets gratuitously.

## **3. Analysis of Risks in the Merger and Acquisition**

In the development of enterprises, M&A is a foreign trade strategy, a very complex economic behavior, and a measure taken by enterprises to improve and develop themselves. However, the capital operation in China started late with some shortcomings and the external conditions of M&A are not mature enough, so many risk problems will arise in the M&A. Different conditions and reasons will lead to two types of M&A risks. Firstly is the systemic risk, which is caused by global uncertainty, such as economy, politics and other events. It has nothing to do with the enterprise's business strategy, so no matter what kind of business strategy the enterprise adopts, such risks can not be avoided. Different from systemic risk, non-systemic risk is dispersible, which is caused by the single business mode and the defects of internal control of the enterprise itself. Therefore, to overcome such risks, enterprises can only rely on themselves for adjustment.

## **4. Measures to Prevent Legal Risks in the Merger and Acquisition of Enterprises**

Various kinds of risks will appear in the process of M&A, among which legal reasons play an important role. That is to say, law is of great significance for the success of M&A and enterprise's development after M&A. The legal risks include environmental protection risks, business risks, exchange rate risks, labor risks and so on.

### **4.1 Relevant Regulations on the Prevention of Legal Risks in the Merger and Acquisition of Enterprises in China**

Accounting Law, Intellectual Property Law, Labor Law, Company Law, Investment Law, Listed Companies, Anti-monopoly Law, Merger and Acquisition Law and some international laws and conventions are all related laws to prevent legal risks in M&A of enterprises. In the Company Law, there are definite provisions on the number of shareholders, the scale and nature of capital contribution, trade union management and other issues of the M&A. The Anti-monopoly Law specifies in detail the criteria for the misuse of government administrative power, investigation of monopolistic acts, the criteria for evaluating and classifying monopolistic acts and so on. In the Labor Law, there are detailed provisions for the signing and dissolution of labor contract, the salary and treatment of employees, joining the union, the appointment and settlement of employees and the role of the union organization. In the M&A, there are higher legal risk prevention requirements.

From the above, we can see that although our legislation covers the legal risks in M&A, there are still many shortcomings. On the one hand, the level of legislative efficiency is quite low. As there are many stakeholders and links involved in the M&A among enterprises, a relatively high-level legal adjustment and regulation of the relationship and behavior of each stakeholder is needed. However, in reality, only a small part of the legislation on M&A is formulated by the Standing Committee and the National People's Congress while a series of regulations, local regulations and administrative regulations are formulated by the State Council and its ministries, which greatly reduces the universality and authority of laws and regulations in the process of the M&A. On the other hand, there is a lack of uniform guidance in legislation. At present, most are defensive laws on

the M&A in China. That is to say, only when problems arise, laws will be amended or only when problems occur next time, laws will be prevented. But if this way to deal with all kinds of legal problems in the process of M&A is adopted, the role of legal guidance and maintenance can not be fully played and the M&A will not be achieved through complete laws or avoid the losses caused by risks. China is in an urgent need of a real legal system, which is expected to predict, manage and guide foreign M&A, overseas M&A of Chinese enterprises as well as domestic M&A.

## **4.2 Government Supervision Mechanism**

In the process of M&A between enterprises, it is essential to guard against legal risks. On the one hand, we need to guard against supervisory operations and the implementation of laws. On the other hand, we should standardize the legal system. In China, we mainly carry out preventive operations in the following two ways.

### **4.2.1 Supervision and management of relevant government departments**

The M&A between enterprises will cause many problems, such as impacts on the industry, transfer of property, layoffs of employees, etc. These problems are not only the surface changes of enterprises, but also insert great impact on the economy and society, which leads to serious consequences. In order to avoid legal risks in the process of M&A, the government's supervision and management are required to be carried out from many angles. The State-owned Assets Supervision and Administration Commission should supervise the M&A of enterprises with state-owned assets and avoid the improper disposal of property rights disputes, so as to ensure that the interests of the state and collectives are not damaged. The Securities Regulatory Commission and other organizations need to supervise the M&A of Listed Companies in the securities market. The process must be open, fair and transparent, which can reasonably solve the legal risks such as intellectual property rights of products, accounting subtitles, property rights confusion and so on. Some specific areas may also be monitored by the state and relevant departments, and affected by local government policies and regulations.

### **4.2.2 Disturbance of social institutions and organizations**

Some social organizations, as non-participants in the process of M&A, will obtain the relevant information of M&A through some channels, and then publicize and report them, so as to make the M&A more open and transparent and reveal some legal risks and problems, especially in the cross-border M&A. They also should refer to the development of industry organizations and learn from the situation of other countries in the world. Employees' problems must be considered in the M&A of enterprises as well as the environmental protection and social employment.

All in all, this is a very complex issue, and no organization has the right to coercive interference at present. In the actual situation, unscientific and unreasonable M&A accounts for a large part of domestic enterprises' M&A. Here are two main reasons. Firstly, no specific organizations or institutions have been established to perform the duties of supervision and management. In order to provide services and guidance for M&A, in most cases, only the state or some departments set up temporary committees or organizations for reference and coordination. The relatively strong administrative powers make enterprises in the market economy fail to have the autonomy or freedom. On the other hand, the use of laws is unreasonable or even evades problems. At present, there are no mandatory rules related to the M&A in China, which leads to the simplification of M&A among enterprises. In many cases, only internal consensus among enterprises has been reached, but those related issues have not been taken into account. Therefore, the enterprise only realizes the M&A in the contract but does not really realize it. Such M&A will lead to many disputes, such as a lack of strict management, unclear asset allocation, staff discord and so on. Finally, local protectionism is serious. Because of local government's consideration of local finance and economy, M&A between enterprises faces great obstacles in finance and taxation. For example, after the M&A is completed, there will be a certain degree of legal application in the problem of relocation of headquarters, which touches the sensitive area of local law and results in the imbalance of income and costs after the M&A. Especially for us, we are not only looking forward

to the M&A of foreign capital and technology, but also afraid of its arrival. As a result, we think that the M&A has changed our identity and nature, so with a lack of common sense, we lose freedom and can not look at the problem from a global point of view.

## 5. Conclusion

In order to effectively avoid the legal risks of M&A, it is necessary to improve domestic laws and regulations and take effective measures. Scientific and correct evaluation of enterprises' development requirements is what enterprises need to do before the M&A. Combining with the development prospects and the security analysis of enterprises, the sustainable investment management of enterprises needs to be well done, and the most suitable investment enterprises should be selected, so as to reduce risk in the M&A. To effectively prevent legal risks, it is necessary to have practical business integration and cultural integration programs to avoid legal risks from the direction of enterprises' development, so as to enable enterprises to develop in a longer term.

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