

## FREEMAN BRIEFING

### May 27, 2008

#### Issue in Focus: China's "Going Out" Investment Policy

For much of the last two decades, China has been a top destination for foreign direct investment (FDI.) China's emergence as a global economic player through "opening up" to the participation of outside investors is well-chronicled. Few Chinese companies, however, have translated domestic success into international market share. In a country deeply sensitive to its semi-colonial past, this has not gone unnoticed.

Since the beginning of the millennium, China's central government has encouraged domestic companies to think globally and invest overseas. In 2001, head of the National People's Congress Wu Bangguo encouraged "competitive enterprises" to invest abroad and "go global".<sup>1</sup> As outlined by former President Jiang Zemin at the 16<sup>th</sup> National Party Congress, the government hopes this "going out" strategy will "bring about a number of strong multinational enterprises and brand names."<sup>2</sup>

The "going out" policy is not solely driven by national pride, however. Economic incentives have also lead the government towards the "going out" investment strategy in recent years; increasing overseas direct investment should help cool off China's overheating, investment-driven economy and diminish excess liquidity.

The early returns on the policy are modest, but undeniable. Between 1990 and 2000, China only averaged some US\$3 billion of outward FDI per year and in 2000, total outward FDI stock sat at US\$27 billion. By the end of 2006, however, total outward FDI stock but had more than tripled to US\$90 billion. Year-on-year growth in outward FDI the past few years is over 15 percent.<sup>3</sup>

Despite these gains, annual outward FDI at under US\$20 billion is still modest when compared with the United States, for example, which in 2006 sent US\$217 billion in FDI overseas. Beijing is not content, therefore, with progress to date. In early 2007

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<sup>1</sup> People's Daily. *China Launches Two-Way Investment Strategy*, September 21, 2001, [http://english.peopledaily.com.cn/english/200109/12/eng20010912\\_80006.html](http://english.peopledaily.com.cn/english/200109/12/eng20010912_80006.html)

<sup>2</sup> People's Daily, *Full Text of Jiang Zemin's Report at 16<sup>th</sup> Party Congress*, November 18, 2002, [http://english.people.com.cn/200211/18/eng20021118\\_106984.shtml](http://english.people.com.cn/200211/18/eng20021118_106984.shtml)

<sup>3</sup> Outward FDI flows in 2007 were US\$18.76 billion, up from US\$16 billion in 2006.

then Minister of Commerce Bo Xilai said that Chinese investment overseas was “still too small.”<sup>4</sup> In response, in September 2007, governor of the People’s Bank of China Zhou Xiaochuan announced that the bank would “remove unnecessary restrictions on reviewing sources of foreign exchange funds, as well as on foreign currency purchase and profit remittance” and “allow domestic firms to use their own foreign exchange.”<sup>5</sup>

Whether or not the results of China’s “going out” policy are dramatic enough to please Beijing, China’s investment plans and the particular nature of some Chinese company investments have raised eyebrows and rung alarm bells in other parts of the world. The bid for US-oil services company UNOCAL in 2003 by the China National Offshore Oil Corporation (CNOOC) touched off a firestorm in the U.S. Congress. The bid for IBM’s laptop unit by China’s Lenovo was scrutinized extensively before being approved in 2005. Concerns about investments by China’s new sovereign wealth fund (China Investment Corporation or CIC) in the United States are being broadly debated in Washington.

Investments outside the United States have typically received less scathing an inquiry, but political sensitivity to Chinese investment is not uniquely an American phenomenon. The recent purchase of a stake in Australian mining giant Rio Tinto by China’s largest aluminum producer, Chinalco, for example, went through with relatively little fanfare. An effort to acquire a stake in Australian resource giant BHP Billiton has not fared so well, however; a test of Australia’s new China-savvy Prime Minister Kevin Rudd. In a sign that the Chinese government is keen to avoid triggering further opposition to Chinese investments, the National Development and Reform Commission (NDRC) issued a notice in April 2008, calling for coordination and “guidance from the government” for state owned enterprises (SOEs) making future acquisitions in Australia.

Chinese companies have undeniably been spooked by political opposition to investment in the United States and other countries. The Chinese domestic market continues to pay enormous returns, so the immediate economic imperative to “go out” for companies is not as pressing. However, there is little question that in the next decade, with the full backing of the central government, Chinese companies will continue to invest abroad. Given the strategic political as well as economic implications of China’s “going out” policy, a clearer understanding of China’s motivations and future plans would be useful.

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<sup>4</sup> China Daily, *Chinese Overseas Investment surges by 32%*, January 17, 2007, [http://www.chinadaily.com.cn/bizchina/2007-01/17/content\\_785518.htm](http://www.chinadaily.com.cn/bizchina/2007-01/17/content_785518.htm)

<sup>5</sup> China Daily, *No Threat of Foreign Monopoly in any Industry*, Sep 10, 2007, [http://www.chinadaily.com.cn/cndy/2007-09/10/content\\_6092042.htm](http://www.chinadaily.com.cn/cndy/2007-09/10/content_6092042.htm)

## SOEs Lead and Private Enterprises Follow

To date, the bulk of China's initial outward FDI has been made by the country's SOEs, particularly those administered by central government's ministries and agencies.<sup>6</sup> The share of outward FDI flows in 2004, 2005 and 2006 made by SOEs were 43 percent, 35 percent, and 29 percent of the total, respectively.<sup>7</sup> At the end of 2004, 30 Chinese companies accounted for 80.4% of China's total FDI stock; of these, more than 20 were SOEs administered by the central government.<sup>8</sup> In 2006, the top three Chinese companies in terms of outward FDI stock holdings were China Petrochemical Corporation, China National Petroleum Corporation (CNPC) and CNOOC; private enterprises such as Huawei Technologies and Haier ranked 24<sup>th</sup> and 30<sup>th</sup>, respectively.<sup>9</sup>

In 1999, the Fourth Plenum of the 15<sup>th</sup> National Party Congress emphasized that the government encouraged SOEs to "utilize both domestic and international resources to enhance competitiveness" and "establish branches overseas with comparative advantages to explore international markets."<sup>10</sup> Sinosteel, a raw material processing company managed by the State Assets Supervision and Administration Commission (SASAC) became the first "going out" SOE, and so far has established 21 affiliates around the globe, including offices in Australia, India, Singapore and South Africa.

In November 2004, the NDRC and the Export-Import Bank of China co-issued a decision to "provide credit support to the key overseas investment projects encouraged by the state."<sup>11</sup> These key projects fall into four categories: resource-related, export-driven, research and development, and merger and acquisition (M&A) ventures. The Director of SASAC, Li Rongrong said that, backed by this

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<sup>6</sup> SOEs are owned at the central, provincial and municipal levels.

<sup>7</sup> "2005中国对外投资始破百亿美元," Xinhua, Sep 5, 2006, [http://news.xinhuanet.com/fortune/2006-09/05/content\\_5050556.htm](http://news.xinhuanet.com/fortune/2006-09/05/content_5050556.htm)

<sup>8</sup> "2004年度中国对外直接投资统计公报分析," Sep 1, 2005, <http://wjmj.ningbo.gov.cn/ztpd/detail.phtml?catId=016002&newId=948&path=>

<sup>9</sup> Ibid. This paper does not address allegations that certain companies, including Huawei, have legacy ties to the PRC Government or receive specific state-directed support in ways that prevents them from consideration as "true" private companies. This paper, for its purposes, accepts the statement of a senior People's Bank of China Official, in a private interview in May 2008, "the Chinese people believe Huawei is a private company."

<sup>10</sup> "中共中央关于国有企业改革和发展若干重大问题的决定" News of the Communist Party of China, 1999, <http://cpc.people.com.cn/GB/64162/71380/71382/71386/4837883.html>

<sup>11</sup> "发改委和进出口银行关于对国家鼓励的境外重点投资项目给与信贷支持的通知," 2004年11月, <http://finance.sina.com.cn/g/20041102/14041126323.shtml>

national financial support, “in 2005, a dozen large-scale and competitive central enterprises went out and signed tens of energy and resource contracts.”<sup>12</sup> Among these central enterprises are SOE oil giants CNPC, Sinopec and CNOOC, which are actively acquiring overseas resource assets as part of China’s energy security policy.

### A Role for SMEs?

At first blush, the larger SOEs would seem to raise more political sensitivities in their international activities than smaller, private companies that form the bulk of China’s economy. However, these companies have been much less-active in “going out” than their bigger, state-owned brethren.

Just a few years ago, small- and medium-sized (SMEs) private Chinese enterprises had no access to preferential financing and had to resort to their domestic parent companies or high-cost “underground channels” for funds, which severely hindered their efforts to “go out”. This is still the case for most SMEs in China today. The CEO of Chigo Airconditioning, a private company based in Guangdong Province, Li Xinghao complained that SOEs and non-SOEs are “treated very differently regarding governmental financial support.” In the air conditioning industry, for example, Li said that “Haier, as a former SOE, could easily get years of interest-free governmental loan to set up factories in U.S. while Chigo, as a private enterprise, has only acquired a half year loan with lots of restrictions.”<sup>13</sup> Meanwhile, SOEs continue to have easy access to long-term and large-scale loans.<sup>14</sup>

Notwithstanding these difficulties, more private enterprises are “going out” and becoming a more powerful force in China’s economic development. NDRC Vice Director Zhang Xiaoqiang has said that the government “encourages enterprises of all kinds of ownerships with comparative advantage, including both large enterprises and medium and small ones, to invest overseas.”<sup>15</sup> Former Minister of Commerce

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<sup>12</sup> “中国企业走出去：增势强劲成主流,” 中华网, <http://www.gzboftec.gov.cn/articles/2007-10/22817.htm>

<sup>13</sup> “非公企业境外投资门槛亟待降低,” August 4, 2006, <http://www.smenj.gov.cn/web/template/freshResourceArticle/20060804120440609.html>

<sup>14</sup> 尹明善, “十七大报告启示录,” 2007年11月26日, [http://www.jjsgsl.gov.cn/news\\_view.asp?newsid=270](http://www.jjsgsl.gov.cn/news_view.asp?newsid=270)

<sup>15</sup> “发改委：扶持企业在四个领域对外投资,” 新浪财经, May 21, 2007, <http://finance.sina.com.cn/roll/20070521/12201419294.shtml>

Bo Xilai claimed that “China’s ‘going out’ policy treats SOEs and private enterprises equally without discrimination.”<sup>16</sup>

*TCL Group: a Case Study*

When acquiring technology, Chinese companies do not discriminate by geographic region; they will venture across boundaries to secure technologies that benefit their companies. In an interview, Li Dongsheng, the CEO of TCL, a publicly traded electronics manufacturer and distributor based in China, said that his company’s acquisition of France’s Thomson Group in 2004 was aimed at gaining technology used in rear projection televisions as well as access to European markets. TCL believed that the rear projection technology would catapult them to the top of the industry. However in the rapidly changing technology world, rear projection was soon surpassed by flat screen TVs. Li Dongsheng lamented that TCL was inexperienced in acquisitions at that time and was unable to foresee the changes in the industry.<sup>17</sup> Li Dongsheng also discussed the lack of actual support from the Chinese government for TCL’s “going out” endeavors. Although the government began to call for companies to invest abroad in 2000/01, Li Dongsheng talked frankly of the reality of official policy – for example, actual government support in the form of preferential policies was not enacted until 2006. With TCL’s acquisition of Thomson Group, which cost 100 million Euros, government-run banks supplied only one-tenth of the funding. This ratio and amount of government support, according to Li Dongsheng, pales in comparison to countries such as the United States, France, Japan, and South Korea. As such, Li Dongsheng believes that the Chinese government has a lot of room to improve regarding its policy making in this area in order to actually support the “going out” policy in practice.

Whether or not Chinese private enterprises can “go out” depends on three significant factors: capital, government approval, and market information. The Chinese government has begun to create a favorable “going out” environment for these once-ignored entities. In 2007, the Ministry of Commerce, Ministry of Finance and People’s Bank of China published “Several Opinions on Encouraging, Supporting and Guiding Non-public Enterprises to Invest Overseas,” aiming to provide financial support, market information and training for to-go-out enterprises. China Export & Credit Insurance Corporation (Sinosure) signed a comprehensive cooperation agreement with Export-Import Bank in 2006 to further provide risk management services for enterprises of all kinds of ownership.<sup>18</sup> The Ministry of Commerce issued “Provisions on The Examination and Approval of Investment to Run

<sup>16</sup> CCTV, 专访商务部部长薄熙来：对非承诺如何兑现, December 2006, [http://news.china.com/zh\\_cn/domestic/945/20061113/13740429\\_3.html](http://news.china.com/zh_cn/domestic/945/20061113/13740429_3.html)

<sup>17</sup> China Times. *TCL扭亏 国际化实践“鹰的重生”*. March 15, 2008 <http://www.chinatimes.cc/Article/CJJD/2008-03-15/80932.html>

<sup>18</sup> “中国企业海外投资获双重保障,” 新浪, February 2006, <http://finance.sina.com.cn/roll/20060213/0556545886.shtml>

Enterprises Abroad” in 2004 and adopted an online credential distribution system in 2005, which has greatly simplified governmental approval procedures to accelerate the “going out” of Chinese enterprises.

There is evidence that private enterprises have become more significant players in China’s outward FDI in recent years. The outward FDI of private enterprises accounted for 47 percent of China’s total outward FDI in 2003, 56 percent in 2004 and 70 percent in 2005.<sup>19</sup> The number of private enterprises with overseas operations jumped from 1,000 in 2002 to 2,573 in 2005. The percentage of private enterprises among all overseas Chinese enterprises has risen from 50 percent in 2002 to 64 percent in 2005.<sup>20</sup> According to Export-Import Bank of China statistics, among over 800 Chinese enterprises doing business in Africa, only around 100 are SOEs, the remainder being private enterprises. Of these, a significant concentration is from Zhejiang Province, a traditional hotbed of private enterprise.

Indeed, private companies based in Zhejiang Province are taking the lead in outward foreign investment and were the source of over 90 percent of the province’s overseas investment in 2005. Fujian and Jiangsu follow Shanghai with private enterprises contributing over 50 percent of these provinces’ total outward FDI.<sup>21</sup> In 2007, some 50 percent of Shanghai’s 72 newly approved overseas investment projects were led by private enterprises; 18 of these enterprises are from adjacent provinces in the Yangtze river delta and headquartered in Shanghai, signaling a new trend in private enterprises’ overseas investment strategy: private enterprises based in the hinterland are moving their headquarters to coastal cities to facilitate “going out.”<sup>22</sup>

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<sup>19</sup> “民营企业国际化发展的现状,” 中国网, Feb 5, 2007,  
[http://www.china.com.cn/info/data/txt/2007-02/05/content\\_7761931.htm](http://www.china.com.cn/info/data/txt/2007-02/05/content_7761931.htm)

<sup>20</sup> 邢厚媛, “民营企业走出去: 现状, 问题和对策,” 2007年7月28,  
[http://64.233.169.104/search?q=cache:2j-3oLukQPcJ:www.acfic.org.cn/cenweb/portal/user/anon/page/AcficEconomy\\_CMSItemInfoPage.page%3FmetainfoId%3DABC0000000000019080+%E5%95%86%E5%8A%A1%E9%83%A8+%E6%B0%91%E4%BC%81+%E8%B5%B0%E5%87%BA%E5%8E%BB+%E7%94%9F%E5%8A%9B%E5%86%9B&hl=en&ct=clnk&cd=1&gl=us](http://64.233.169.104/search?q=cache:2j-3oLukQPcJ:www.acfic.org.cn/cenweb/portal/user/anon/page/AcficEconomy_CMSItemInfoPage.page%3FmetainfoId%3DABC0000000000019080+%E5%95%86%E5%8A%A1%E9%83%A8+%E6%B0%91%E4%BC%81+%E8%B5%B0%E5%87%BA%E5%8E%BB+%E7%94%9F%E5%8A%9B%E5%86%9B&hl=en&ct=clnk&cd=1&gl=us)

<sup>21</sup> 邢厚媛, “民营企业走出去: 现状, 问题和对策,” 2007年7月28,  
[http://64.233.169.104/search?q=cache:2j-3oLukQPcJ:www.acfic.org.cn/cenweb/portal/user/anon/page/AcficEconomy\\_CMSItemInfoPage.page%3FmetainfoId%3DABC0000000000019080+%E5%95%86%E5%8A%A1%E9%83%A8+%E6%B0%91%E4%BC%81+%E8%B5%B0%E5%87%BA%E5%8E%BB+%E7%94%9F%E5%8A%9B%E5%86%9B&hl=en&ct=clnk&cd=1&gl=us](http://64.233.169.104/search?q=cache:2j-3oLukQPcJ:www.acfic.org.cn/cenweb/portal/user/anon/page/AcficEconomy_CMSItemInfoPage.page%3FmetainfoId%3DABC0000000000019080+%E5%95%86%E5%8A%A1%E9%83%A8+%E6%B0%91%E4%BC%81+%E8%B5%B0%E5%87%BA%E5%8E%BB+%E7%94%9F%E5%8A%9B%E5%86%9B&hl=en&ct=clnk&cd=1&gl=us)

<sup>22</sup> Caijing, *上海民营企业走出去势头猛*, Feb 21, 2007  
<http://www.caijing.com.cn/newcn/home/jswx/china/2008-02-21/49072.shtml>

### Is the “Going Out” policy more Industry-oriented or Region-oriented?

In 2006, China’s non-financial outward FDI flowed mainly into two regions: Latin America with 48 percent and Asia with 43.4 percent, followed by Europe at 3.4 percent, Africa 2.9 percent, North America 1.5 percent, and Oceania 0.8 percent.<sup>23</sup>

Does the Chinese government prefer to do business with Latin America and Asia and to cultivate favorable relationships with them due to political considerations? The evidence would suggest not. On the contrary, China’s “going out” policy is currently more industry-oriented than region-oriented.

Chen Xiaohong, director of the Enterprise Research Institute at the State Council’s Development Research Center, commented that “Chinese enterprises choose investment regions based on the industries to which they belong: resource-dependent industries choose to invest in developing countries in Africa and Latin America; technology-seeking industries prefer developed countries especially the U.S. and Western Europe; market-seeking commodity industries choose to invest in Eastern Europe, Africa and also Latin America.”<sup>24</sup>

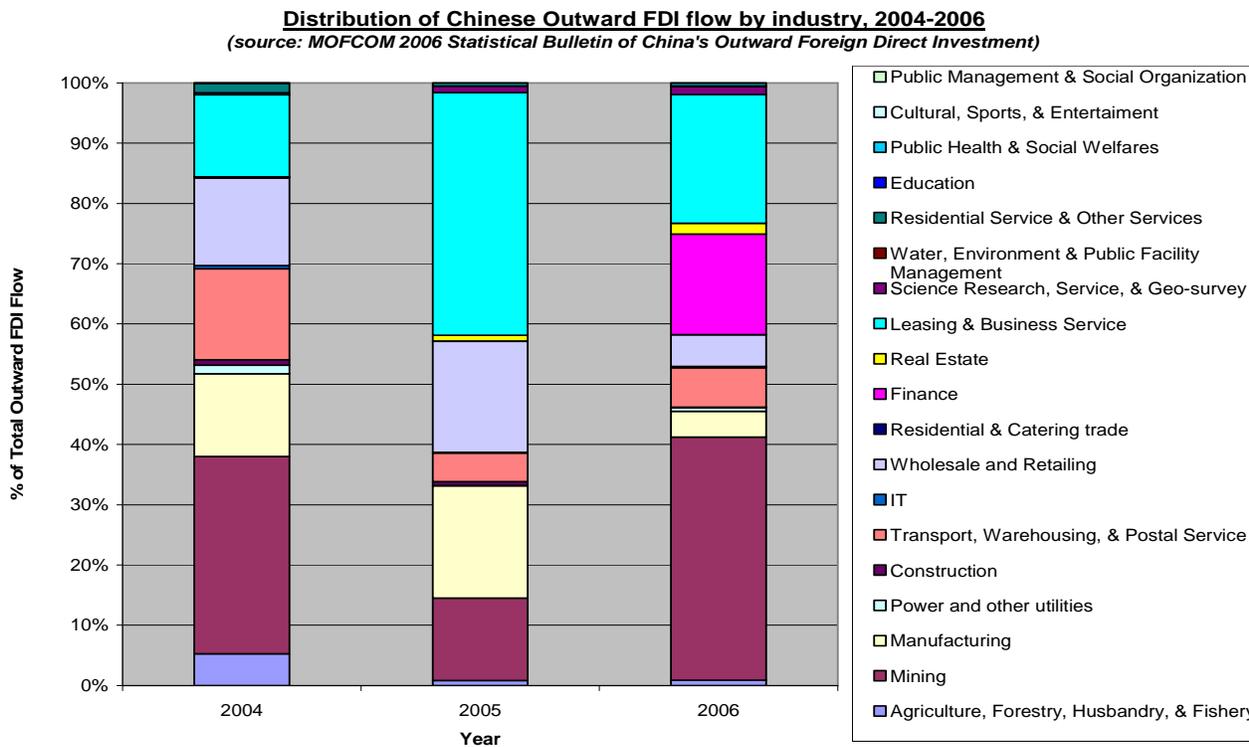
The investment pattern reflects the importance of natural resources found in Africa, central Asia and Latin America for China’s economic development. By the end of 2005, M&As in the oil and gas sector by Chinese enterprises accounted for 61 percent of aggregate global transactions value in all industries that year. CNPC’s acquisition of PetroKazakh Inc. in 2005 is the biggest acquisition of a foreign company by a Chinese company to date.

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<sup>23</sup> In <2006 Statistical Bulletin of China's Outward Foreign Direct Investment >, Data from this bulletin comes from survey of over 4000 Chinese enterprises and is issued by the Ministry of Commerce, National Bureau of Statistics and State Administration of Foreign Exchanges together for the first time.

<sup>24</sup> 陈小洪,“中国企业国际化经营:初步观察和思考,” 中国经济时报, Sep 4, 2006, <http://www.cre.org.cn/cre2007/Article/Print.asp?ArticleID=1038&Page=1>

**Table 1: Distribution of China’s Outward FDI Flow by Industry, 2004-2006**



- *Industries with most outward FDI flow in 2004:* Mining (33%), Transport, Warehousing, & Postal Service (15%), Wholesale and Retailing (15%)
- *Industries with most outward FDI flow in 2005:* Leasing and Business Service (40%), Manufacturing (19%), Wholesale and Retailing (18%)
- *Industries with most outward FDI flow in 2006:* Mining (40%), Leasing and Business Service (21%), Finance (17%)

While natural resources continue to play a significant role in China’s outward FDI flow, markets and technology are becoming increasingly important factors that drive Chinese enterprises overseas. At the 2007 Chinese Enterprises Outbound Investment

Conference, NDRC Vice Director Zhang Xiaoqiang clarified that the Chinese government encouraged overseas investment in four focused fields: resources, infrastructure and production equipment, R&D, and the services industry.<sup>25</sup>

The increase in Chinese outward FDI into Latin America indicates a strategic move by the government to develop overseas markets, given the prediction that economic growth rates on the continent will average between 3-4 percent from 2006 to 2010.<sup>26</sup> President Hu Jintao's visit to four Latin American countries in 2004 witnessed the signing of contracts worth billions of dollars for Chinese enterprises in the oil, mining and fishery industries. As a market of some 500 million people is obviously appealing, this investment strategy, once regarded as merely a "project in exchange of resources," has added new elements since then. Raw materials, low cost labor and land, increasing buying power of residents, and proximity to North America are all contributing to the "Latin America investment heat" among Chinese enterprises. Besides resource-dependent industries such as oil and mining, China's consumer goods industry is moving factories from Mainland China and Southeast Asia here. China's FDI flow into Latin America increased from around US\$1.38 billion in 2003 to US\$8.47 billion in 2006, and accounted for 48 percent of China's overall FDI in 2006.<sup>27</sup>

For example, in 2001 Gree Electric Appliances invested US\$20 million to establish a fridge production base in the Manaus special economic zone in Brazil, which has an annual production of 200,000 appliances. With advantageous production costs, low tax, and Brazil's economic influence in the region, within three years Gree has risen to become one of the top three most popular household appliance brands in Latin America. Many famous Chinese household appliances suppliers have followed Gree's example and set up factories, such as Haier, Midea, Chunlan, Aucma, Chigo, and Little Swan. Haier Computer is also planning to enter into the PC market in Latin America.<sup>28</sup>

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<sup>25</sup> “发改委：扶持企业在四个领域对外投资,” 新浪财经, May 21, 2007, <http://finance.sina.com.cn/roll/20070521/12201419294.shtml>

<sup>26</sup> 谢文泽, 中国企业走向拉美面临的问题与政策思路,

中国社会科学院院报, 2006年1月 <http://www.cass.net.cn/file/2006011253203.html>

<sup>27</sup> In <2006 Statistical Bulletin of China's Outward Foreign Direct Investment >, Data from this bulletin comes from survey of over 4000 Chinese enterprises and is issued by the Ministry of Commerce, National Bureau of Statistics and State Administration of Foreign Exchanges.

<sup>28</sup> “海尔电脑瞄准拉美市场,” 新浪, Feb 17, 2007, <http://tech.sina.com.cn/it/2007-02-17/16381387475.shtml>

China's FDI flow into Africa is also steadily increasing, from US\$74.81 million in 2003 to US\$519.86 million in 2006. President Hu Jintao's visit to eight African countries in January of 2007 further solidified already deepening economic ties between China and the continent. By the end of 2005, China had signed with 41 African countries the Bilateral Trade Agreement; with 28 African countries, Bilateral Investment Agreement of Encouragement and Guarantee; and with 8 African countries, Avoidance of Double Taxation Agreements. China is also the biggest investor in African countries' infrastructure through the Export-Import Bank of China.

Oil still accounts for the biggest share of exports from Africa to China (73 percent of total African exports in 2006) while mechanical and electrical products have replaced light industry products as China's top exports to Africa (45 percent of total Chinese exports in 2006). Though most Chinese mechanical and electrical products suppliers such as Chigo, Chunlan and TCL are Original Equipment Manufacturers (OEMs) of famous international brands in Africa, the low cost of land and labor, preferential trade agreements with the EU and the U.S., and thriving markets due to economic development, have also drawn Chinese manufacturers such as Haier, Hisense and Shinco to set up factories and to bring advanced technology there. Shinco became a designated brand for Nigerian government procurement in 2006 and Haier has moved production of some key and high value-added parts to Tunis and Nigeria.<sup>29</sup>

### **Non-Resource Related FDI Activity**

While China's FDI flows to Africa and Latin America remain mainly driven by a search for new resources and markets, Chinese enterprises seeking technology and know-how target the United States and Western European countries. Mergers and Acquisitions as a main shortcut to gain technology and know-how accounted for 39 percent of China's outward FDI in 2006 (US\$8.25 billion).<sup>30</sup> Excluding M&As in raw materials and energy, telecommunications has risen to the second most attractive field for M&As, followed by household appliances, machinery manufacturing and petrochemicals.

In 2007, Chinese companies completed 37 transnational M&As, an 117.6 percent increase compared with 17 in 2006. Strong domestic economic growth, appreciation

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<sup>29</sup> “中国家电产业开拓非洲市场前景浅析,” [http://www.africa.gov.cn/ArticleView/2007-1-16/Article\\_View\\_4535.htm](http://www.africa.gov.cn/ArticleView/2007-1-16/Article_View_4535.htm)

<sup>30</sup> 中国企业国际化战略报告课题专家委员会, *中国企业国际化战略报告2007蓝皮书*, December 2007 <http://finance.sina.com.cn/chanjing/b/20071115/09384176717.shtml>

of the Yuan and the U.S. subprime mortgage crisis are three leading reasons for this increase.<sup>31</sup> One half of the top ten Chinese M&A bids of 2007 occurred in the financial sector in part as a result of the U.S. subprime mortgage crisis, including China Investment Corp's US\$3 billion investment in private equity fund Blackstone Group; China Development Bank's share purchase in Barclays Bank; the Industrial and Commercial Bank of China's purchase of a 20 percent stake (US\$5.5 billion) of Standard Bank of South Africa; and Ping An group seeking a 4.18 percent stake worth 1.81 billion euros in Fortis.<sup>32</sup> In the non-financial sector, the recent largest M&A bid occurred in January 2008 when China's Youngor Group acquired the men's garment section of U.S. company Kellwood valued at US\$120 million, making it the biggest overseas acquisition in China's garment industry, and a sign of the burgeoning financial strength of the Chinese manufacturing sector.

### Missteps along the Way

However, of the 213 overseas M&A attempts concluded by Chinese enterprises from 1986 to 2006, over 60 percent have failed. China's largest soft drink producer Wahaha's failed marriage with the French food company Danone and TCL's with Thomson has alarmed many Chinese enterprises. Moreover, China Minmetals' failed bid for the biggest Canadian mining company Noranda; CNOOC's Unocal bid; Huawei's 3Com bid; and the recent CITIC group bid for Bear Stearns all indicate that Chinese M&As in developed markets still face obstacles.

In the U.S. and Western Europe fierce competition, strict regulations, and high production costs are among the reasons many Chinese enterprises continue to seek M&A partners in Southeastern Asian countries, which share much in common with China in terms of business culture and consumer habits.<sup>33</sup> According to a survey of 150 Chinese Enterprises' FDI conducted by the World Bank in 2006, the top three favored "going out" destinations were East Asia, South Asia and Southeast Asia, followed by Africa, North America and Western Europe.<sup>34</sup>

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15 财经网, *2007年中国企业跨国并购创新高*, Jan 18, 2008 ,  
<http://www.caijing.com.cn/cjkxx/cjkx/2008-01-18/45648.shtml>

32 China Daily, *Top Ten M&A bids in 2007*, Jan 7, 2008,  
<http://english.sina.com/business/p/1/2008/0107/140371.html>

33 搜狐新闻, *中国企业海外并购瞄准亚洲 重点在能源技术领域*, Sep 9, 2005  
<http://news.sohu.com/20050909/n226912085.shtml>

34“调查显示近六成中国企业计划三年内走出去,”2006,  
<http://www.chinafastener.net/gb/news/3397.htm>

However, SMEs eager to invest directly in the United States face less opposition than well-known Chinese SOEs, whose deals have tended to become politicized and raised fears over “national security” interests. Though Chinese entrepreneurs remain wary of entering the U.S., uncertain about restrictive visa rules, language and cultural barriers, and the political environment, Chinese manufacturers, particularly those that import parts or raw materials from the U.S., are looking at setting up assembly operations.<sup>35</sup>

Liu Keli, owner of a Chinese printing company, recently invested US\$10 million in South Carolina to build a factory that will employ 120 workers. Liu spent less than one-fourth on land in South Carolina than he would have in southeast China, where he already runs three other plants. Liu is reportedly among a wave of Chinese entrepreneurs planning to expand into the U.S. to build factories, buy companies, and invest in businesses and real estate.<sup>36</sup>

According to the Council of American States in China, more than 30 states in the U.S. have staff members or representatives in China. With the U.S. economy slumping and unemployment rising, even some tough critics of China are courting Chinese investment. In March, one delegation to China included the governor of Missouri, two U.S. senators, the mayor of St. Louis and two dozen other officials and businesspeople in an effort to encourage investment in St. Louis’ lagging airport, Lambert Field, as an entrepôt for Chinese trade and investment into the United States. California’s efforts to attract Chinese investment have been consistent, with Gov. Arnold Schwarzenegger, state legislators and local officials visiting China frequently since 2005.<sup>37</sup>

According to Liu Keli, the top challenge facing Chinese SMEs, which aim to tap the U.S. market, is “being associated with low-tech and bad quality.” Liu commented: “it will take time. People’s perception can only change little by little with hard work.” Liu, the son of farmers, sees his company’s move into the U.S. as a source of pride. “It is a lot of pressure however my business has become more competitive, which is one of the real benefits from this expansion.”<sup>38</sup>

### **Comparisons of China’s Outward FDI to Developed/Developing Countries**

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<sup>35</sup> “Chinese Firms Bargain Hunting in U.S.,” Los Angeles Times, May 5, 2008, <http://www.latimes.com/news/printedition/front/la-fi-chinainvest5-2008may05,0,6765407.story>

<sup>36</sup> Ibid.

<sup>37</sup> Ibid.

<sup>38</sup> Ibid.

Although Chinese companies do not follow a policy of discriminating by region, they do invest more in some places than others; recent trends, however, indicate a gradual move away from traditional investment favorites Asia and Latin America.<sup>39</sup> Chinese companies, backed by the central government, are scouring the world for resources—and increasingly, technologies and brand names.

In developed countries such as the United States, acquisitions by Chinese companies are scrutinized heavily due to their strategic political as well as economic implications. The United States is especially anxious about acquisitions by China that will affect national security. For example, the recent attempt by Huawei Technologies to acquire a division of 3Com, a United States networking company, was quashed after U.S. government scrutiny based on fears of transferring network security technologies to a company with legacy ties to the Chinese military officials.<sup>40</sup> From Huawei's perspective, it does not see itself as a security threat. Xu Zhijun, chief marketing officer of Huawei, believes that “if the U.S. Government is concerned about Huawei, if some of the lawmakers are concerned about Huawei . . . Cisco is everywhere within China. Who should be more concerned?”<sup>41</sup>

Despite the failure of major deals to successfully run the U.S. government and public gauntlet, Chinese companies nevertheless hope to invest in the United States, still attracted by its superior technologies and broad consumer base. In a recent interview with *China Daily*, NDRC Vice Minister Zhang Xiaoqiang said: “We hope U.S. policies and regulations do not become barriers for Chinese investors . . . [as] investors both from the U.S. and China have shown a strong desire to invest in each other.”<sup>42</sup> However, if protectionist policies and obstacles remain unchanged, Chinese companies will ultimately look elsewhere to invest. Recently, a commentary in the *Beijing News* entitled: “Chinese Overseas Investment Must Urgently Stop Relying on the United States”<sup>43</sup> cited the recent Huawei takeover bid as a sign of increasing

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<sup>39</sup> Sohu. 中国海外投资将快速增长. Jan 22, 2007.  
<http://business.sohu.com/20070122/n247758951.shtml>

<sup>40</sup> InternetNews Realtime IT News. *Why did the U.S. Government Kill Bain-3com?*. March 21, 2008  
<http://www.internetnews.com/commentary/article.php/3736006/Why+Did+The+US+Government+Kill+Bain3Com.htm>

<sup>41</sup> Techworld.co. *Huawei exec lashes out at US over 3Com*. February 13, 2008.  
<http://www.techworld.com/networking/news/index.cfm?newsid=11423>

<sup>42</sup> Jing, Fu. *China Daily. US Policies May Deter Investors From China.*, December 12, 2007.  
[http://www.chinadaily.com.cn/bizchina/2007-12/12/content\\_6315177.htm](http://www.chinadaily.com.cn/bizchina/2007-12/12/content_6315177.htm)

<sup>43</sup> The Bei Jing News. *中国对外投资亟须摆脱‘美国依赖症’*, February 26, 2008  
<http://www.thebeijingnews.com/comment/jjpl/1050/2008/02-26/018@093359.htm>

U.S. protectionism regarding its technology and recommended that Chinese investors look to other advanced and investment friendly nations with equally desirable technologies, such as the UK and Germany.

In contrast with the United States, Chinese investment is more welcomed in many developing countries. Investments differ from developed countries in that they are more likely to be related to natural resources and less related to technologies. Although there has been some grumbling in some developing markets about China's intentions, the resulting discussion is less focused on China as a competitive threat, and more on China as another in a line of foreign suitors.<sup>44</sup>

China's role in emerging Europe is more subtle still. There, China has used its long-standing relationship with countries such as Bulgaria, Romania, and Hungary prior to their entry into the European Union to its benefit, building manufacturing and distribution hubs in those markets that now have direct access to the European Union. In an interview with the *People's Daily*, Prime Minister Sergei Stanishev said Bulgaria was very willing to be a bridge between Western Europe and China for Chinese businesses.<sup>45</sup>

Underscoring the increasingly important role China is likely to play as a source of outward foreign direct investment in coming years, the government reported that overseas investments in the first quarter of 2008 had already outpaced those made in the whole of 2007. Outward foreign direct investment totaled US\$19.3 billion from January-March, a three-fold increase on the same period last year. China is now the world's 13<sup>th</sup> largest overseas investor, moving up from 26<sup>th</sup> in 2002, and is No. 1 among developing nations.

Chinese investment will almost certainly continue to grow in global importance. Whether it grows in response to Beijing's strategic direction or as a result of market conditions is an open question. Likewise, acceptance of Chinese investment abroad seems likely to be a function of whether Beijing takes a heavy hand in pushing that investment. Based on a review of current trends, the path seems smoothest for investment abroad by Chinese SMEs and private companies.

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<sup>44</sup> During Hu Jintao's December 2006 visit to South Africa, his host, President Thabo Mbeki, also recently warned of "an unequal relationship," between China and Africa similar to that which existed in the past between African colonies and the colonial powers. "China can not only just come here and dig for raw materials and then go away and sell us manufactured goods," he said.

<sup>45</sup> People's Daily Online. *Bulgaria to advance Europe-China Strategic Performance*. November 18, 2006  
[http://english.peopledaily.com.cn/200611/18/eng20061118\\_322874.html](http://english.peopledaily.com.cn/200611/18/eng20061118_322874.html)

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