Deutsche Bank Research

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Global champions in waiting

Perspectives on China's overseas direct investment

A recent string of high-profile cross-border merger and acquisition deals involving Chinese companies as acquirers, such as state-owned oil giant CNOOC's attempted takeover of California-based Unocal in mid-2005, has increased the spotlight on China's growing overseas direct investment.

Strong growth, but from a low base. Even though China's ODI is expanding at a rapid pace, the country still trails most developed economies and several key developing nations in terms of both its accumulated ODI stock and annual flows.

Energy needs and domestic competition key drivers. The bulk of current Chinese ODI is driven either by the country's increasing need to secure overseas energy and raw material resources or as a countermeasure to intensified competition and overcapacity in a number of key sectors of the domestic economy. The acquisition of advanced technology, brands and managerial know-how also figures prominently as a driver for Chinese ODI.

Government support is increasing. The Chinese government's financial and political support of ODI – under the slogan of 'Going Global' – has intensified in the wake of the country's accession to the WTO in 2001. A key aspect of the government's policy has been the development of internationally competitive 'global champion' enterprises.

Outbound Chinese M&A of growing importance. Cross-border mergers and acquisitions has gradually emerged as the dominant vehicle for Chinese ODI. The track record of these deals in terms of generating value remains mixed, however.

A sample of Chinese "global champions"

2004, USD bn

	Sector	Revenue	Net income
Sinopec	Oil/gas	71.45	3.90
PetroChina	Oil/gas	48.18	12.45
Hai'er	White goods	12.29	0.19
Baosteel	Steel	7.09	1.14
CNOOC	Oil/gas	6.68	1.96
Chalco	Aluminium	3.91	0.80
Huawei	Telecoms	3.83	0.62
TCL	Electronics	3.29	0.04
Lenovo	PCs	2.90	0.14
Galanz	White goods	1.60	0.70
Tsingtao	Brewery	1.04	0.03

Source: Company data

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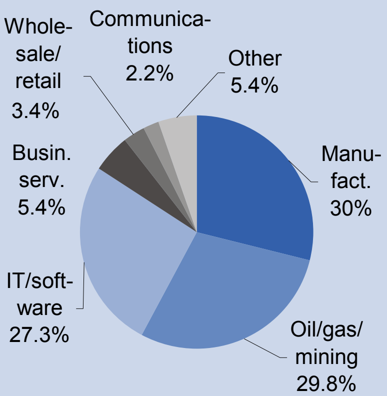
The emergence of Chinese ODI

Chinese ODI dominated by manufacturing, natural resources and IT sectors
Volume by sector of origin, 2005



Source: MOFCOM 1

While China's leading position as recipient of global FDI flows has been extensively documented, the overseas investment activities of Chinese companies have traditionally received much less attention. However, a recent spate of high profile cross-border merger and acquisition (M&A) deals involving Chinese companies – primarily within the resources, manufacturing and IT sectors – has brought increased interest in the issue of Chinese overseas direct investment (ODI) (see charts 1 and 2). These transactions have included: the USD 1.75 bn acquisition by Chinese computer manufacturer Lenovo of IBM's personal computer business in December 2004; an unsuccessful USD 1.3 bn bid by China's largest household appliance manufacturer Hai'er for US rival Maytag in May 2005; as well as the highly-publicised bidding war that unfolded during mid-2005 between US oil major ChevronTexaco and state-owned Chinese CNOOC for control of the smaller California-based industry rival Unocal. Such developments point to the emergence of China as a global investor, reflecting not only the country's increasing integration into the world economy but also its need to find overseas markets.

Playing catch-up

As a consequence of its increasing economic power driving it to target overseas investment opportunities, Chinese ODI flows have undergone a remarkable expansion over the past 25 years, with particularly strong growth posted since the country's entry into the WTO in 2001 (see charts 3 and 4). For 2004 and 2005, growth in ODI registered at 93% and 26%, respectively. Further supporting this pattern of expansion are Ministry of Commerce (MOFCOM) projections suggesting annual increases in Chinese ODI stock in excess of 20% between 2005 and 2010, translating into an additional USD 60 bn of ODI over this period.[1]

Major outbound acquisitions by Chinese companies
Jan 1999 to Jan 2006

Announce-ment date	Deal status	Acquired stake	Bid value EUR m	Target name	Target domicile	Chinese bidder
May 2005	Aborted	n.a. (100%)	15,255	Unocal	USA	CNOOC
Aug 2005	Completed	100%	3,204	PetroKazakhstan	Canada	PetroChina
Jan 2006	Pending	45%	1,894	Akpo oil field assets	Nigeria	CNOOC
Dec 2004	Completed	100%	1,303	IBM (Personal Computer Business)	USA	Lenovo
Jun 2001	Completed	100%	1,154	Hyundai Display Technology	South Korea	BOE Technology
Jun 2005	Aborted	n.a. (100%)	1,050	Maytag	USA	Hai'er
Jan 2002	Completed	86%	672	Repsol-YPF (Indonesian assets)	Indonesia	CNOOC
Oct 2003	Pending	13%	593	Gorgon Liquefied Natural Gas Field	Australia	CNOOC
Nov 2003	Completed	67%	450	Thomson SA (television manuf. unit)	France	TCL
Jul 2004	Completed	49%	419	Ssangyong Motor	South Korea	Nanjing Auto
Jun 2005	Pending	100%	370	PetroChina International	Indonesia	CNPC, PetroChina
Jul 2005	Completed	100%	72	MG Rover	UK	Nanjing Auto

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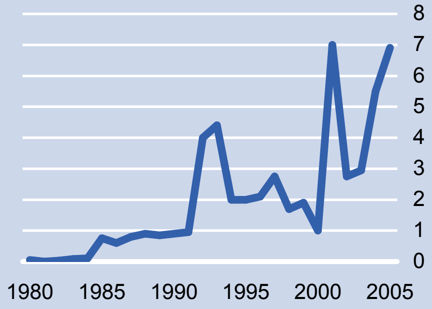
Yet, despite strong prospects for growth in Chinese ODI, China still trails most developed countries and several key developing nations

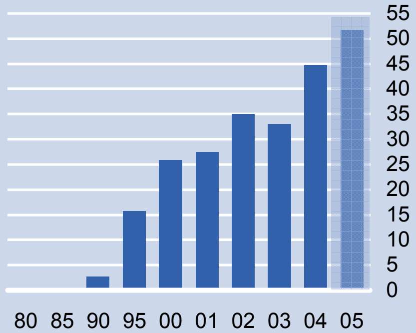
[1] People's Daily (October 29, 2005).

China's ODI has risen rapidly in terms of both annual flows...
USD bn



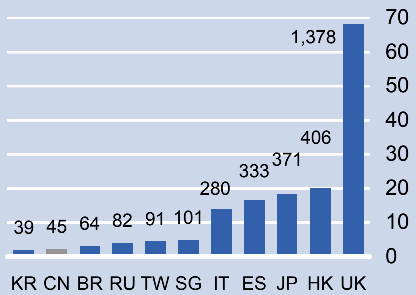
Source: Asia Pacific Foundation of Canada, MOFCOM 3

... and accumulated stock
USD bn



Source: Asia Pacific Foundation of Canada 4

Chinese stock of ODI still low
Accumulated stock, year-end 2004, % of US, abs. USD bn values in figures



Source: World Investment Report 2005 5

in terms of both accumulated ODI stock and annual ODI flows (see charts 5 and 6), reflected also by China's annual ODI outflow and stock of investment for 2004 having represented only 0.9% and 0.55% of respective global totals.[2] In terms of the ratio of accumulated ODI stock to GDP, which for China stood at 2.4% in 2004, the country lags far behind not only in its ability to attract inward FDI, but also ranks well below the global average (24.0%) as well as the levels for developed (27.3%) and developing countries (12.7%).[3]

The role of 'round-tripping'

When examining Chinese ODI there is also a need to distinguish between what can be properly classified as real investment – an equity investment with substantial operational involvement in a going concern – and what falls under the epithet of 'round-tripping'. Round-tripping involves taking domestic capital out of the country only to then bring it back in as foreign capital, arbitraging the institutional benefits afforded to foreign companies in China. In this context, some Chinese ODI effectively constitutes the outbound leg of round-tripping. Estimates of the percentage of FDI into China that is the product of round-tripping arbitrage range from 25-40%, with the bulk of this capital inflow originating in tax-friendly jurisdictions such as Hong Kong, the Cayman Islands and the Virgin Islands – in turn the three largest destinations for Chinese ODI.[4] In absolute terms, stripping out the above estimated round-tripping flow range from the ODI going into Hong Kong and the Caribbean would imply a reduction in China's overall ODI flow for 2005 of some 15-20% relative to the reported MOFCOM figure of USD 6.92 bn.

Chinese ODI: Key drivers

Chinese ODI is often grouped into three major categories according to the general motive of the investment.

1. Access to energy and raw materials

The need to secure access to overseas energy resources and raw materials to support China's high economic growth rate continues to be a key strategic driving force. Over the past twenty years, China has moved from being East Asia's largest oil exporter to becoming the world's second largest importer of oil, accounting for nearly a third of global growth in oil demand in 2005.[5] A similar picture of explosive growth in demand on the part of China has also been forming in the case of aluminium, copper, nickel, iron ore and other key commodity products. Decentralisation within the Chinese energy sector has seen energy administration increasingly passed on from centralised planning agencies to state-owned energy companies, which is generating a supply-side focus in terms of energy development underscored by the aggressive cross border M&A policy being pursued by CNOOC and China's other state-owned oil majors. The natural resource-seeking ODI of the Chinese energy majors is intimately connected to the government's pursuit of a national energy security agenda aimed at countering the risks associated with the country's increasing energy import dependency by

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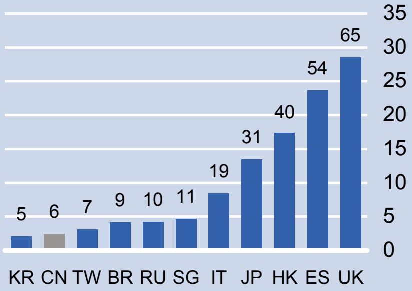
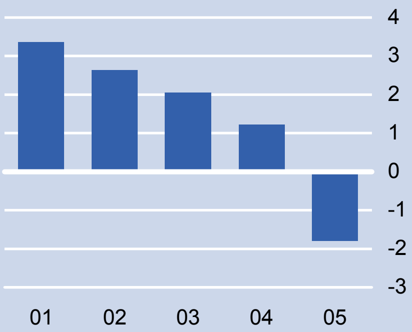
[2] Asia-Pacific Foundation of Canada (2005).
[3] Own calculations based on UNCTAD (2005).
[4] Global Insight (2006).
[5] Zweig and Bi (2005).

China also trails in terms of outbound FDI flows
Year-end 2004, % of US, abs. USD bn values in figures



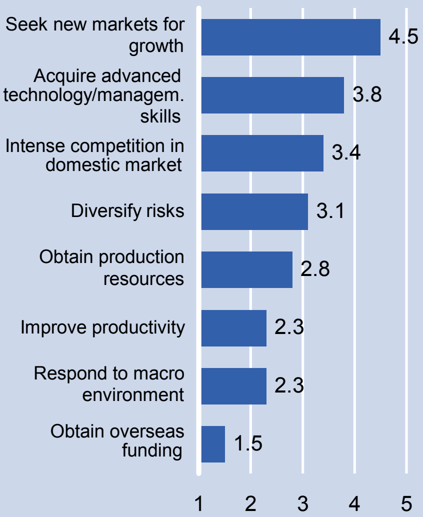
Source: World Investment Report 2005 **6**

Heavy profit margin erosion: the case of TCL
Net income/revenues, %



Source: Company data **7**

Primary motivations for global expansion
1 = not important, 5 = very important



Source: IBM Institute for Business Value, 2006 **8**

encouraging Chinese energy firms to secure overseas energy assets and supply agreements. Meanwhile, the Chinese authorities have been courting the governments of host states aggressively by strengthening bilateral trade relations, awarding aid, and providing much-needed transport and communications infrastructure. This process of 'dollar diplomacy', of which a prime example was offered by the USD 100 bn in Chinese investment into Latin America promised by Chinese President Hu Jintao during his visit to the region in 2004, has won China access to key natural resource supplies, including gold from Bolivia, coal from the Philippines and oil from Ecuador. Another example of the government's close involvement with and support of overseas-directed energy asset acquisitions are the current conditions stipulated by the influential policy-setting National Reform and Development Commission, requiring China's energy firms to purchase equity in upstream energy suppliers, principally through overseas acquisitions.[6]

2. Acquisition of technology, brands and know-how

Chinese companies are also investing overseas in an effort to acquire advanced technology, brand names, distribution networks and managerial know-how, as exemplified by Lenovo's acquisition of IBM's notebook business division and TCL's purchase of Thomson's TV manufacturing unit. This motive has been given impetus by the increased awareness on the part of both state-owned and private companies in China of the need to strengthen their global competitiveness, particularly in the wake of the country's accession to the WTO in 2001.

3. Hyper-competition in domestic market

Excessive competition, thinning margins and overcapacity within many industries in China has spurred companies to invest abroad with a view to creating an overseas-based platform from which to gain access to local markets as well as realising competitive advantages through production cost efficiencies. This trend is particularly prevalent within the white goods and consumer electronics sector where, according to analysis by McKinsey and Co., estimated overcapacity runs at 30-40% for washing machines, refrigerators and microwave ovens and at nearly 90% for televisions.[7] The impact on the bottom-line is often painfully clear, as in the case of the steady erosion of TCL's profit margin over the 2001-2005 period (see chart 7). An example of Chinese enterprises seeking to counter such difficult market conditions is the establishment by Hai'er of a manufacturing plant and distribution centre in the United States, as well as the company's acquisition of a Padova, Italy-based factory for local white goods production. In this context, Chinese enterprises' access to preferential financing from domestic state-owned banks can help facilitate overseas expansion in the face of margin and earnings pressures within the home market. Also weighing in on the motivations of Chinese exporters has been ODI as a route for circumventing regional protectionism and trade barriers, as in the case of Mexico and NAFTA, as well as for averting growing complaints from China's trading partners over its anti-dumping practices.

The above motives for overseas expansion by Chinese companies are also reflected in a recent poll conducted by the IBM Institute for Business Value among 60 leading Chinese state-owned (47) and

[6] Global Insight (2006).
[7] Quoted in: Wu (2005).

private (13) companies with annual revenues of over USD 1 billion, which had been screened for their 'global potential' (export volumes, foreign presence, internationally-oriented management strategy etc. (see chart 8)

The poll concluded that seeking new markets for growth is the key driver behind Chinese ODI, followed by acquisition of advanced technology and management skills, as well as the intensity of competition in the domestic market. It is noteworthy that obtaining production resources ranks well below these primary motivations, with no specific reference to securing natural resources as a driver for Chinese ODI, suggesting that this more politically motivated and government directed investment driver may be confined to a few of the largest state-owned natural resource enterprises only.

"Going global": The role of the Chinese government

The roots of the Chinese government's current advocacy of the country's public and private enterprises pursuing overseas investment stretch back to the opening of the Chinese economy in the late 1970s (see Appendix). However, government industrial policy directed at growing Chinese ODI has been given increased impetus and a more formalised supporting policy framework in the wake of the 1997-98 Asian financial crisis and the country's entry into the WTO in 2001 under the epithet of 'Going Global'. The policy was given weight in 2001 by the then Premier Zhu Rongji in connection with the government's 10th five-year plan and was reinforced as recently as March 2006 in a key policy speech delivered by Premier Wen Jiabao to the annual plenum of the Chinese People's Political Consultative Conference, in which Mr Wen noted that the government will "institute a policy support and service system and improve the mechanisms for coordinating overseas investment and risk management".[8] While the focus of the 'Going Global' strategy on encouraging Chinese companies to embrace "The Two Markets" – i.e. domestic and foreign – represents a continuation of policies pursued previously by the Chinese government, the implementation of ODI-friendly industrial policies, such as the relaxation of foreign currency controls, marks a further turning point in the development of Chinese ODI. As such, the 'Going Global' strategy in the post WTO-era functions as a complement to the Chinese government's successful advocacy of foreign direct investment flows into China as a key pillar of support for the country's economic development.

The key motives behind the Chinese government's advocacy of its 'Going Global' strategy differ, not surprisingly, in their essential form from those of private enterprises, which are primarily driven by the more purely commercially oriented motives listed under points 2 and 3 in section II above. In effect, the government's push for the development of national industry champions and the procurement of overseas natural resources underpins a broader politically driven agenda of economic nationalism focussed on issues of energy security, geopolitical positioning and national competitiveness.

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[8] Xinhua News Agency (March 5, 2006).

Scope of government involvement

State support for the overseas expansion of Chinese enterprises takes a number of different forms. These include the implementation of investment-friendly policy frameworks – such as the relaxation of foreign currency control in 2003 by the State Administration of Foreign Exchange (SAFE) – direct and indirect subsidies and the offering of favourable financing in the form of credit lines and low-interest loans from state-owned financial institutions. Preferential financing may play a substantial part in Chinese ODI transactions, as in the instance of the acquisition of Ssangyong Motors by Shanghai Auto, which reported that 66% of the acquisition had been financed through preferential loans by three state-owned banks.[9] Another case in point is the leading telecoms manufacturer Huawei, which recently received a USD 10 bn line of credit from the China Development Bank to help fund its overseas expansion.[10] An additional, more indirect, avenue of governmental support benefiting Chinese enterprises seeking expansion abroad is the opportunity for partaking commercially (through the preferential awarding of construction contracts etc.) in the implementation of Chinese foreign aid programmes in developing economies throughout Africa, Asia and elsewhere.

Although the Chinese government's commitment to supporting the overseas expansion of the country's enterprises remains firm, it is worth noting that the implementation of this policy is, in characteristic fashion, kept under tightly controlled reins, reflective of the central government's view of its pivotal position at the centre of the Chinese economy. Historically, the Chinese government has capped China's total ODI at some USD 5 bn a year, while requiring companies investing in excess of USD 10 m to gain special approval concerning cross-border capital and foreign exchange transfer. SAFE has previously blocked a number of proposed overseas acquisitions by Chinese enterprises on the grounds that they were considered efforts to illegally transfer foreign exchange holdings to offshore destination.[11] A recent relaxation of foreign currency controls has so far been limited to 24 trial areas, including Shanghai, Beijing and the eastern seaboard provinces of Jiangsu and Zhejiang.[12] But change could be underway, following recent indications from the government that it is seeking to further relax or possibly fully abolish these controls in 2006, a move sure to provide further impetus to Chinese ODI activity.[13]

A sample of Chinese "global champions"
2004, USD bn

	Sector	Revenue	Net income
Sinopec	Oil/gas	71.45	3.90
PetroChina	Oil/gas	48.18	12.45
Hai'er	White goods	12.29	0.19
Baosteel	Steel	7.09	1.14
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Chalco	Alumin.	3.91	0.80
Huawei	Telecoms	3.83	0.62
TCL	Electronics	3.29	0.04
Lenovo	PCs	2.90	0.14
Galanz	White goods	1.60	0.70
Tsingtao	Brewery	1.04	0.03

Source: Company data 9

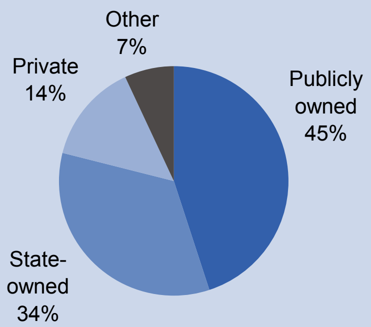
Developing "global champions"

One specific priority for the Chinese government under the 'Going Global' strategy is the creation of a number of 'global champions' – large multinational firms with globally recognised brands able to compete in the international marketplace (see chart 9). Examples of such global champions, of which authorities in Beijing have estimated there will be 150 within a decade[14], would include Hai'er (home appliances – occupying more than half of the small refrigerator market in the US), Galanz (microwaves – producing one third of microwave ovens in the world under its own brand), and

[9] PricewaterhouseCoopers (January 2005).
[10] IBM Institute for Business Value (2006).
[11] Woodard and Wang (2004).
[12] MOFCOM (http://english.mofcom.gov.cn/aarticle/counselorsreport/asiareport/200507/20050700183672.html).
[13] IBM Institute for Business Value (2006).
[14] PricewaterhouseCoopers (January 2006).

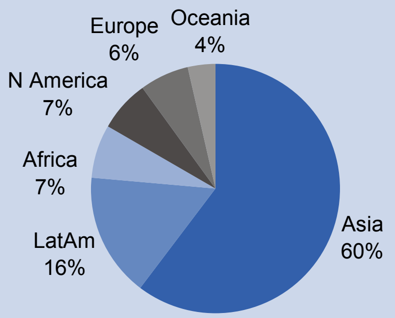
Tsingtao (beer). Political and financial support for such state-owned or state-affiliated enterprises often gives them an advantage over more market-oriented Western companies, as the former may not be subject to the same fiscal discipline vis-à-vis their capital providers, thus significantly reducing their cost of capital. Following years of rapid expansion at home and establishing successful export platforms, strong national players such as Huawei and Hai'er now have the size, financial strength and product quality to engage in significant M&A activity globally. A interesting point of note in this context is the fact that early state-owned targets of the Chinese government's efforts to develop 'global champions', such as electronics group Founder and TV maker Changhong, have by now scaled back their international ambitions, while current privately owned vanguards, including Huawei and TCL, were in fact not designated as national champions in the first instance. D'Long is another, now defunct, example of a company – in this case a Xinjiang-based family-controlled firm – which achieved substantial growth in a relatively short span of time outside the 'global champions' framework, including being engaged in significant overseas M&A acquisitions (see also section below).

Role of the state remains dominant in Chinese ODI
Accumulated ODI stock by ownership type, 2004



Source: Asia Pacific Foundation of Canada **10**

Asia looms large as destination for Chinese ODI
2005



Source: MOFCOM **11**

Changing patterns of Chinese ODI

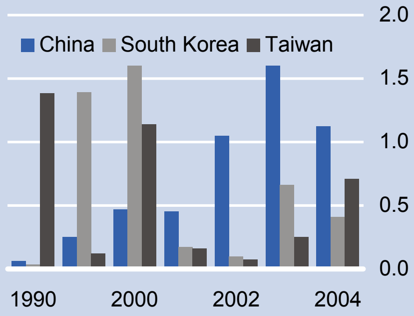
As noted by Hong and Sun, China's ODI has over the past 25 years experienced gradual changes "from the political objective-centred to the commercial interest-oriented, from the central government-dominated to enterprise-led, and from an emphasis on natural resource-seeking to a focus on resource-, market- and technology-seeking investment".[15]

Role of the state dominant, but receding

Despite the continued dominance of government-owned or –affiliated enterprises in Chinese ODI, increasing diversification of the leading players is beginning to mark a move away from this pattern. Thus, in 2004, the share of ODI held by state-owned enterprises fell to 34% (2003: 43%), while those of publicly owned (i.e. where the state exercises relative, but not absolute, majority share control) and private companies rose to 45% (2003: 39%) and 14% (2003: 12%) respectively (see chart 10). The involvement of the state in ODI has been most evident in investments to procure natural resources, which has been driven predominantly by state-owned oil and mining companies, such as CNOOC or Sinopec, representing China in both a commercial and political capacity. Thus, state-owned oil companies, effectively acting as vehicles for the implementation of Beijing's national energy security agenda, accounted for nearly half of total outward Chinese M&A activity in 2005.[16] The public/private split has been comparatively more balanced in the case of ODI driven by the objectives of strengthening international competitiveness and securing overseas market access, where the impetus for investing abroad has largely been strategic and commercial in nature. Investment under these two latter category headings have primarily been driven by leading export firms within the electronic appliances and machinery sectors, such as Huawei, TCL and Hai'er.

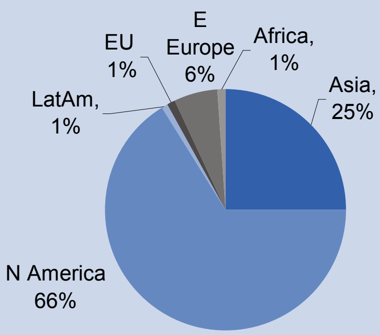
[15] Hong and Sun (2004).
[16] Economist Intelligence Unit (2006).

China has overtaken South Korea and Taiwan
Outbound M&A investment, USD bn



Source: World Investment Report 2005 **12**

North America dominates in terms of bid value...
Chinese outbound M&A investment, Jan 1999 to Jun 2005



Source: Schüller and Turner **13**

Heavy focus on Asia

The regional distribution of Chinese ODI has increasingly changed away from an early focus on developed countries in North America, Oceania and Europe[17] in favour of Asia – particularly Southeast Asia – as Chinese companies have set up production facilities in the region with the aim of expanding their market share in the host countries and reduce production costs (see chart 11). According to data from MOFCOM[18], a full 60% of overseas direct equity investment made by Chinese companies in 2005, equivalent to USD 2.54 bn, went into other Asian countries. The main recipient has been Hong Kong, receiving upwards of three quarters of Chinese ODI flowing into Asia – a significant portion of which is likely to be the product of round-tripping – supplemented by smaller flows into ASEAN countries (particularly Thailand, Singapore, Indonesia and Cambodia) as well as South Korea and Japan. Latin America was, on paper, the second-largest recipient of Chinese ODI in 2005, with USD 659 m (16.3% of total) invested, though the bulk of these flows again most likely involve 'round-tripping' to Caribbean tax havens such as the Cayman Islands and the British Virgin Islands as described above. Investment in Africa continued to break new ground, with USD 280 m (6.9% of total) being invested chiefly in natural resource projects in Sudan, Algeria, Nigeria and South Africa. North America and Europe received smaller flows representing 6.7% and 6.3%, respectively, of total ODI, with European flows mainly channelled into Russia, Germany, the UK and Kazakhstan.

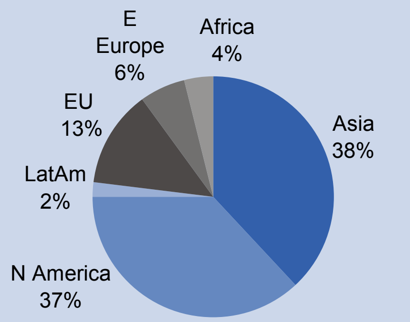
Chinese cross-border M&A

One of the most notable developments in the context of Chinese ODI has been the gradual emergence of cross border M&A as the dominant vehicle for China's direct investment abroad relative to other forms of ODI, including joint-ventures and establishment of overseas subsidiaries, which were more prevalent in the earlier phases of the development of Chinese ODI. In sharp contrast to the decrease of M&A activity by companies in Japan, South Korea and Taiwan, Chinese cross-border M&A purchases have risen from a mere USD 60 m in 1990 to USD 1,125 m in 2004, representing a 19-fold increase (see chart 12). Recent figures from MOFCOM point to M&A having made up 80% of China's total overseas investment in the first half of 2005, with overseas M&A up by a notable 182.5% compared to the same period in 2004.[19] The expansion in Chinese cross-border M&A purchases is driven by the same factor as ODI growth in general, namely the intensified level of competition in both the domestic and global marketplace faced by Chinese companies, particularly since China's accession to the WTO. Given the fact that foreign companies manage virtually all intellectual property in China and account for 85% of its technology exports[20], Chinese firms have increasingly realised that they cannot compete on low cost alone, and have targeted overseas acquisitions as a route to building up their R&D and brand value. However, the geographical make-up of Chinese cross-border M&A differs somewhat from the general

[17] Collectively accounting for 76.7% of China's outward non-trade sector FDI during the period 1979-1991, versus only 14.6% for Asia. Source: Hong and Sun (2004).
[18] http://sy2.mofcom.gov.cn/aarticle/chinanews/200602/20060201518944.html
[19] People's Daily (October 11, 2005).
[20] Economist.com (January 6, 2005).

... but shares the honour with Asia when measured by number of deals

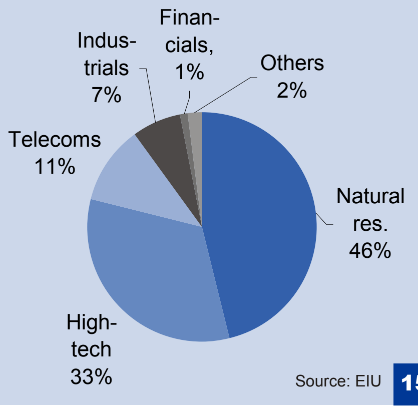
Chinese outbound M&A investment, Jan 1999 to Jun 2005



Source: Schüller and Turner **14**

Resources and IT dominate Chinese M&A activity

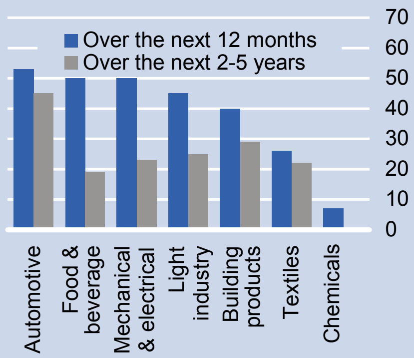
Chinese outbound M&A investment by sector of acquirer, 2005



Source: EIU **15**

Companies polled in APFC survey expecting to in-crease their ODI

%



Source: Asia Pacific Foundation of Canada **16**

pattern for Chinese ODI in that targeting of North American assets has been much more dominant (see charts 13 and 14). As with the general pattern of Chinese ODI, outward cross-border M&A investments by Chinese companies is heavily dominated by natural resources enterprises, accounting for 46% of total Chinese outward cross-border M&A investments in 2005, with high technology the second-most active sector (see chart 15).

A mixed track record

While cross-border M&A can be an effective way of achieving global expansion, studies have shown that as many as 60-70% of M&A deals fail to deliver shareholder value.[21] Looking at the track record of Chinese cross-border M&A, the picture is therefore not surprisingly also a mixed one. National resources companies, such as PetroChina, Sinopec and CNOOC, show the most impressive performance, having aggressively procured assets in more than a dozen countries worldwide, including Australia, Sudan, Indonesia and Nigeria, while building pipeline networks across Asia to satisfy China's energy demands. CNOOC, for example, is now one of the biggest players in Indonesia's offshore oil and gas sector. It is, of course, important in this context to flag the potential implications of Chinese enterprises at times choosing to tread where others fear to – or are prohibited from for political reasons – by investing in countries, such as Sudan and Myanmar, beset with political instability, weak legal infrastructure, human rights issues and so forth. Such a strategy may, arguably, give rise to non-negligible political, legal and economic risks, including the expropriation of assets and reputational damage, with the potential to negatively impact longer-term profitability of investments.

By contrast, consumer-brand and technology companies have struggled to benefit from their overseas investments. So far, TCL has been unable to turn around the TV operations it bought from French TV producer Thomson, while Lenovo's acquisition at the end of 2004 of IBM's personal computer division – three times its size – has contributed little to the company's profitability.[22] But perhaps the most telling example is that of D'Long, a diversified Chinese company spanning food and financial services. D'Long was at one point lauded for its strategy of buying distressed foreign brands, such as venerable US lawnmower and bicycle manufacturer Murray in 2000 and bankrupt German aircraft manufacturer Fairchild Dornier in 2003, on the cheap and cutting cost by taking production back to China. The company collapsed soon thereafter, in 2004, unable to repay its mounting debt.

Future perspectives

As noted above, Chinese ODI looks set for continuous expansion over the near to medium term. One of the fundamental drivers of the continued growth in Chinese ODI will be the supply shortage of key energy and raw material inputs to support the country's economic expansion. For example, China's oil consumption is expected to increase by 50% or more by 2020, while domestic production is expected to stagnate, giving rise to a significant increase in the dependence on foreign-sourced oil.[23] However, China's ODI

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[21] O'Sullivan (2005).
[22] Wu (2005).
[23] Sinton et. al. (2005).

interests will continue to go beyond satisfying energy and raw material needs. A study conducted in 2005 by the Asia Pacific Foundation of Canada (APFC) suggests that the majority of Chinese firms planning foreign investment within the next five years are from sectors of the economy in which – with the exception of the automotive sector – Chinese producers are comparatively competitive globally, such as mechanical and electrical manufacturing and light industry (see chart 16). The survey – which polled a relatively small group of 296 companies constituting a broad and representative sample in terms of turnover size, industry sector and ownership structure – also points to the business potential of overseas markets, favourable overseas tax systems, and the Chinese government's 'Going Global' policy as the key drivers for near- to medium-term Chinese ODI. Other motivations, with a lower priority, include access to natural resources and advanced technology, acquisition of internationally established brands, and avoidance of trade barriers. In terms of the likely destination of Chinese ODI over the next five years, the survey suggests that Asia will continue to top the list by a relatively wide margin, followed by Europe and North America.

These findings are largely mirrored in another study, published in early 2005 by China's Ministry of Commerce (MOFCOM) and the country's Academy of International Trade and Economic Co-operation, in which more than 100 executives at Chinese companies had been polled. The survey showed that 70% of respondents were planning overseas expansion within the coming four years, with the US, Germany and the UK named as the preferred destinations for investment.[24]

Andreas Lunding

[24] PricewaterhouseCoopers (January 2006).

Appendix

"Going Global": an industrial policy takes shape

The historical roots of the Chinese government's current policy of supporting the growth of ODI through an industrial policy of 'Going Global' stretch back to the opening of the country's economy in the late 1970s and divides roughly into three distinct phases:

1979-1985

In the early years of reform up until the mid-1980s, overseas investment could only be undertaken by state-owned Foreign Trade Corporations under the umbrella of the Ministry of Foreign Economic Relations and Trade or equivalent provincial government authorities, with investments being overwhelmingly directed by official political considerations. Accumulated Chinese ODI stood at approximately USD 0.3 bn as of 1985, mainly in the form of joint ventures.

1985-1990

From 1985 onwards, private enterprises were allowed to apply for permission to establish overseas subsidiaries, spurring a step-change increase in the volume of Chinese ODI and a near 10-fold increase in accumulated ODI stock – to USD 2.7 bn – as of 1990.

1990-2000

From the early 1990s, the Chinese government switched from merely allowing to actively encouraging Chinese ODI. The notion of exploring overseas markets as a means to strengthen the competitiveness of Chinese enterprises while avoiding discriminatory measures imposed by export recipient countries began to emerge within national and provincial policy-making circles, with the government sponsoring workshops on business opportunities abroad. Some 120 state-owned enterprises were assembled by the State Council between 1991 and 1997 as vanguards of the government's drive to create global industry champions. To this end, these enterprises were increasingly furnished with access to preferential financing and allowed special rights in terms of profit retention and investment decisions. Investments in the natural resource and chemicals sectors became increasingly important, with an example of this provided by the USD 120 m joint venture investment in the Peruvian mining sector by China Capital Iron & Steel Corporation in 1992. By the end of the decade, Chinese accumulated ODI stock had risen to well over USD 20 bn.

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