Why, who and where? Chinese OFDI on the world stage

The phenomenon of Chinese companies going global has become a defining feature of China's current stage of integration with the global economy. While China remains a minor player in terms of global Outbound Foreign Direct Investment (OFDI) flows, the financial crisis has afforded some of its largest state-owned enterprises, or SOEs, unprecedented opportunities for landmark acquisitions. In the 10 months after Lehman Brothers became the defining casualty of the financial crisis, Chinese bidders announced 50 outbound offers worth US$30 million or more each, totalling about $50 billion.

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. Hence, in the face of economic necessity, Chinese companies are now officially encouraged to go global, and in 2008, China's annual OFDI flow topped $50 billion, almost double the amount in the previous year.

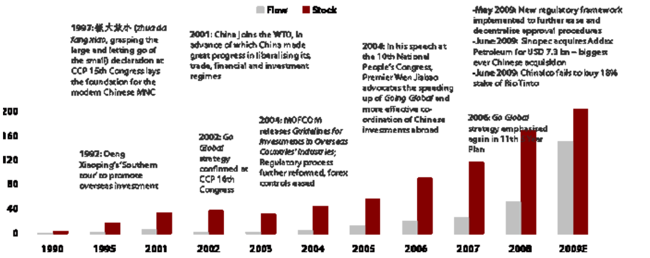
Why?

Chinese companies going global generally engage in four types of strategies. Market-seeking firms seek to expand their export channels to enhance market share and sidestep trade barriers. Due to the relatively low costs in China, efficiency-seeking OFDI has not been an important driver for Chinese firms going global; yet fuelled by rapid economic growth, China's OFDI has become closely associated with a spree in resource-seeking acquisitions in countries and regions such as Australia, Latin America and Africa. Aimed at acquiring knowledge, technology and foreign brands, Chinese OFDI has resulted in its companies investing in the advanced economies of Europe and North America.

The critical question of who?

No official breakdown has ever been published on the proportion of SOEs and private enterprises in China's outward investment projects, but the large number (nearly 8,500 by the end of 2008) of Chinese companies that have invested abroad suggests considerable participation by both SOEs and private firms. Yet the bulk of China's OFDI clearly comes from large SOEs and estimates put the share of Chinese OFDI flows coming from SOEs under the central government at 73.5 per cent in 2003, 82.3 per cent in 2004, and 83.2 per cent in 2005, with the remaining amounts coming from investments under the control of regional governments, non-SOEs controlled collectively, and privately-owned companies.

As the main vehicle in 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. Indeed, largely in response to the 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.



Note: The figures for 1990-2002 are from UNCTAD, and 2003-2008 from MOFCOM. According to Standard Chartered Bank, China's OFDI flow will be USD 150-180 billion in 2009.

The inevitable lack of experience and confidence in managing complicated cross-border investments in heavily-regulated markets has shown Chinese firms lack the necessary specialised skills. Yet, if the rapid moves to go global have highlighted the lack of 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, as well as by high levels of state intervention and varying systems of corporate governance.

Going global going where? Africa and beyond

Africa's relatively unexploited energy resources, timber, agricultural products and fishery had attracted more than 800 Chinese companies by 2006, doing business in 49 countries. Again, China's large SOEs have taken the lead in terms of Chinese investments in Africa. CNPC, for example, China's leading oil corporation, with its involvement in Sudan's oil industry since 1996, has shown it is capable of international standards of petroleum extraction operations.

The activities of Chinese firms in Africa have also attracted their share of criticism, especially in regard to the systematic underevaluation of labour and managerial costs by Chinese firms, 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 large Chinese SOEs such as Sinopec and Petrochina are embracing corporate social responsibility, and as Chinese firms become 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 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."

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