China spreads its wings – Chinese companies go global

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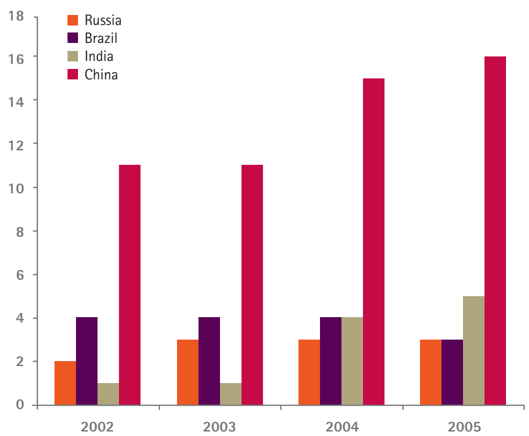
Introduction

Lenovo, Haier, TCL, Huawei, China National Offshore Oil Corporation (CNOOC), Nanjing Automotive and, now, China National Petroleum Corporation (CNPC). Not long ago, these names would have elicited blank looks from most global business executives outside China. Now, however, these companies are part of a trend that is sending shockwaves through the business world. China has 16 companies in the Fortune Global 500 list, up from 11 in 2002 (see Figure 1). The value of overseas acquisitions completed by Chinese companies doubled in 2004, and 2005 has already seen a succession of highly ambitious bids. Chinese companies are looking to make a global impact and achieve high performance.

The recent flurry of high-profile deals involving Chinese companies has been greeted with consternation by the rest of the world. Yet many observers argue that this corporate activity is simply the latest stage of China's re-integration into the global economy. The process began more than 20 years ago when the country threw open its doors to foreign businesses, and has accelerated quickly since China joined the World Trade Organization in 2001. Between 2000 and 2004, China's outward Foreign Direct Investment (FDI) stock increased by more than 70 percent. In 2004, FDI outflows totalled US$5.5 billion, an increase of 93 percent on 2003[1]. The largest recipients were Asia (54.6 percent) and Latin America (32 percent) (see Figure 3).

Now that every multinational has acknowledged the necessity of having a strategy for China, it should come as no surprise that Chinese companies are busy crafting their own strategies for dealing with the outside world. Instead of focusing on the perceived threat of Chinese entrants into their home markets, it is more productive for western companies to understand what is driving this phenomenon and capitalize on the opportunities that arise.

Figure 1: Number of companies in BRIC economies listed in Fortune Global 500 (2002-2005)



Compared with other rapidly emerging economies, China is already way ahead in creating large, successful companies.

Why Go Global? Why Now?

So far, China's remarkable economic growth (an average of 9.4 percent per annum between 1979 and 2004) has come mostly from its trade and export dominance. A combination of low wages, specialized regional networks and product exporters has enabled China to become the global economy's low-cost supplier. Chinese companies have captured majority shares in a number of global product markets[2]. But China has now recognized that to achieve sustainable growth, it needs to develop its relationship with the global economy beyond a simple export-driven model. Accenture has identified four important factors that have been driving Chinese companies to look beyond their national borders:

1. The macroeconomic imperative

Recent years have seen a conspicuous shift away from a purely export-led strategy toward a model also incorporating outward FDI, with a heavy focus on mergers and acquisitions (M&A). This strategy is deliberate and based on sound macroeconomic reasoning. A purely export-driven economy is constrained by the natural limits of trade growth. By moving operations beyond domestic borders, Chinese companies can benefit from business behind the trade and tariff barriers of other economies. In this respect, Chinese executives can learn much from the Japanese and Korean experience in the 1980s.

The globalization of operations also allows Chinese companies to break into new markets, particularly in higher-value sectors. These markets sometimes require companies to operate in close proximity to buyers. Controlling operations in more developed markets also allows Chinese companies to capture a larger portion of the value chain and, consequently, increased profit margins.

As China's own domestic markets continue to grow, Chinese companies operating abroad can play an important role in shaping products and services to fit the needs and tastes of the Chinese economy. They also can bring new knowledge and capabilities back into China.

2. Building political influence

China's global political and economic aspirations are an important factor driving expansion abroad. In addition to building economic relations with more countries, China's outward investment has a dual purpose of building China's political capital and influence around the world. China's chosen route to economic expansion has therefore been closely aligned with its strategy to strengthen its global political presence. In particular, for some time, business and political leaders have worked in tandem to build strong relationships with developing countries (see figure 2).

Companies like Huawei and ZTE have used their experience in building China's own markets to develop new ones in other emerging economies, before tackling developed economies. Their better understanding of emerging markets provides a stronger guarantee of success in their initial overseas expansion plans, improving chances of a smoother entry into more developed western markets later on. Meanwhile, China has been building alliances with other developing economies in political forums and multinational negotiations.

Importantly, Chinese companies often face fewer political constraints compared with their western counterparts when it comes to investment destinations. China has been one of the few countries investing in what are widely seen in the west as less reliable economies such as Sudan, Iran and Zimbabwe.

Figure 2: Focus on developing countries and energy

Africa	Latin America	Central Asia	Middle East
• China has struck trade deals with 40 African countries and has established a China-Africa Business Council to boost mutual trade and development.[1] • China sources nearly a third of its oil from Africa[2] and currently has oil interests in Sudan, Chad, Nigeria, Angola, and Gabon. • Construction, telecoms, timber and fisheries also are common sectors for cooperation.	• China has signed more than 400 trade agreements and projects with Latin American countries[5] and plans to invest US$100 billion over the next 10 years.[6] • While concentrating on natural resources, China also has been investing in manufacturing, telecoms, infrastructure, textiles, food production and joint satellite projects. • China's major investments have been in Brazil, Mexico, Chile, Argentina, Peru and Venezuela.	• China has trade missions in every Central Asian country and forms part of the Shanghai Cooperation Organisation (SCO), with Russia, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan. • China has invested in energy projects throughout the region, with large investments in Kazakhstan. • Central Asia has been used to balance China's dependence on Middle Eastern energy sources.	• China signed a "Framework Agreement" with the Gulf Cooperation Council in July 2004 and agreed to negotiate a free trade zone via the China-Gulf Cooperation Council.[12] • The Middle East accounts for more than 50 percent of China's oil imports. Saudi Arabia, Iran and Oman are the top three exporters to date. • China is also interested in the potential of the region's oil services. By 2001, nearly 3,000 service contracts worth US$2.7 billion had been signed.
Noteworthy Deals • Nigeria – in 2004, PetroChina signed a one-year oil-supply contract worth US$800 million with the Nigerian National Petroleum Corporation, which will supply 30,000 barrels of oil per day.[3] • Angola – in March 2005, China signed nine cooperation agreements with Angola, mainly for the development of Angola's oil and gas sectors. A US$69 million agreement between Angola's MundoStartel and China's ZTE Corporation to develop telephone networks in Angola was also signed. Angola is China's second-largest trading partner.[4]	**Noteworthy Deals** • Venezuela – CNPC, which already operates two Venezuelan oil fields, has agreed to spend more than US$400 million[7] in developing 15 declining oil fields in eastern Venezuela. • Brazil – Sinopec signed a US$1 billion agreement with Brazil to build a gas pipeline across the country[8] in September 2004. • Brazil's state-owned oil giant Petrobras is exploring opportunities for joint operations with CNOOC in China, Brazil and other regions in the world.	**Noteworthy Deals** • Kazakhstan – China and Kazakhstan agreed in May 2004 to build a 1000-kilometre pipeline, worth US$3.5 billion, from the central Karaganda region to Xinjiang.[9] • In August 2005, CNPC agreed to buy Petro-Kazakhstan for US$4.2 billion. • Uzbekistan – Uzbekistan and China signed an oil deal in May 2005 to set up a joint venture and attract US$600 million in direct investment to Uzbekistan.[10] CNPC is also expected to invest in 23 oil fields in the country in a 50:50 joint venture.[11]	**Noteworthy Deals** • Iran – a preliminary agreement was signed in November 2004 for China to buy 10 million tonnes of Liquid Nitrogen Gas per year over the next 25 years[13], a deal worth at least US$100 billion.[14] • Saudi Arabia – Saudi Arabia signed an agreement on natural gas drilling and production with Sinopec in March 2004. The spending in the first phase of the project was US$300 million.[15]

3. Competitive flexibility

China's domestic market is becoming ever more crowded and competitive as companies battle fiercely for their slice of the most populous consumer market in the world. Domestic enterprises that once enjoyed dominance in their own backyard now find themselves under increasing pressure from foreign companies, with margins being squeezed and profits trimmed. As foreign multinationals enter China and benefit from the low-cost sourcing, local knowledge and booming consumer markets, the natural competitive advantages of Chinese companies in their home and foreign markets will diminish. In response, there is an urgent call for Chinese companies to master new skills that traditionally reside with non-Chinese multinationals: in areas like marketing and branding, higher value-added goods and services, advanced technological innovation and management.

In the face of increasing foreign competition, China's strategy is to build its presence overseas. Going global enables Chinese companies to gain access to technology and bring their operations in line with international standards. In particular, global operating models allow Chinese companies the flexibility to place business units wherever they afford the greatest comparative advantage. Nanjing Automotive's recent purchase of Rover is an example in which the company plans to move the bulk of its production to China while keeping R&D facilities in the United Kingdom.

Nanjing Automotive also has gained the use of the Rover brands – access to brands has been a crucial factor in many recent deals involving Chinese companies. Because of the complexity of the Chinese market, there are many regional Chinese brands, but few national ones able to compete in international markets. Building a brand from scratch is a challenging task and China is only beginning to develop the skills required to do so. Some observers suggest that China may need another 5 to 10 years to nurture globally-recognized brand names[3]. With the rapid pace of globalization, Chinese companies are finding they do not have the time cushions once enjoyed by their Japanese and Korean counterparts as they pursued a more gradual organic development 10 to 20 years ago. As a result, brand-buying is seen by many as a logical short cut.

By associating themselves with a top brand name or product, Chinese companies can quickly raise their international profile as well as gaining instant access to new markets. Lenovo's purchase of IBM's personal computer operations in December 2004 is the most often cited example of this strategy. With this US$1.75 billion deal Lenovo, a company hardly known outside China, suddenly became the world's third-largest PC manufacturer after Dell and HP, gaining significant international coverage.

4. A strategy to fuel growth

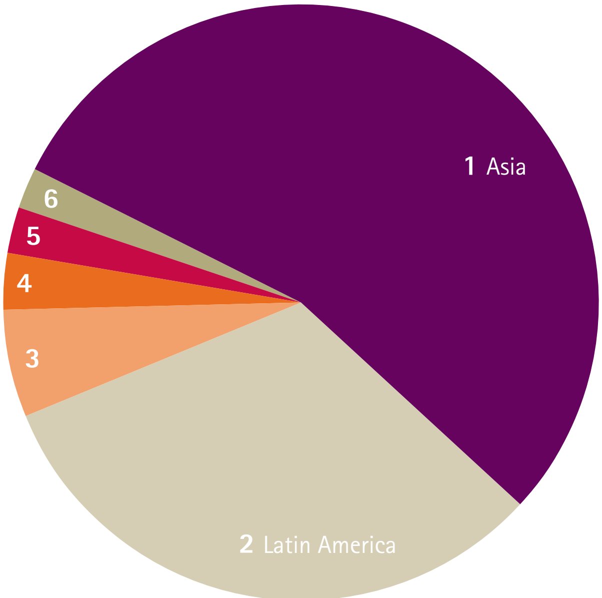
Another significant driver of China's globalization strategy is the desire to secure the energy and resources needed to sustain economic growth. More than half of the economy's overseas investment has been in the resources sector as Chinese companies have taken stakes in oil-production facilities in Algeria and Canada, natural-gas reserves in Iran and Saudi Arabia, and mining projects in Australia, Brazil, Papua New Guinea and Zambia, to name a few[4]. With the help of state diplomacy and loans in regions like Latin America, energy companies such as Sinopec and CNPC have been able to secure large energy-exploration and development projects as well as joint projects with local energy companies.

A coordinated effort

The Chinese government also has played an important role in setting the trajectory for the country's journey toward globalization. Recognizing the over-dependence on export-led development, the Chinese government initiated a "go-out" policy in 2002; a plan to create between 30 and 50 "national champions" from the most promising or strategic state-owned enterprises in China by 2010. Labeled as "state-owned but not government-run", China's national champions enjoy a range of benefits from the government including information-sharing networks, domestic tax breaks, cheap land and low-interest funding from state-owned banks[5]. With foreign currency reserves amounting to roughly US$700 billion, state-supported Chinese companies can draw on a pool of ready capital for strategic acquisitions. In December 2004, for example, the China Development Bank (one of the most active banks in financing companies investing abroad) issued a low-cost US$10 billion loan to Huawei to promote its international operations.[6]

The "go-out" policy reinforces the government's efforts to support the rapid development of technological skills and know-how, as well as building new markets and global brands that will underpin further economic growth at home. The quest has begun to create Chinese companies on a par with global giants such as Coca-Cola, Microsoft and Wal-Mart.

Figure 3: China's FDI Outflows (2004, Billions of US$)



Sources: China Ministry of Commerce, New York Times, FT, China Daily, Daily Telegraph

1. Asia US$3bn (54.6%)
Top Destinations – Hong Kong, Indonesia, Singapore

Recent Deals – In August 2005, China National Petroleum Corporation agreed to pay US$4.2 billion for Petro-Kazakhstan, a firm based in Canada with energy assets in the Central Asian country. This would be China's biggest-ever cross-border takeover.

2. Latin America US$1.76bn (32%)
Top Destinations – Brazil, Mexico

Recent Deals – In 2004, Chinese steelmaker Baosteel sealed a US$1.5 billion deal with Brazilian iron-ore producer Companhia Vale do Rio Doce (CVRD) to operate a steel plant in São Luís. This represents the largest foreign Chinese manufacturing investment.

3. Africa US$0.317bn (5.8%)
Top Destinations – Sudan, Nigeria, South Africa

Recent Deals – CNPC has invested US$14.4 billion in Sudanese oil as of April 2005. The cost of Khartoum's new refinery alone was US$628.4 million. CNPC has also built a 1500-kilometre pipeline, linking the Heglig oilfield with Port Sudan. Sudan provides half of CNPC's overseas oil.

4. Europe US$0.17bn (3.1%)
Top Destinations – Russia, UK, Germany

Recent Deals – In July 2004, TCL and Thomson Electronics formed TCL Thomson Electronics (TTE), the world's largest television manufacturer with assets of more than US$500 million and an annual capacity of 20 million color television sets

5. North America US$0.126bn (2.3%)
Top Destinations – US, Canada

Recent Deals – Lenovo acquired IBM's personal computer business for US$1.75 billion in December 2004. The deal makes Lenovo the industry's third-largest player behind Dell and Hewlett-Packard.

6. Oceania US$0.12bn (2.2%)
Top Destinations – Australia

Recent Deals – In December 2003, China Huaneng Group agreed to pay US$227 million for a 50 percent share of OzGen. The deal represented China's first major overseas acquisition in the power-generating sector.

Challenges for China

There is a great misconception that Chinese companies are going to change the global business landscape overnight. China's total overseas acquisition activity of US$3 billion in 2004 is actually a mere fraction of the US$243 billion[7] value of the global total of mergers and acquisitions (M&A) in only the first quarter of 2005. The World Bank recently reported that one-third of Chinese enterprises had lost money on their foreign investments and that 65 percent of their joint-ventures had failed[8]. China's course may be set, but the journey to high performance will be long.

"China's top 500 are greatly inferior to their world's counterparts in terms of scale, productivity, profit-making capacity, managing capacity and competitiveness" Chen Jinhua, Chairman of Chinese Federation of Enterprises

Figure 4: Springs and hurdles to globalization

	Chinese companies face particular problems in going global...	...but have many factors working in their favour
Operational	• Chinese companies going global have to get to grips with very different management styles, cultures, priorities and mindsets. • They also have to conform to international standards, systems and processes. Their corporate governance framework in particular remains underdeveloped. • Chinese companies have so far struggled to establish international brands. No Chinese company features in the BusinessWeek-Interbrand 100 Top Global Brands.	• With a higher labor-to-capital mix, Chinese companies are more flexible in adapting processes than their Western counterparts. • Chinese companies have the advantages of local knowledge and cultural overlap in Asia's fast-growing markets that are the main target of today's multinationals. • Chinese firms still enjoy a significant cost advantage over Western multinationals that tend to set up only selected operations in China.
Human Capital	• Chinese companies often lack managerial expertise and experience. China will need 75,000 executives with international experience in the next five years, currently there are 5,000.[1] • Chinese companies still face obstacles in the war for talent. Non-Chinese multinationals still enjoy advantages in terms of pay and prestige.	• There is a strategic push to nurture new talent in science and technology in China. There will be about 3.3 million college graduates in 2005 of whom 600,000 will be engineers[2]. • The diaspora of Chinese talent – western-educated, and familiar with Chinese culture and values – provides a valuable resource for Chinese companies going global.
Economic and Political	• The recent outcry surrounding Chinese purchases abroad, particularly in the United States and European Union, has highlighted protectionist obstacles to China's globalization. • State influence on corporate planning may lead to the pursuit of goals beyond profit maximization. • Large state firms in protected industries are likely to be less efficient due to the lack of competitive pressures.	• The prospect of further currency revaluations will reduce the cost of overseas acquisitions for Chinese companies. • China's "national champions" receive cheap land and finance, tax breaks and preferential access to listing their shares. • By operating in previously protected markets, large state-owned enterprises have accumulated cash hoards that they can use to buy assets abroad.

Hurdles to globalization

M&A is a popular but difficult option

Only a small proportion of M&A deals succeed in creating value and there is little reason to believe that Chinese companies will do any better. In fact, on closer inspection, there may be reason to think that the prospects for Chinese companies are less favorable than most, given some of the unique challenges they face when expanding beyond their borders.

Cultural issues can be a hurdle...

In addition to the issues that face any company looking to expand inorganically (such as post-integration planning, adapting to new business environments and balancing short- and long-term value creation), Chinese companies face the hurdles of getting to grips with very different management styles, culture, priorities and mindsets to other companies. Of the Chinese joint-venture failures analyzed in a recent World Bank report, more than 85 percent of CEOs attributed their difficulties to differences in managerial styles and corporate culture.[9]

...as can a lack of experience and familiarity

Chinese companies may well be hampered by a lack of adequate management skills, knowledge and experience in dealing with newly enlarged transnational companies and managing global brands. They may have to align their firms with unfamiliar international standards, regulations and systems, as well as familiarizing themselves with western styles of corporate governance, all of which will take time and patience.

Gaining acceptance in new consumer markets will take time

Should they wish to use their own brands, Chinese companies will also have to win over skeptical consumers, in much the same way as western firms have had to spend large amounts of time first understanding and then selling to the Chinese. Given the way in which China's emergence has run into political barriers in several markets, most notably the United States, this might be a challenging task.

Figure 5: China's early movers

Company	Revenues	Recent overseas activities	Example competitors	
			Foreign	Domestic
Huawei Technologies – telecoms equipment manufacturer	US$3.8 billion (2004)	• December 2004 – first major European contract from Dutch Telfort to build a 3G mobile network. • February 2005 - formed a partnership with British Marconi Corporation in an attempt to extend reach into European markets.	• Cisco Systems (United States) • Nortel Networks (United States) • Siemens (Germany) • Nokia (Finland)	• ZTE Corp • Datang Mobile
TCL - manufacturer of electronics and electrical appliances	US$3.5 billion (2003)	• October 2002 - purchased Germany's Schneider Electronics. • November 2003 – purchased France-based Thomson Electronics' television operations • August 2004 - acquired 55 percent of Alcatel's mobile handset operation for US$55 million. (But the joint-venture lost US$45.7 million in the first quarter and was later dissolved).	• Sony (Japan) • Philips (United Kingdom) • Samsung (South Korea)	• Hisense • Ningbo Bird
Lenovo - China's biggest PC product and service company	US$2.9 billion (year to March 2005)	• December 2004 - acquired IBM's PC business for US$1.75 billion	• Dell (United States) • HP (United States)	• Great Wall Technology
Haier - white goods manufacturer	US$1.9 billion (2004)	• 2003 – recorded 300 percent sales growth in the United Arab Emirates; plans to invest US$1 million in logistics centers in Dubai and Sharjah zones • July 2005 - abandoned its US$1.28 billion bid to acquire US Maytag after Whirlpool entered with a US$1.37 billion offer.	• Whirlpool (United States) • Electrolux (Sweden) • Sony (Japan)	• TCL
Sinopec - the principal refining company in China. It also produces about a quarter of the country's domestic crude oil	US$72.8 billion (2004)	• August 2004 - acquired US energy group First International Oil Corporation (with assets in Kazakhstan) for US$153 million. • October 2004 - agreed to buy oil and liquid natural gas from Iran. • May 2005 - paid US$84 million for a stake in Canada's Northern Lights oil sands project.	• ConocoPhilips (United States) • ChevronTexaco (United States) • Exxon Mobil (United States) • Royal Dutch Shell (Netherlands) • BP (United Kingdom)	• Petrochina

Implications

China's entry into global markets is often seen as a threat in political and business circles. The political pressure that persuaded CNOOC to drop its bid for Unocal is a case in point. The fear of China taking assets, jobs, business and in this case, access to resources, can sometimes provoke an emotional response. A more pragmatic approach would allow all sides to explore opportunities for mutual economic benefit[10].

China's emergence is not a zero-sum game

Acquisition can create new shareholder value for foreigners...
From a shareholder's perspective, the new breed of Chinese companies that are actively seeking acquisition targets can only be good news. It is often underperforming companies that are being targeted, and the injection of Chinese money brings much needed funds for restructuring and higher levels of performance. In November 2002, a group led by China Netcom bought Asia Global Crossing (AGC), a company that was thrown into a liquidity crisis when its majority-owner and US parent Global Crossing Limited declared bankruptcy in January 2002. The Netcom-led group provided US$150 million in new loans and US$120 million in equity to AGC[11]. The deal represented the first purchase of a major telecommunications entity outside China by a Chinese company and Netcom now stands as the second-largest provider of fixed-line phone services in China with wider operations across the Asia Pacific region.

...and breathe life into depressed regions
There are many different forms of Chinese participation in overseas economies, many of which are collaborative. Chinese investment can play a positive role in a host country's economy if it is properly understood and received. Greenfield investments, for example, have seen Chinese companies moving into rundown factories and sites vacated by western companies (many of whom are often relocating their manufacturing businesses to China), bringing with them new business and opportunities to those in the region. Chinese television maker Hisense, for example, decided to establish a factory in the Hungarian town of Sarvar that had only a couple of months earlier been vacated by Microsoft, which was moving its production lines to China in 2004[12].

Small businesses can make a large impact
The most significant impact of China going global will arguably come from Chinese small and medium-sized enterprises (SMEs) that have already been quietly, yet steadily, expanding beyond China's borders, looking for growth and business opportunities. By 2004, more than 7,000 Chinese enterprises had invested in 160 countries and regions around the world[13]. Chinese SME investment has already been greatly welcomed in the Midwest region of the United States – so much so that the governors of Iowa, Wisconsin and Missouri recently visited China to promote investment opportunities in their states, and the governor of Minnesota is planning to lead 200 state officials and businessmen to China in November 2005[14].

Case Study: ZTE goes global

Founded in 1985 and based in Shenzhen, ZTE Corporation is China's largest listed telecoms manufacturer and wireless-solutions provider. In 2004, ZTE achieved growth of 35 percent, recording sales of US$4.1 billion. Profits jumped 50 percent to an estimated US$186 million.

In addition to strengthening its leading position in the Chinese telecoms market, ZTE is making significant strides overseas. The company is part of the Chinese State Council's "China Torch Program", a government-sponsored strategic initiative designed to develop China's high-technology industries with an emphasis on global expansion. The group now serves more than 150 companies in over 60 countries, making it China's biggest telecoms equipment exporter: in 2004, exports soared 170 percent to US$1.6 billion.

In December 2004, ZTE conducted a public offering on the Hong Kong Stock Exchange raising US$455 million. Satisfying the requirements of international capital markets has demanded greater transparency and provided a stronger financial platform for ZTE to implement its global strategy. ZTE has ambitious international growth targets: CEO Yin Yimin wants overseas sales, which currently make up 21 percent of total revenues, to account for 50 percent as early as 2006.

ZTE's globalization strategy initially targeted other emerging economies. In May 2004, the company secured a US$100 million mobile-phone order from VIVO (the largest mobile carrier in Brazil), the most valuable mobile-phone contract ever won by a Chinese company. ZTE also serves telecoms providers in India, Indonesia, Pakistan, Russia and Egypt to name a few. ZTE's success in developing countries owes much to its understanding of China's own emerging markets. This has allowed it to outperform bigger and more experienced competitors.

ZTE's long-term strategy is to expand into the more mature markets of Western Europe and the United States. To gain a foothold in these markets, ZTE has formed strategic partnerships with electronics giants such as Texas Instruments, Motorola and Alcatel.

ZTE places a large emphasis on product innovation and development. Nearly half the company's employees are involved in R&D where it spends close to 10 percent of its annual sales income. ZTE has also set up 13 research and development centers worldwide to better serve its overseas markets.

ZTE is embracing international standardization by joining structures such as the "3rd Generation Partnership 2" and the International Telecommunications Union (ITU). ZTE has even pioneered its own standards that have already been adopted around the world.

Global success is unlikely to come overnight, but with its set of distinctive capabilities and competitive advantages, ZTE's global expansion will put pressure on some of the industry's established players and has the potential to influence the structure of the industries in which it operates.

Sources: ZTE Annual Report 2004, DBS Vickers Securities

Conclusion

To achieve high performance, Chinese companies need to identify where their competitive advantages will lie in a global marketplace and build the necessary skills to capitalize on these opportunities.

Whether everyone welcomes it or not, China's outward integration into the world economy is going to continue and accelerate. Those who ignore China's emergence stand to lose a great deal. Those who embrace it will ensure that China going global will bring benefits not only to the Chinese, but to the entire global economy.

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China Spreads its Wings – Chinese companies go global

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Figure 4: Springs and hurdles to globalization

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This paper forms part of a series of publications examining the business implications of China's emergence as a major market and global economic player. Current publications in the series include:

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