

# *Risk Analysis of Cultural Enterprises' Overseas Mergers and Acquisitions--Taking Wanda's Acquisition of American Legendary Pictures as an Example*

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**Abstract:** In the era of economic globalisation, cross-border mergers and acquisitions (M&A) have become an important way for enterprises to carry out foreign direct investment, and at the same time, with China's economic transformation and consumption upgrading, the cultural industry contains great business opportunities. Cross-border M&A of cultural enterprises can help accelerate the international transformation of China's cultural enterprises, which is of great significance to enhance China's national soft power. In the past two decades, the success rate of Chinese enterprises participating in cross-border mergers and acquisitions has averaged 62%, and there are more cases of failure, and enterprises face many risks and challenges in cross-border mergers and acquisitions. In this process, international business negotiation plays an important role. Good international business negotiation strategy and process can make the M&A proceed more smoothly, and at the same time can ensure that the stakeholders involved in the M&A will not be harmed. Therefore, it is of great significance to study the risks faced by enterprises in cross-border M&A cases. Through the case study, it is found that in the case of Wanda's acquisition of American Legendary Pictures, the M&A risk has a negative impact on Wanda's long-term performance, and the synergistic effect has not been well realised. In the early stage of M&A, we should focus on the motivation of M&A; in the stage of M&A implementation, we should choose the payment method and financing method carefully; and in the stage of M&A integration, we should not slacken the management of overseas assets.

## 1. Introduction

Since 2012, China's cultural sector has attached great importance to the development of cultural undertakings and cultural industries, and with China's economic transformation and consumption upgrading, the cultural industry contains great business opportunities. Cross-border mergers and acquisitions (M&A) of cultural enterprises can help accelerate the international transformation of China's cultural enterprises, and at the same time, M&A is also an important way to further deepen

the development of China's culture, which is of great significance to enhance China's national soft power. Cultural enterprises are different from industrial enterprises such as automobile industry and energy industry, and face different risks and challenges in cross-border M&A. In this process, international business negotiations play an important role. A good international business negotiation strategy and process can make the M&A proceed more smoothly, and at the same time can ensure that the stakeholders involved in the M&A will not be harmed.

The process of mergers and acquisitions throughout mergers and acquisition risks, any link in the risk may lead to the ultimate failure of the merger and acquisition. At present, domestic and foreign scholars have done a lot of research on the risks of cross-border M&A, but not many studies have analysed the risks faced by cultural enterprises in this scenario. Therefore, taking Wanda Film's acquisition of American Legendary Pictures as a case study, the text takes cultural enterprises as the research object, analyses the risk of cultural enterprises participating in overseas M&A, and puts forward corresponding risk control suggestions for cross-border M&A of Chinese cultural enterprises from the perspective of international business negotiation.

## 2. Literature Review

Cross-border mergers and acquisitions (M&As) are business operations in which an enterprise of one country acquires control of all or part of the business of an enterprise of another country by purchasing all or part of the assets or shares of the enterprise in the other country[1]. Cross-border M&A is the fastest way for enterprises to acquire valuable assets such as new technologies and brands, and it is time-consuming, fast-returning and less investment than greenfield investment. And enterprises can reach operational synergies through M&A, and ultimately achieve the goal of economies of scale and realise the strategic objectives of enterprises [2]. At the same time, M&A is a double-edged sword, with both risks and benefits. Problems such as insufficient investigation before M&A, excessive valuation, irrational governance structure after M&A, shareholders pursuing short-term benefits too much, lax terms of M&A contracts, and hidden dangers in the M&A process will lead to the failure of M&A cases. International business negotiation plays an unignorable role in all aspects of cross-border M&A. In the process of international business negotiation, both parties negotiate based on maximising their own interests, and strive to ensure that they maximise their own profits in this M&A case. The premise of consistency of interests is often an important factor in the success of the final negotiations between the two sides. Negotiation is a process of negotiation on the basis of the needs of both parties, through certain means and strategies, and each party makes concessions[3]. International business negotiation is an indispensable part of cross-border M&A.

As the two sides of the commodity transaction do not have exactly the same information, and at the same time, they cannot grasp the information that the other side has. And information as a valuable resource, in the face of M&A transactions, both sides need to pay a considerable cost to collect information. In addition, in the process of transmission of information, there are various unexpected circumstances, resulting in information distortion. Incomplete and incorrect information motivates both parties to an M&A transaction to participate more actively in the M&A negotiation process. The risk of information asymmetry is further exacerbated by the fact that international trade faces greater distances compared to domestic trade.

The serious information asymmetry problem that exists between market investors and M&A events may make M&A become a tool for undue arbitrage, making it difficult to exert the positive effects that M&A is supposed to play in optimising resource allocation[4]. During the M&A process, M&A premiums are higher when the acquirer perceives that the VC institution plays a positive role and sends good signals [5]. The research initiated by institutional investors for the M&A event not only significantly increases the success rate of the M&A event, but also

significantly increases the financial and operational performance that can be brought about by the realisation of the M&A, and the higher the frequency of the research for the M&A case, the more significant the enhancement effect will be[6]. Due to the information asymmetry between the two parties, business negotiation is particularly important. International business negotiation in the process of mergers and acquisitions can avoid the risk of information asymmetry to a certain extent.

Operating synergy effect is also called operating economy (Operating Economy), refers to the complementary nature of the operation, so that two or more companies through mergers and acquisitions merged into one company, to achieve a significant reduction in costs or a substantial increase in revenue, mainly manifested in the realization of economies of scale through mergers and acquisitions and the advantages of complementary and so on[7].

The profitability growth of Ping An of China after the merger and acquisition of Shenzhen Development Bank is on an upward trend, the growth rate of total assets, net profit growth rate to maintain a steady growth, the advantage of operational synergies is significant[8]. The operational synergies brought about by mergers and acquisitions are precisely the goal of M&A.

### 3. Overview of Merger and Acquisition Events

Wanda Film Company Limited ("Wanda Film", hereinafter referred to as "Wanda Film"), is a wholly-owned subsidiary of Wanda Group, "Wanda Cinema" was listed on the A-shares of the Shenzhen Stock Exchange in 2015, and was renamed as "Wanda Film" in 2017, is a film and television production company with a complete industry chain of films and TV series. Wanda Film has invested in film and television works in recent years, such as the series of "Detective Chinatown", "My Motherland and I", "Captain China", etc. In 2012, Wanda Group acquired 100% of the equity of AMC, the second largest cinema operator in the United States, and in May 2021, Wanda Group withdrew from the board of directors of AMC in its entirety, retaining only a minority stake in AMC, with a cumulative recovery of 1.476 billion U.S. dollars, and in the context of both the domestic and overseas COVID-19's impact, focusing more capital on the domestic film market and maximising investment returns. The following is a diagram of Wanda's movie industry chain.

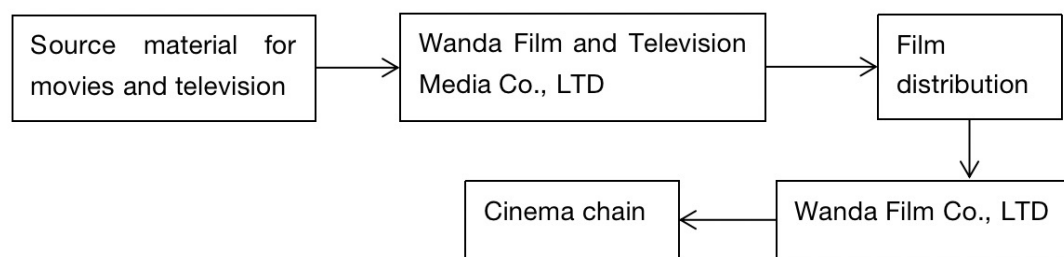


Figure1:Wanda's movie industry *chain*

According to the annual report of Wanda Film 2022, in 2022, the national gross box office of RMB30 billion was realised, a decrease of 36.4% in the same period as compared to 2021, and the number of moviegoers was 0.7 billion, a decrease of 39.2% as compared to the same period of 2021, and Wanda Film realised box office receipts of RMB4.39 billion (excluding service fees), a decrease of 29.4% as compared to the same period of 2021, and the number of moviegoers was 1.1 million, down 33% from the same period in 2021, with a recovery significantly better than the industry average. But with the adjustment of domestic policies and continued economic recovery, the movie industry witnessed an industry-wide recovery in the first quarter of 2023. With the adjustment of domestic policies and continued economic recovery, the national box office of movies in the first quarter of 2023 increased by 13.5% as compared with the same period of 2022, ushering

in the recovery of the entire industry chain of the movie industry. The following financial metrics data is from Wanda Film's 2022 Annual Report.

*Table 1: Main Financial Indicators of Wanda Film for 2022*

	2022	2021	2020	2019
Revenues(CNY)	9,695,316,675	12,490,346,327	6,295,481,617	15,435,362,985
Cash flows from operating activities	1,194,1184,934	2,981,031,422	482,122,394	1,858,832,299
Basic earnings per share(CNY)	-0.867	0.047	-3.158	-2.275
Average return on net assets	-24%	1.18%	-60.51%	-29.23%

Legendary Pictures is an American film production company founded in 2000, which is involved in businesses mainly including film, television, animation and digital media, etc. Its works such as "Warcraft", "Godzilla" and "Inception" have a considerable global influence and have extremely high attendance rates during their release. Before Wanda announced the acquisition of Legendary Pictures in 2016, Legendary Pictures' revenue had been in the red for two consecutive years, which exposed Legendary Pictures' weaknesses as an independent production company once upon a time: fluctuating performance and weak risk resistance.

As a form of international direct investment, M&A is the easiest and most efficient way for enterprises to develop overseas markets.

Wanda's acquisition of Legendary Pictures is a vertical merger and acquisition, Legendary Pictures and Wanda belong to the upstream and downstream relationship within the film and television industry, Legendary Pictures has a strong production capacity, and the Wanda Group, as one of the world's largest cinema operators, Wanda formed a more complete film industry chain after the merger and acquisition[9]. At the same time, Legendary Pictures has the advantage of famous IP and copyright, which is also scarce for Wanda. Through the acquisition of Legendary Pictures, Wanda can take advantage of the influence of Legendary Pictures in the global market to develop Wanda films and achieve operational synergies. By acquiring Legendary Pictures, Wanda can significantly expand the scale of the enterprise, promote the transformation of the industry, obtain globally famous copyrights and IP, improve the right to speak in the market, perfect the industrial layout, and promote the production of the domestic film industry through the synergistic effect and the diversification of the products, so as to make the global film and television industry develop in a benign way.

In December 2015, Wanda American Entertainment, Inc, as a wholly-owned subsidiary of Qingdao Wanda Film & TV Investment Company, acquired all the shares of Legendary Pictures held by Waddell & Reed for a consideration of US\$411 million; in January 2016, Wanda Group announced that it had paid US\$3.5 billion through cash payment to acquisition of Legendary Pictures in the United States; in March 2016 Wanda Film made Legendary Pictures a wholly-owned subsidiary of Qingdao Wanda Film & TV Investment Company through the issuance of unsecured notes and a management buyout; in May 2016, Wanda Film opened a planned IPO; in 2016, Wanda Film disclosed its merger and acquisition pre-proposal and planned to acquire Wanda Film & TV, at which time Wanda Film & TV was valued at RMB 37.5 billion as a whole; in August 2016, Wanda Film merger and acquisition of Legendary Pictures failed to integrate; in 2017, Wanda Group packaged and listed Wanda Film and Television, but according to its official release, it is alleged

that due to the differences in the way of operation, it is necessary to further integrate the overseas assets, and divested Legendary Pictures.

#### 4. Merger and Acquisition Risk Analysis

##### 4.1. M&A Planning Stage

Wanda needs to consider the following issues in the planning stage of M&A of Legendary Pictures: firstly, the performance of Legendary Pictures, which suffered consecutive losses in 2014 and 2015, and will cause huge performance pressure on Wanda after the acquisition; secondly, the well-known IP and film special effects production experience of Legendary Pictures is a strong attraction for Wanda films; thirdly, after the acquisition, Wanda will need to implement cross-border operation, and whether this mode of operation is consistent with Wanda's development plan. All of the above issues need to be reasonably resolved in the subsequent negotiations between the two parties.

In the process of M&A planning and preliminary investigation and M&A negotiation, both sides of the merger and acquisition also face the risk of information asymmetry, and both sides of the enterprise should obtain all kinds of information about the other side in a timely manner in order to ensure that the information gap is reduced, so that the enterprise will not be in a passive position in the negotiation of the merger and acquisition. In the case of Wanda's acquisition of Legendary Pictures, the two companies are located in obvious market differences. The American film market is highly competitive, and the level of film and television special effects production technology is high, which has produced many excellent film derivatives; on the contrary, the domestic film industry at that time, in the film creative atmosphere, the level of film and television science and technology production and the completeness of the film industry chain with the U.S. film and television industry, there is a big gap. Domestic film and television cultural enterprises, led by Wanda Film, have limited understanding of foreign cultural enterprises and film market, and in the process of M&A negotiation, both parties may conceal their real situation, and due to the asymmetry of information, the acquired enterprise can use this to raise the transaction price.

##### 4.2. M&A Implementation Stage

M&A pricing is mainly determined by the valuation of the target company, but the actual transaction process will be affected by many other factors. In addition to the internal issues of the M&A parties, external issues such as the existence of a bidder, the timing of M&A negotiations, employment placement issues, and relevant government policies will also have an impact on M&A pricing. In the negotiation process of pricing, any party involved in an M&A case maximises its own interests through pricing negotiation strategies such as bargaining strategy, collusion strategy, and leveraging strategy[10]. If the enterprise underestimates the cost of M&A too much, it will waste a lot of time getting into a price tug-of-war in the negotiation with the acquired enterprise on the price of the internship M&A, thus losing the bargaining power.

The products of cultural enterprises are mainly cultural works, and their assets are mainly intangible assets, and the products issued by such enterprises not only rely on the production experience and technology of the enterprises, but also need strong cash flow to support. The core competitiveness of cultural enterprises is the valuable and excellent IP resources derived from the cultural works they create, such as Disney, Universal Pictures, Marvel Studios, etc. The IP resources owned by these enterprises have created huge profits for the enterprises in the form of intangible assets. In addition, consumers' brand dependence on cultural enterprises is also the source of the strong core competitiveness of these famous cultural enterprises. It can be seen that the

experience and technology, scarce IP resources and cultural branding effect owned by cultural enterprises will all have an impact in pricing.

M&A payment is an important part of realising the transaction in the process of M&A implementation. In the process of cultural enterprise mergers and acquisitions, the enterprise's financing constraints significantly affect both the M&A performance and the payment method, and the M&A enterprise can send a positive signal to investors through the payment method; in addition, the enterprise should improve its own creditworthiness in order to guard against financing risks. In the implementation stage of M&A, the way of paying the consideration in cash has obvious advantages for the acquired enterprise, and it is an efficient and convenient way of payment for the acquirer. Paying the consideration in cash allows the acquirer to obtain the control of the other enterprise faster, but at the same time, this payment method will bring heavy cash flow pressure to the acquirer, and the cash flow capacity determines whether the merger and acquisition case can be carried out smoothly and the subsequent operating ability of the merged enterprise.

After many rounds of negotiations, Wanda decided to pay Legendary Pictures about \$3.5 billion in cash. Obviously, the cash payment not only aggravates Wanda's financial burden, but also brings considerable pressure on Wanda Group's daily operating activities[11]. Longer capital recovery period is a major feature of the industry in which cultural enterprises are located, and Wanda Film was constantly expanding through mergers and acquisitions before it acquired Legendary Pictures, but the capital investment of these mergers and acquisitions is difficult to realise the income immediately during the current period, which will inevitably affect the capital turnover ability for Wanda Film.

Under the premise of the continuous improvement and development of the domestic securities market, the Securities Supervisory Commission has also raised the threshold of film and television industry mergers and acquisitions, and has implemented strict control over the mergers and acquisitions of enterprises in the film industry[12]. Wanda's acquisition of Legendary Pictures is an attempt to create "Hollywood of the East" and "Disney of China", which will lead to the transformation of Wanda Group's other industries. As Wanda Film has the backing of other industries of Wanda Group, Wanda Film has a strong advantage in M&A financing, and large banks are willing to cooperate with Wanda and provide loan services to it.

In the case of Wanda's acquisition of Legendary Pictures, the US\$3.5bn cash payment consideration puts a lot of pressure on Wanda's capital turnover and cash flow, and although Wanda Group is well-funded, this pair of consideration still brings a huge debt to Wanda Film. In addition, the subsequent debt servicing of the financing is a long-term and continuous problem for the enterprise, and the expected return after the merger and acquisition is not clear, which brings great challenges to the operation of the enterprise in the later stage.

### 4.3. Integration Stage

There are significant differences between China and the United States in terms of economy, culture and concepts, so in the late stage of M&A, both parties need to pay attention to the integration of operating resources, human resources and corporate culture caused by the different cultures.

Wanda and Legendary Pictures have differences in corporate culture, differences in Chinese and American cultures, and differences in audience profiles in the Chinese and American film industries, all of which are objective and long-standing problems. In the process of M&A integration, it is inevitable to protect the interests of both parties through business negotiation to the greatest extent possible, to protect the corporate culture of Wanda Film as a prerequisite, and at the same time pay attention to the localised adaptability of Legendary Pictures, and play its industry-leading



advantages to the fullest.

## 5. Recommendations

As the largest private enterprise in the domestic film, television and cultural media industry, Wanda Film's experience in overseas mergers and acquisitions is representative of the industry, and the risk control of Wanda Film's participation in cross-border mergers and acquisitions is also applicable to all kinds of cultural enterprises to a certain extent.

In the planning stage of M&A, enterprises need to take successful M&A as the ultimate goal, focusing on considering the motivation of both parties to choose M&A; the reasonableness, feasibility and necessity of the motivation, and contacting and negotiating between the two parties through appropriate international business negotiation strategies, adhering to the principle of consistency of interests, and trying to minimise the risk of asymmetry of information between the two parties, so as to facilitate the subsequent pricing of M&A; in the implementation stage of M&A, participating in the pricing of M&A through proactive international business negotiation. In the M&A implementation stage, through active international business negotiations, participate in the M&A pricing decisions to ensure that their own interests are maximised, and at the same time through the negotiation of prudent coordination of a payment method suitable for both sides, in order to reduce the pressure on the cash flow of the acquirer and the pressure on the turnover of assets; in the stage of integration of the merger and acquisition, personnel changes, conflict between the local culture and the local cultural confrontation, and changes in the financial and operational changes can not be avoided, the two sides need to do a good job of contingency planning in the negotiation of the merger and acquisition process. to prevent and resolve the subsequent risks.

## Funding

If any, should be placed before the references section without numbering.

## Data Availability

Data sharing is not applicable to this article as no new data were created or analysed in this study.

## Conflict of Interest

The author states that this article has no conflict of interest.

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