The phenomenon of Chinese companies going global has in the course of the present decade become a defining feature of the present stage of China’s integration with the global economy. While China remains a comparatively minor player in terms of global Outbound Foreign Direct Investment (OFDI) flows, the financial crisis has afforded some of its largest SOEs unprecedented opportunities to make landmark acquisitions. In the ten months since Lehman Brothers became the defining casualty of the financial crisis, Chinese bidders have announced 50 outbound offers worth USD 30 million or more each, totalling about USD 50 billion. Blighted only by Chinalco’s high-profile shut out at Rio Tinto and Beijing Automotive’s failed bid for Opel, on the backdrop of a global recession Chinese companies have completed twenty-four deals worth a combined USD 17 billion, with twenty-one deals still pending. Since Chinalco’s Rio Tinto disappointment, two-thirds of the offers have been in mining and energy, along with China’s largest oil acquisition to date: Swiss oil explorer Addax Petroleum, bought by Sinopec for USD 7.24 billion. With operations in Iraq and West Africa, Addax’s oil blocks were considered too risky by some of Sinopec’s Western rivals, yet the Addax deal is indicative of China’s appetite for resource-seeking assets wherever they can be procured, and this has drawn China’s flow of outward investment increasingly into the developing world. Chinese OFDI was virtually non-existent on the eve of China’s economic reform era in 1978, and remained largely insignificant until 2004. Yet by this time China had become the world’s largest consumer of tin, seaborne-traded iron ore, zinc, aluminium, copper, and nickel, and the second-largest consumer of lead and oil – all of which China now has insufficient supplies of for the domestic market. Hence in the face of economic necessity, Chinese companies are officially encouraged to go global, and in 2008, China’s annual OFDI flow topped USD 50 bn (almost double the amount for 2007), while the stock of Chinese cross-border investments is estimated to have reached about USD 170 billion by the end of 2008. Yet why has China embarked on a Going Global strategy, and who exactly are at the forefront of this outward drive? After considering these questions, this article will briefly view the future of China’s OFDI in the perspective of China’s investment experience on the African continent, where Chinese investors are presently making a distinctive impact.

ECONOMIC IMPERATIVES

China can satisfy its considerable demand for natural resources with purchases on international commodity markets, or, as a primary driver of Going Global, it can actually utilise outward investments to secure ownership of the companies that supply these resources. Yet the vastly expanding footprint of Chinese companies in the world is not simply attributable to a desire for resources, but is also inherent to the new requirements of China’s evolving growth model. In the decades after the commencement of economic reform in 1978, China was able to achieve rapid growth by vastly increasing the scale of production in manufacturing and by enabling investment flows. During this time of China becoming the factory of the world, a large number of Chinese companies, mostly based on the eastern coastline and along the river deltas, became successful exporters of a large number of products, gradually outgrowing domestic economies of scale. Yet faced with severe competition in the domestic market, for many of these Chinese firms, increasing comparative advantage and capturing an increased share of the production chain simply meant going abroad. China’s inward FDI stock reached USD 876 billion by 2008, still vastly superior to China’s outward stock of USD 170 billion, and in the decades preceding this many Chinese firms had absorbed foreign investments and gained knowledge and experience from working with foreign partners. In 2001, China’s accession to the World Trade Organisation (WTO) opened the floodgates
for China’s OFDI, which increased by more than six times compared to the previous year. With the proclamation of an official Go Global policy with the 10th Five-Year Plan (2001-05) and a substantial easing of OFDI regulations in 2004, a new era had officially dawned, and China’s outward flow of investments arrived on the world stage in full force.

WHY? THE PUSH/PULL LOGIC

Chinese companies going global generally engage in four types of strategies: market-seeking, efficiency-seeking, resource-seeking, and strategic-asset seeking. Market-seeking drivers are a logical outcome of China’s export-oriented growth model. In essence, Chinese firms will seek to expand their export channels to enhance market share and sidestep trade barriers. A number of surveys have confirmed market-seeking as the leading motivation for Chinese firms going global, and prominent examples in this regard are home appliance and consumer electronics manufacturers such as Haier, TCL, and Huawei Technologies, which have entered affluent markets like the US where they can operate in closer proximity to end-buyers and build stronger global brands. While inevitably pulled to bigger markets, market seekers are also pushed to expand abroad due to severe competition and overcapacity in their domestic market, as is the case with China’s home appliance sector. Due to the relatively low costs in China, efficiency-seeking OFDI has not been an important driver of Going Global for Chinese firms, yet this may well change in the future. For example, increasing labour costs in China’s Pearl River Delta have made production in neighbouring countries such as Vietnam and Thailand more attractive, and Chinese companies have invested in African countries like Malawi and Senegal to benefit from duty-free treatment applied by some developed countries to products imported from these African countries. Fuelled by rapid economic growth, China’s OFDI has perhaps most closely become associated with a spree of resource-seeking acquisitions in countries and regions such as Australia, Latin America and Africa. China’s three major state-owned oil companies, CNPC, CNOOC, and Sinopec, are said to have already succeeded in acquiring more than 100 projects between them across the globe, and have remained prominent in seeking acquisitions in 2009. A large number of Chinese players are also active in the mineral resources industry, and companies like Minmetals, Chalco, and Chinalco are investing in countries across the globe to secure assets in minerals and metals. Aimed at the acquisition of knowledge, technology and foreign brands, strategic-asset-seeking OFDI has driven Chinese companies to invest in advanced economies in Europe and North America. While ranking second behind market-seeking as a motive for Chinese companies going global, very few Chinese companies actually engage in pure asset-seeking OFDI because of the challenges in mastering the capabilities to absorb such assets. Hence asset-seeking OFDI is often combined with market-seeking or efficiency-seeking OFDI. In the automotive industry, for instance, Chinese companies have made great effort to acquire reputable brands like the Korean Ssangyong (bought by Shanghai Automotive Industry Corporation, SAIC), and MG Rover (bought by Nanjing Automobile Group Corporation). While a few Chinese firms like Huawei ZTE have made successful investments in Europe by being able to adapt to the local market, Chinese asset-seeking investments abroad have not been particularly profitable. While the acquisition of often financially weak companies with vastly different corporate cultures pose a formidable challenge, Chinese firms’ comparative lack of experience have made it hard for them to build effective working relationships with host country stakeholders, to integrate corporate and national interests, and to integrate home and host country operations.

THE CRITICAL QUESTION OF WHO?

The rapid increase of China’s investment footprint in the world becomes even more impressive when one considers the relative novelty of Chinese OFDI. As a global investor, China remains a comparative lightweight both in terms of FDI flow and total FDI stock. In the period 2000-07, average Chinese outflows accounted for less than 1% of global outflows annually, less than other transitional economies like Russia. In 2007, US investments flows were 14 times larger than China’s, and its FDI stock was about 30 times that of China’s. Yet barely 10 years into the Go Global policy, the rapid growth of China’s OFDI in the midst of the financial crisis has illustrated just how far its Multinational Companies (MNCs) have come in a very short time, yet also their remaining shortcomings. It was only in the late 1980s that the modern Chinese MNC first emerged when a ministerial department was transformed into the state-owned China National Petroleum Corporation (CNPC). China National Offshore Oil Company (CNOOC), Sinopec and Sinochem were all formed at this time, and by the late 1990s the typical Chinese MNC - operating in the most strategic sectors of China’s economy like
mining or energy—had solidified as large corporations reliant on state political support and financial backing yet engaging in innovative actions such as equity joint ventures with foreign firms and listings on foreign stock exchanges.

Notwithstanding substantial losses from fledgling OFDI projects in the Hong Kong real estate and stock markets between 1991 and 1997, a Go Global policy was first enunciated in 1999 with OFDI being encouraged in processing trade activities to support national exports. The policy was consolidated at the Chinese Communist Party’s 16th Congress in 2002, with a clear objective of encouraging domestic firms to internationalise their activities as a means to acquiring strategic resources and expanding into foreign markets. The overarching goal was to increase the competitiveness of about 180 corporate champions who would with time be able to become true multinationals and enter the Fortune 500, benefiting from preferential tax concessions and political backing.

Authorities also gradually eased approval procedures while shifting responsibility from central to local agencies. Notably in 2004, the regulatory process was reformed and foreign exchange controls were eased, leading to a marked upsurge in China’s OFDI. In May 2009, a new regulatory framework was implemented which reduced approval times, lifted value thresholds, and transferred authority to local Ministry of Commerce (MOFCOM) branches. The State Administration of Foreign Exchange (SAFE), one of the institutions charged with approving overseas investments, also announced that it had eased approval procedures and expanded the foreign exchange reserves available for investments abroad. Where previously the government strictly controlled China’s entire investment apparatus, it now increasingly acts rather as a regulator and arbitrator, yet it retains overall executive discretion over all potential deals.

Resource-seeking and strategic asset-seeking large Chinese MNC champions who play a leading role in China’s outbound investments currently still retain an indelible link with the Chinese government. No official breakdown has ever been published on the share of SOEs and private enterprises in China’s outward investment projects, but the large number (nearly 7,000 by the end of 2007) of Chinese companies that have invested abroad suggests considerable participation by both SOEs and private firms. Yet the bulk of China’s OFDI is clearly performed by large SOEs, and estimates have in recent years put the share of China’s OFDI flows coming from SOEs under the central government at 73.5% in 2003, 82.3% in 2004, and 83.2% in 2005, with the remaining shares split between investments under the control of regional governments, non-SOEs controlled collectively, and finally, privately-owned companies. This clear dominance of SOEs is hardly surprising, considering that nearly all Chinese companies in the natural resources industry are SOEs, and until 2003, outward investment was principally only allowed for SOEs.

As the main vehicle of the very short history of China’s OFDI, China’s SOEs have encountered a very particular image problem in that they are often perceived as mere government vessels. Chinalco’s failed bid for a larger stake of Rio Tinto and CNOOC’s failed attempt to buy US-based petroleum enterprise Unocal in 2005 were both indicative of the particular challenges China’s SOEs can encounter, especially in developed countries. Indeed, largely in response to the rapid emergence of investors from China and the Middle East, most Western countries have tightened investment regulations in recent years. In short, investment protectionism has increased and Chinese firms have often borne the brunt of politicised review processes in developed countries. This has made the question of WHO a significant issue when it comes to Chinese outbound investment in different parts of the world, and has recently caused China to announce that it will seek to use more home-grown private equity firms to seek overseas deals.

The inevitable lack of experience and confidence in managing complicated cross-border investments in heavily regulated markets has shown Chinese firms to be lacking in the full requirement of the necessary specialised skills. Problems encountered with SAIC’s venture with Korean carmaker Ssangyong and Baosteel’s abandoned steel slab project in Brazil are examples of such missteps. Yet if the rapid growth of Going Global has highlighted the lack of management skills of Chinese firms in conducting large Western-style acquisitions, many of the target countries for Chinese OFDI, particularly in Africa and Asia, are characterised by comparatively weak institutions and incomplete protection of intellectual property rights, high levels of state intervention and varying systems of corporate governance. Where Western MNCs tend to be proficient in operating in stable markets with
transparent regulation, Chinese MNCs, by contrast, are experienced in dealing with less straightforward regulatory frameworks and more opaque political constraints. In the developing world, this has served as a distinct advantage, and coupled with the implementation of a new-fangled political rapport with Africa, has made the expanding Chinese presence in Africa an insightful embodiment of the state of Going Global.

GOING GLOBAL GOING WHERE? AFRICA AND BEYOND

Africa’s relatively unexploited energy resources, timber, agricultural products and fishery by 2006 attracted over 800 Chinese companies, doing business in 49 countries. China’s large SOEs, focused on natural resources, have taken the lead in Chinese investments in Africa. CNPC, China’s leading oil MNC, with its involvement in Sudan’s oil industry since 1996 has demonstrated its ability to manage a petroleum extraction operation to international standards while transforming Sudan’s energy sector into the country’s leading exporting industry. China has made similar investments in Nigeria, Angola and Gabon, while often successfully outbidding Western firms by linking their investments to large infrastructure projects and lower labour costs. A host of Chinese SMEs and construction firms are also active across the entire continent.

The activities of Chinese firms in Africa has also attracted a share of criticism, especially in regard to Chinese firms’ systematic underevaluation of labour and managerial costs, which has given them a crucial edge in bidding processes. Allegations of a lack of environmental and social oversight have also affected some Chinese SOEs in Africa, notably in Zambia. Yet there is evidence that large Chinese SOEs like Sinopec and Petrochina are embracing a corporate social responsibility agenda, and as Chinese firms become more fully integrated into the global market, increasingly accountable to shareholders and adhering to governance principles, their business practices will change accordingly.

Chinese OFDI may have found a compatible outlet in an African environment of weak regulatory frameworks and high levels of state intervention, yet as the general economic outlook in China gradually outgrows such features, the nature of Chinese OFDI going forward into the next decade is likely to be increasingly characterised by a similar emulation of Western best practices. China’s goal, in an insightful assessment by the head of CNOOC, one of China’s major oil conglomerates, “is not to overturn the world order but instead to participate in this order and to reinforce it and even to profit from it.”

* Barry Van Wyk is the Editor of The China Analyst
* This article first appeared in the the September issue of The China Analyst [2]
* Please send comments to editor@pambazuka.org [3] or comment online at Pambazuka News [4].

Categories: Emerging powers in Africa Watch [5]
Issue Number: 448 [6]