China Inc. Goes Global

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China's overseas investment has been on the increase, mostly supported by government strategy and its sovereign wealth funds. Last year marked a major shift in China’s investment position, as overseas direct investment exceeded inbound foreign direct investment for the first time. Dr Martyn Davies explores why Chinese outbound movement of foreign capital has evolved into a sophisticated strategy to acquire leading global companies.

There are now 95 Chinese firms on the Global Fortune 500 list of the world’s largest companies (the US has 128). In 2014 they jointly posted US$5.8 trillion in revenues. A large number of these companies are emerging as multinationals as they take their businesses global. I have been very fortunate in my career to observe, and later participate in, the outbound movement of Chinese capital in search of investments and acquisitions that began around the turn of the current century. What began as a very state-heavy and, at times, clumsy attempt by a handful of state-owned enterprises (SOEs) that had previously little or no international experience to invest abroad, has evolved into a far more sophisticated strategy to acquire leading global companies in the global marketplace.

In 2000, China’s outbound foreign direct investment (FDI) stock amounted to approximately US$28 billion. By the end of 2014 this stood at about US$870 billion, almost half of which was in the energy sector. Last year, China’s overseas direct investment (ODI) had increased 14.1% to US$102.9 billion – with the highest increases in investment going to the European Union and US markets.

2014 marked a major shift in China’s investment position in that its ODI exceeded the amount of foreign direct investment into the country for the first time. Quoted in the Financial Times, China’s Assistant Minister of Commerce, Zhang Xiangchen, stated that “China is already a capital exporting country and it is now poised to become a net exporter of capital”.

**Origins of state capitalism abroad**

Despite the high growth performance of China’s own internal economy, the Chinese government has been encouraging designated Chinese SOEs to invest abroad since 2002 – its so-called Go Out strategy, initially crafted by the Hu Jintao administration. This aimed to create a number of “national champions” – globally competitive enterprises that could act as vehicles of foreign commercial policy vehicles for the People’s Republic abroad. China Inc.’s international forays have been mostly financed by borrowing large amounts of capital, at highly preferential rates, from its so-called policy banks, namely the China Export-Import Bank (EXIM Bank) and China Development Bank (CDB). They have been at the sharp end of financing the internationalisation of China Inc. and have been instrumental in helping SOEs to establish a beachhead in global markets (often at the expense of other competing nationals).

Aligned with this state-heavy slant, the government created a number of dedicated sovereign wealth funds – to direct capital abroad in support of its SOEs. For example, the US$747 billion China Investment Corporation (CIC) initially looked to invest in equities and in the US financial sector, but it has shifted its focus into long-term assets such as infrastructure and agriculture, both in developed and emerging economies, and in early 2015 established a dedicated subsidiary to oversee this strategy. The China-Africa Development Fund (CAD Fund) was established as a dedicated regional fund to support China’s aggressive investment across Africa.
largely linked to the resources and commodities sector. Capitalised with US$5 billion, the CAD Fund has been active in investing across the African continent, acting as a type of hybrid investor mobilising sovereign wealth like a private-equity fund. Chinese Premier Li Keqiang also recently announced the creation of a US$3 billion fund aimed at facilitating financing towards Central and Eastern European (CEE) countries, which aids the US$10 billion credit line that Beijing established in 2012 to support co-operative projects within the CEE bloc.5

Recalculating risk?
In the initial stages of China’s Go Out strategy, risk was constructed differently to most Western multinational investors. Political stakeholders pursuing a geoeconomic interest controlled the strategy, rather than traditional private shareholders. The state-owned structure of Chinese policy banks facilitated an approach where capital was invested to support the broad interests of the state, versus shorter-term commercial interests. This approach also resulted in the very rapid deployment of capital into assets and countries that had historically been considered as high-risk by conventional investors and offered strong growth potential and returns. The traction that China Inc. has gained in Africa and Latin America attests to this.

Ian Bremmer, from political risk and consulting firm Eurasia Group, refers to the trend of politically enabled or financed investment as state capitalism which he describes as, “an economic system in which governments seek to exert an influence on market outcomes for political purposes”.6 He asserts that, “China and Russia are leading the way in the strategic deployment of state-owned enterprises” in the global economy.7 Many governments in Western countries have grappled with forming coherent policy responses to this trend, sometimes resulting in arbitrary actions of political protectionism against targeted Chinese investments, especially in the energy and telecommunications sectors.

China’s ability to deploy capital even during cyclical downturns – for example during the financial crisis – has, however, won it a great deal of political capital in the emerging world. Jiang Jianqing, chairman of the state-owned Industrial and Commercial Bank of China, said at a previous World Economic Forum regional meeting in Africa that Chinese investment in Africa is, “growing and becoming more diversified, even as the global downturn curbs investment by other countries”. In many cases, China has become the major source of credit for emerging economies.

China’s initial outbound expansion strategy into developing economies is not dissimilar to that of the internationalisation of Korean firms in the 1990s. Chinese companies, like their Korean predecessors, are using so-called peripheral markets to act as a launch pad for their subsequent global expansion. This strategy enables them to gain experience and build volume in their businesses.8

Strategic drivers of internationalisation
Over the past half-decade Beijing has encouraged leading SOEs and Chinese companies to invest and operate overseas – dubbed as “going global”. The reasons behind this policy are numerous and evolving. Key determinants of this force since 2000 are:

- **Resource seeking:** Securing energy and resource assets and long-term supply contracts across an array of commodity assets, particularly energy resources;
- **Market seeking:** Locating manufacturing processes offshore to offset rising costs as well as risk of protectionist sentiment that is becoming more prevalent against Made in China products;
- **Strategic influence seeking:** Looking to project global political and cultural influence (soft power) through establishing a wide geographic presence of state-owned and state-aligned firms, due to an inherent distrust of Western political-economic influence;
- **Technology and brand seeking:** Acquiring brands, technologies, distribution and sales channels. Chinese firms have sought to acquire leading global companies that can fast-track their integration and inclusion into the global economy. This is the current focus of Chinese policymakers.

Identifying trends and setting the overarching strategy is one thing, but implementing it is quite another. The challenges facing Chinese firms abroad are primarily operational. Chinese firms’ entry into developing states, these tend to over-rely on political relationships rather than operational ability. This has been apparent in South Africa, for instance, where many Chinese firms have been unsuccessful in the local marketplace. Political
alignment and relations are not a remedy for lack of local knowledge and expertise. Chinese firms are used to dealing with tough and competitive conditions, but seem far less adept at understanding local cultural circumstances.

However, the operational difficulties facing Chinese companies are not so different to other foreign firms – and their ability to manage and overcome challenges and investment risk is not yet proven.

Creating global banks
China’s investment abroad has traditionally been spearheaded by its policy banks and sovereign wealth funds. But with its growing international confidence, China wants to enhance its geo-economic influence through the deployment of capital. Beijing has initiated two international development banks – the Asian Infrastructure Investment Bank (AIIB) launched in March 2015 and the New Development Bank (often referred to as the BRICS Bank) launched in July 2015. Each has start-up capital of US$50 billion and are intended as strategic counterweights to the long-standing Western banking institutions – in particular the World Bank – even though World Bank president Jim Yong Kim, recently pledged his support to work closely with the AIIB towards the goal of ending poverty. The target clients will predominantly be in the developing world.

The initial US-dominated opposition to the launch of the AIIB was captured by former US Treasury Secretary Larry Summers who stated that, “This past month may be remembered as the moment the US lost its role as the underwriter of the global economic system… I can think of no event since Bretton Woods comparable to the combination of China’s effort to establish a major institution and the failure of the US to persuade dozens of its traditional allies, starting with Britain, to stay out of it.” China’s Go Out strategy has morphed into a long-term strategic effort to reshape the global financial architecture.

In April 2015, President Xi Jinping announced plans to draw on China’s foreign exchange reserves to inject US$62 billion into state-owned policy banks to provide extra support for China’s New Silk Road plan, which is set to build infrastructure and other investment links with foreign markets, to stimulate demand for China’s industrial exports. This could deepen the unease from the US foreign policy and business circles.

Looser regulations to free capital
China’s approach to internationalisation is rapidly evolving from a very state-centric strategy that initially focused on resources, into a more sophisticated market-oriented one. Chinese firms now operate far higher in the economic complexity value chain, seeking to acquire intellectual property and technologies and enhance their managerial abilities to fast-track their global competitiveness. Internationalisation is no longer just the domain of SOEs.

While observers are somewhat surprised by the rapid rise of China’s corporations, its largest firms are most often not the most competitive. The majority of China’s largest enterprises are state owned and have grown tremendously over the past decade – not so much due to the rapid expansion of the Chinese economy, but rather through a government-engineered merger and acquisition process to bulk-up to (supposedly) compete abroad.

In China’s twelfth Five Year Plan (2011-2015) Beijing sought to create the national champions that were part of its Go Out strategy. Leading Chinese SOEs and Chinese companies seeking to invest abroad were set a target of 50% of their profits to come from international markets within five years. Beijing has targeted 17% average annual growth in ODI during this period with a target of US$150 billion by the end of 2015. This forms part of Beijing’s Go Out strategy to create national champions.

Until recently, Chinese SOEs’ lack of competitiveness has been a case of the regulatory environment not leading the strategy. Despite China’s internationalisation, bureaucratic approval and capital controls have made it very difficult for Chinese firms to engage in mergers and acquisitions abroad. According to the Financial Times, China maintains tight restrictions on cross-border financial and portfolio investments and the renminbi is still not fully convertible, but the outward flow of direct investment is being facilitated by looser Chinese regulations.”

By streamlining the process, the Xi government is clearly intent on expanding and deepening its international investment policy. Chinese firms are becoming increasingly acquisitive abroad. Recent investments by Dalian Wanda Group in prime real estate in the US, Anbang Insurance purchasing the Waldorf Astoria Hotel

5 “China pledges $3b investment fund for Central, East Europe”, China Daily, 17 December 2014
7 Ibid
9 Quoted in Bloomberg Business, 6 April 2015
in New York, Lenovo Group acquiring Motorola Mobility, Fosun International investing in movie production company Studio 8, Portuguese state bank Caixa Geral de Depositos and Club Med, all point towards China Inc.’s strategy of buying into leading global brands.

Furthermore, the slow pace of recovery after the global financial crisis has resulted in depressed valuations in many developed world companies in Europe, forcing companies to sell equity at a discount. This has presented an evident buying opportunity for Chinese firms, which would allow them to acquire international skill-sets in areas of importance for the homeland.

As China Inc.’s international investment footprint deepens, so the geopolitical influence of China will increase, in line with its rising power ambitions. I am now observing how this process is being driven by dynamic and incredibly well qualified young Chinese talent. The cadre set are no longer on the frontline of China’s newly emerging companies.

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