Im Fokus

Global Ambitions: Chinese Companies Spread Their Wings

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Introduction

Spectacular acquisitions of well-known international firms by Chinese companies have triggered both surprise and unease in the West. Looking at the headlines of some recently published articles on this rather new phenomenon, most of them reflect the "China threat" thinking now common in the West: "The dragon tucks in" (*The Economist*, 30.06.05), "China: Is the World Really Prepared?" (Bernstein 2004), "The Chinese are coming" (*Der Spiegel*, 1/2005), and "Will the World become Chinese?" (*Die Zeit*, 25/2005).

This article aims at providing a more balanced understanding of the importance of Chinese companies' global expansion. The first section of this article gives an overview of the development of China's overseas investment. Section 2 looks at the international mergers & acquisitions (M&A) activities of Chinese companies. Section 3 studies the role of the Government in the "going out" strategy. Section 4 deals with the quest of Chinese companies to become global players, and the final section analyses the prospects of Chinese overseas investment.

Research on Chinese overseas direct investment (ODI) is actually just at the beginning, not only because ODI from China is a relatively new phenomenon, but also due to major statistical problems (see box 1). The data in the World Investment Report made by UNCTAD (the United Nations Conference on Trade and Development) is based on a balance of payments accounting, include trade-related capital movement and has a broader coverage than official Chinese data from the Ministry of Commerce (MOFCOM) until the year 2002, which is why the two sources of information fail to tally. For the purpose of analysing Chinese activities on the international M&A market, we based our analysis on databases from Dealogic and Thomson Financial, both of whom are global market leaders in information provisioning to the investment banking industry. Differences in the published data sets between Dealogic and Thomson Financial can be substantial, since they are two independent commercial information providers.

1 Development of China's overseas investment

China is well known as a country that is attracting large flows of foreign capital. Since the end of the 1990s, however, we have observed a new phenomenon, namely that of China becoming an important source of foreign direct investment (FDI). In fact, the country replaced Japan in the list of the expected top five home countries of ODI for the period 2004-2005.[1]

Due to some well-covered venture activities by Chinese transnational companies in the media, many developing countries expected that China would even come to rank second as a source of FDI, following the USA. Compared to traditional home countries of FDI, the individual value of Chinese ODI projects is still much smaller, however (UNCTAD 2004b: 15-16). In addition, China's share of the global volume of FDI flows in 2003 was only 0.3 percent (UNCTAD 2004a).

FDI represents an investment in an enterprise made by a foreign-investing firm, involving a long-term relationship and a certain degree of control over the company by the foreign equity owner. There are three components of FDI included in the national balance of payments statistics, namely equity capital, reinvested earnings and intra-company loans (Frost 2004: 2).

According to statistics from UNCTAD, which include these FDI components, the accumulated volume of China's outward direct investment (ODI) came to US$ 37 billion by the end of 2003.[2]

China's Ministry of Commerce reports that ODI grew by 27 percent in 2004, representing a volume of US$ 3.27 billion (see table 1). Chinese companies are pushing for even faster expansion in the years to come. The Government expects another impressive jump to a volume of around US$ 5 billion for the year 2005 (C.a., 3/2005, Dok 33).

[1] This list is headed by the USA, followed by Germany, the UK, France and then China.

[2] In contrast to this figure, MOFCOM reports an accumulated non-financial overseas investment volume of U$ 37 billion by the end of 2004 (MOFCOM 2005: 2).

Table 1: Development of China's outward direct investment (in US$ million and percentages)

	1985-95	1999	2000	2001	2002	2003	2004	2005**
China's ODI flows	1,591	1,775	916	6,884	2,518	1,800	3,270	5,000
- as a percentage of gross fixed capital formation	1.0%	n.a.	0.2%	1.5%	0.5%	0.4%	n.a.	n.a.
China's ODI stocks	15,802	24,9	25,804	n.a.	35,206	37,006	40,276*	45,276*
- as a percentage of gross domestic product	n.a.	n.a.	2.4%	n.a.	2.8%	2.6%	n.a.	n.a.

* The figures are derived by adding up the reported ODI volume in 2004 and 2005 (MOFCOM/NBS-Report 2004).
** Forecast for 2005 (C.a., 3/2005, Dok 33).
Source: UNCTAD 2001, 2002 and 2004a.

Information on the structure of Chinese investors is based on statistics jointly issued by MOFCOM and the National Bureau of Statistics (NBS), which, however, give a stock value of outbound FDI by Chinese mainland companies of only US$ 33.2 billion at the end of 2003. According to this report, 3,439 Chinese enterprises had established 7,470 companies in 139 countries by the end of 2003. 43 percent of these were State-owned enterprises, while private companies only accounted for 10 percent. The companies with other forms of ownership were limited liability companies (22 percent) and shareholding companies (11 percent). It can be assumed that the State has a strong saying in these companies as well. The largest investors were engaged in manufacturing and wholesale and retail business. Out of the total number of investing companies, a share of 27 percent invested in manufacturing, 10 percent in wholesale and retail, 14 percent in commercial services and 11 percent in construction (MOFCOM/NBS-Report 2004).

Looking at the history of Chinese ODI, many researchers have come to the conclusion that up until the middle of the 1980s the number of investment projects was rather small and the average investment level less than US$ 1 million. Most ODI was done through State-owned corporations in the area of trade and transport. In the second stage, which lasted until the beginning of the 1990s, liberalisation allowed non-State firms to invest offshore as well. The number of investment projects increased rapidly during this period and the average project size increased to around US$ 1.4 million. In the following years up until 2001, a surge in overseas investment took place. Besides investment by manufacturing companies, many local and provincial enterprises started to establish overseas offices in the property sector and for speculative purposes. In order to counter the overheating of the economy and the increasing flight of capital, the Government tightened its control over ODI. However, some industries such as textiles, machinery and electronics, continued to receive State support for their overseas expansion. The average investment size grew further and amounted to US$ 2.6 million by 2001 (1999-2001) (Wu/Chen 2001: 1,237-1,240; Wong/Chan 2003: 278-281; Frost 2004: 4-5).

In terms of regional distribution, Asia has replaced North America as the most important region of China's ODI flows since the beginning of the 1990s. Basing their figures on MOFCOM statistics, Hong and Sun (2004: 9-10) calculated that Asia's share grew from 14.6 percent (1979-91) to 34.7 in the period 1991-96 and to 35.7 percent between 1997 and 2001. In contrast, the share of Chinese ODI in North America decreased from 47.3 percent to 8.9 percent and was 10 percent in the above-mentioned periods.

The change in the regional distribution of Chinese ODI in favour of Asia, especially Southeast Asia, is closely connected to the growing interest of Chinese companies in setting up production sites and expanding their market share in this region. Countries in North America, especially Canada, were important for securing access to natural resources up until the beginning of the 1990s.

In later periods, Chinese companies diversified their strategy of gaining access to overseas energy and raw materials and included individual countries in Africa and Latin America in their expansion plans. In the period 1997-2001 the share of the two regions taken together grew to around 40 percent.

The regional distribution of the cumulative investment value supports the argument that Asia is the most important destination for Chinese investment. According to MOFCOM statistics the region received around 60 percent of Chinese ODI flows in the period 1979-2002 (UNCTAD 2003: 4). In his research on Chinese ODI development, Stephen Frost (2004: 5) points out the crucial role of the ASEAN countries, especially Thailand, Singapore and Indonesia.

For the year 2003, the above-mentioned statistics from MOFCOM and the NBS show that out of the total volume (US$ 2.85 billion, considerably less than the figure in the UNCTAD report; see table 1), 53 percent was invested in Asia, three quarters of which was targeted at Hong Kong. The second largest share was absorbed by Latin America (36.5 percent), followed by Europe (5.3 percent), Africa (2.6 percent), North America (2 percent) and Oceania (1.1 percent) (MOFCOM/NBS-Report 2004).

Box 1: Chinese ODI and overseas M&A statistics

Research on Chinese overseas direct investment (ODI) is still on a small scale, not only because the topic is a relatively new phenomenon, but also due to severe statistical problems. Data from UNCTAD's World Investment Report is based on balance of payment accounting, include trade-related capital movement and has a broader coverage than Chinese official data from the Ministry of Commerce (MOFCOM), which is why the two sources frequently fail to correspond. In addition, official statistics might only reflect part of total ODI because some capital is invested through private channels and thus not included in the officially reported statistics on approved ODI (Frost 2004: 5).

For example, in a 2003 report on China's overseas investment, UNCTAD points out that MOFCOM statistics only encompass part of total ODI. According to the report, the size of the outward stock has been underestimated because reinvested earnings, intra-company loans and non-financial and private sector transactions have not been included in the MOFCOM figures until 2002 (UNCTAD 2003: 10). According to MOFCOM the cumulative ODI was US$ 9 billion at the end of 2002. In contrast, UNCTAD reported an accumulative volume of US$ 35 billion at the end of 2002 (UNCTAD 2003: 2, 4). MOFCOM seem to have, however, adjusted its statistical calculation in 2003, because the value of total ODI was reported to be US$ 33.2 billion at the end of 2003.

In order to analyse Chinese activities in the international M&A market, we based our study on databases maintained by Dealogic and Thomson Financial, the global market leaders in information provisioning to the investment banking industry. Due to the different disclosure rules of (stock) markets worldwide, their data is especially reliable on M&A transactions made by publicly held companies. In addition to published information based on notification requirements, other sources are covered as well. For example, many financial advisors submit transaction details in order to be covered in league tables. If all of the parties involved in an M&A transaction agree upon utmost confidentiality, however, and if they are not subject to disclosure requirements, a transaction may not show up in the database. This option has to be kept in mind when looking at the activities of Chinese State-owned enterprises or if illegal capital outflow is involved in a transaction.

To examine the outbound M&A activity of Chinese companies, we used a report by Thomson Financial as well as primary data provided by Dealogic for the period from 1.1.99 to 30.6.05. The differences between Dealogic and Thomson Financial's published data sets are sometimes substantial since they are two independent commercial information providers. For instance, deals are sometimes split up into separate transactions so that the overall number of transactions increases. Depending on the provider's policy, cross-border deals can be accounted for in different countries. In the German data set from Dealogic, for instance, the Welz transaction didn't show up as a Chinese investment because the Chinese buyer is registered in Germany. Therefore, it was counted as a transaction between two German companies. The Hoechst transaction is another example of the difficulty of defining the transaction parameters: the buyer is China-based, but is a subsidiary of a Singapore conglomerate; German Hoechst is a subsidiary of French Sanofi-Aventis. In another case, a transaction turned up in which a German company sold one of its US production facilities to its own joint venture with a Chinese company. But this transaction doesn't say much about Chinese acquisitions behaviour in Germany.

Another problem with M&A data is that many M&A attempts fail to succeed. To understand the market, it is not only important to look at completed deals, but at announced deals as well. Due to anti-trust and other regulatory requirements, it can take years before a transaction is legally closed. Moreover, quite a number of announced deals are ultimately rejected or withdrawn. The quality of an M&A data set relies on the ability of the information provider to separate rumours or intentions to acquire assets on the one hand and a definite announcement on the other.

Table 2: Selected announced mergers & acquisitions data, US$ million

Region	Sub-Region	Selected Countries	2004 Value US$ million	2004 Number of Deals	2003 Value US$ million	2003 Number of Deals
Worldwide			1,949,001	30,426	1,379,542	28,652
Americas			942,003	10,457	635,932	9,488
	North America	United States	833,575	8,313	570,008	7,702
Europe			693,841	9,379	504,916	9,954
	Eastern Europe		41,631	872	44,063	1,399
	Western Europe		652,211	8,507	460,854	8,555
		Germany	59,409	1,175	54,806	1,200
Asia-Pacific			182,723	8,043	138,725	6,968
	North Asia	**China**	**24,539**	**2,141**	**28,873**	**1,570**
		Hong Kong	13,590	724	10,083	563
		Japan	108,544	2,090	76,384	1,790

Source: Thomson Financial (2005).

2 Overseas M&A activities undertaken by Chinese companies

M&A are just one element of Chinese ODI. According to the MOFCOM and NBS report on ODI, the share of M&A was only 18 percent of total overseas investment in 2003 (MOFCOM/NBS-Report 2004). However, strategic acquisitions of well-known foreign companies have been central in the perception of China becoming an aggressive buyer of overseas assets and a global threat.

More specifically, outbound direct investments can be put into two main categories: investment in new assets or investments in existing assets. For instance, if a sales network or a production facility is built from scratch, this is referred to as a "greenfield investment". The cross-border M&A market belongs to the second category and is a market for sales and purchases of substantial company shares or specific assets, mainly for strategic reasons. M&A is a general term for deals activity and includes not only mergers and acquisitions, but also takeovers, consolidations and management buy-outs, to name just a few (Business Library). Cross-border M&A activity is closely related to the development stage of financial systems, and especially that of stock markets.

Based on a Thomson Financial report (2005) and Dealogic primary data, we shall first give the reader an overview of Chinese outbound M&A flows in the last six-and-a-half years and compare this to the global market; secondly, look at the geographical spread of these M&A activities; thirdly, reveal the most important industries targeted by Chinese M&A; and fourthly, look at the German market in more detail (see box 2).

According to a Thomson Financial report (2005), the global M&A market exceeded a volume of US$ 1.9 trillion and 30,000 transactions in 2004 (see table 2). The United States is the largest M&A market. In 2004, over US$ 833 billion and 8,300 transactions were reported in the USA (Thomson Financial 2005: 12).

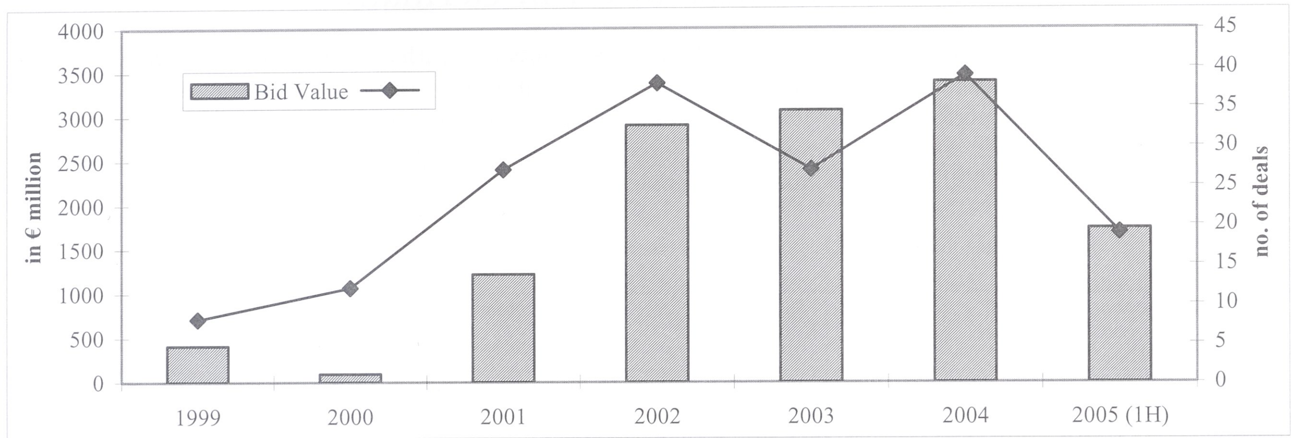
In 2004, 2,141 transactions with a volume of US$ 24 billion were announced in China. In terms of total deal value, this accounts for about 1 percent of the global M&A market; Hong Kong's M&A market is not included in the mainland market. Unlike the Hong Kong market, the Chinese M&A market is characterised by the privatisation of State-owned companies and huge inflows of foreign direct investments. However, the statistics stated in table 2 show the overall market and do not reveal the details of the outbound M&A activities of mainland China-based companies.

In order to understand the M&A development of Chinese bidders, we have to turn to the Dealogic database (which is used as the basis for the following calculations). According to Dealogic, there have been 171 foreign acquisition attempts made by mainland China-based companies worldwide over the past six-and-a-half years. Euro 28 billion was offered by Chinese companies for these announced acquisitions. However, this number is highly skewed by one single offer: the Euro 15 billion bid for the US oil company Unocal by CNOOC in June 2005.[3] Only 129 of all attempted acquisitions have been successful so far; fourteen buying offers have been rejected or withdrawn. Nevertheless, since January 1999 an upward trend of outbound M&A activities can be observed, not including the Unocal bid (see figure 1).

Although the overseas expansion of Chinese companies via M&A is quite impressive, it has to be seen in a more comparative perspective (see figure 2). During the above-mentioned period, 2,533 M&A deals with a volume of Euro 94 billion could be observed in which a Chinese company bought another Chinese company. Additionally, 111 transactions with a bid value of Euro 5.6 billion were reported in which a company from mainland China bought a Hong Kong-based business. Compared to the domestic Chinese and Hong Kong M&A market, outbound M&A activities conducted by Chinese companies have not been that spectacular. On average they accounted for only 6 percent going by the number of transactions and 22 percent by transaction volume (mainly due to the Unocal bid). During the past six-and-a-half years, outbound activities by Chinese companies amounted to less than 10 percent compared to overall M&A activities by Chinese companies.

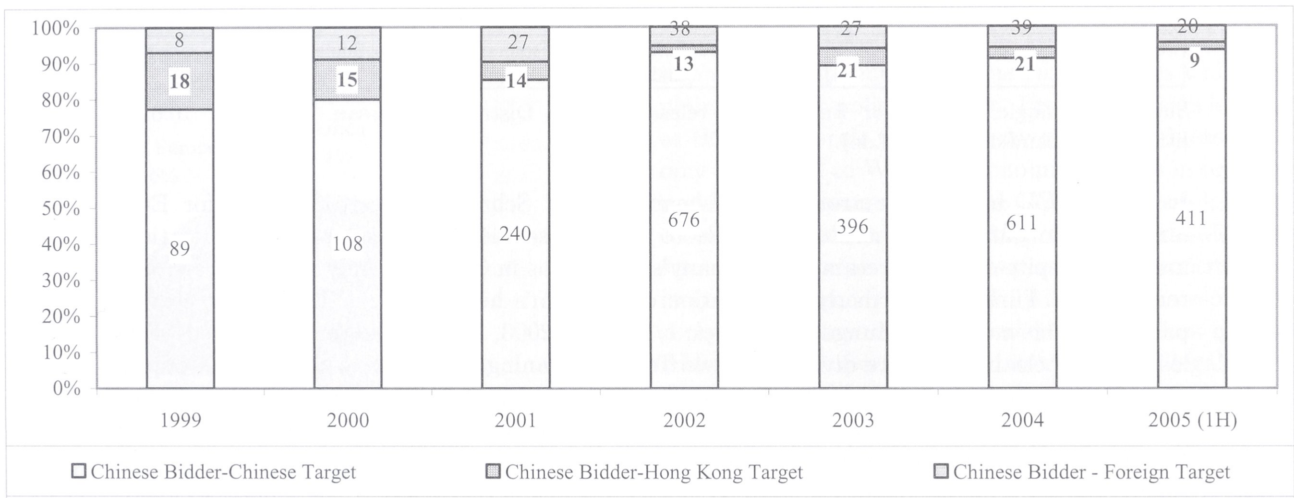
[3] On June 23, 2005, CNOOC offered US$ 67 per share or approx. US$ 18.5 billion to Unocal's shareholders.

Figure 1: Chinese companies buying foreign companies, January 1999 – June 2005 (the Unocal bid is not included)



Source: Own calculations based on Dealogic data (data as of July 7 and 8, 2005).

Figure 2: Development of target regions of Chinese bidders, January 1999 – June 2005 (no. of deals)



Source: Own calculations based on Dealogic data (data as of July 7 and 8, 2005).

During the same time, Euro 136 billion (2,302 transactions) were invested by foreign companies in Chinese companies.

Looking more closely at the geographical distribution of Chinese M&A activities, we find a concentration of deals and tránsaction volume in Asia and North America. With 39 percent of all deals, Asian companies attracted by far the highest number of Chinese bidders, closely followed by North American corporations with a share of 37 percent. However, when calculating deals based on transaction volume, North American companies, mainly from the US, were the preferred targets: two thirds of the total M&A volume was invested there (with the Unocal bid representing a heavy weight). During the same period of time, only 13 percent of all announced deals were recognised in the European Union, amounting to only Euro 387 million (1 percent of the total Chinese outbound M&A volume) (see figure 3 and figure 4).

What industries did Chinese buyers target? With a share of 25 percent (number of deals) or 77 percent (deal value, including the Unocal bid), investments in natural resources received the highest priority in M&A activities. The second most important area was consumer goods-related industries – business focuses ranged from research & development to production facilities and distribution channels – and included apparel, food, electronic goods and cleaning services, among others. About 20 percent (number of deals as well as deal value) was invested in this area. A share of 12 percent (number of deals) went into non-consumer goods manufacturing facilities as well as into telecommunications, the Internet and IT-related companies.

In sum, the M&A data confirms the trends that can be observed on the outbound direct investment level. We find that Chinese M&A outflow is comparatively small, but indicates an upward trend; that Asia is the main investment region, closely followed by the US; that natural resources are by far the preferred goal Chinese companies are aiming at; and finally, that observed M&A activity in Germany has been low and has tended to concentrate on distressed target companies (see box 2).

Box 2: Chinese M&A in Germany

In Germany, only seven M&A transactions by Chinese companies with an overall volume of Euro 47 million have been recorded during the last six-and-a-half years (see table 3). In comparison, during the same period of time, foreign companies invested Euro 649 billion in 3,252 German firms, and German companies bought 3,208 foreign companies for Euro 431 billion. The latter invested Euro 1.5 billion in 44 Chinese companies.

Table 3: Chinese M&A activity in Germany

Announcement Date	Deal Status	Acquired Stake	Bid Value Euro million	Target Name	Chinese Bidder
19.09.02	Completed	100%	8	Schneider Electronics AG	TCL International
16.04.03	Completed	100%	Not disclosed	Boewe Textile Cleaning GmbH (Business Division)	Sail Star Shanghai
07.05.03	Completed	100%	4	Welz Industrieprodukte GmbH	Huapeng Trading GmbH
2003	Completed	100%	Not disclosed	Lutz GmbH Maschinenbau	ZQ Tools
04.05.04	Completed	94.9%	28	Dürkopp Adler AG (94.9%)	Shanggong
04.05.04	Withdrawn	51%		Schiess AG (51%)	Qinchuan Machine Tool
01.11.04	Completed	100%	8	Schiess AG (in receivership)	Shenyang Machine Tool
26.03.05	Completed	50%	Not disclosed	Hoechst AG (Membrane research and technology department)	Suntar Membrane Technology (Xiamen)

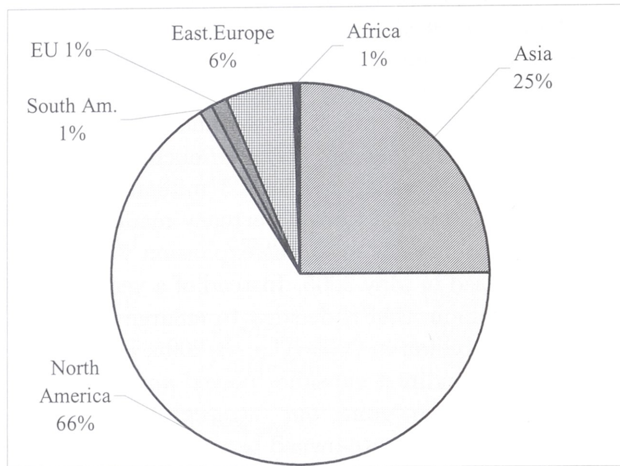
Source: Dealogic, except for Lutz (press release by the District of Passau, Germany, 16.6.04, http://www.landkreis-passau.de).

In 2002, TCL bought the troubled TV manufacturer Schneider Electronics AG for Euro 8 million. To date, TCL hasn't been able to re-energise the brand and turn its operations around. Despite efforts to retain the company's operations in Germany, only 60 employees have remained in Türkheim, formerly the location of the firm's headquarters. The manufacturing part has been moved to Hungary (*Spiegel*, 1/05). In 2003, Wanderer-Werke disposed of its loss-making cleaning service division Boewe Textile Cleaning, selling it to Sail Star Group in Shanghai. Two other purchases of an insolvent company took place the same year: Welz Industrieprodukte in Rathenow was bought by Huapeng Trading for Euro 4 million, and Lutz GmbH Maschinenbau in Neuhaus was taken over by the Shanghai ZQ Tools Group, saving 68 jobs in their respective regions. However, since Huapeng Trading is registered in Hamburg, Germany, it is not clear whether this can really be counted as an outbound investment made by a Chinese company.

In 2004, FAG Kugelfischer sold its unprofitable subsidiary Dürkopp Adler AG, a Bielefeld sewing machine producer to Shanggong Corporation for Euro 28 million. The Aschersleben machine tool manufacturer Schiess AG filed for bankruptcy before being bought by Shenyang Machine Tool for Euro 8 million. In 2005, the only transaction reported by Dealogic in Germany so far has been the acquisition by Suntar Membrane Technology (Xiamen) Co. Ltd. of a 50 percent stake in the membrane research and technology department of Hoechst AG, Frankfurt, a chemicals and pharmaceuticals manufacturer, which is actually a unit of Sanofi-Aventis, France. No financial details have been disclosed. Suntar is a subsidiary of Singapore-based Sinomem Technology Limited, a developer of membrane technology (Lexis Nexis 2005).

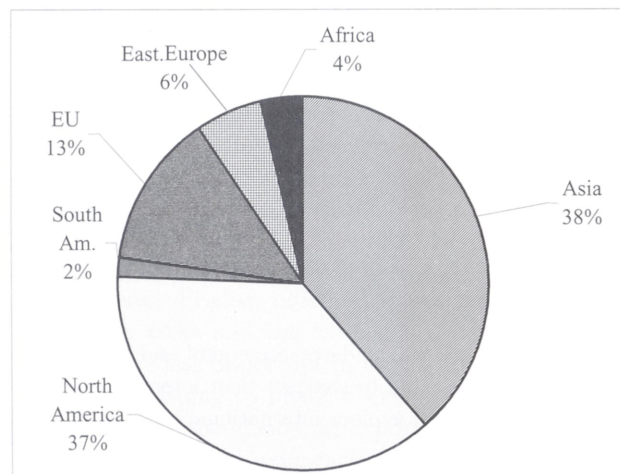
In sum, Chinese acquisitions in Germany have been rather small to date and most of the targets have been businesses in financial difficulty. So far, these investments have been the last hope for the employees of the companies because otherwise the companies would most likely have been shut down. However, whether the acquisition goals (e.g. brand recognition/Schneider, engineering know-how and customer networks/Welz, Lutz, Schiess) can be attained by investing in financially distressed companies has yet to be seen. In the present business life cycle in Germany, many more of these kinds of targets are available. The German market offers much more, however. Many profitable family-owned, medium-sized companies find it difficult to convince a family member to secure the future of the business by becoming the CEO's successor, to name just one example.

Figure 3: Target region (bid value) of Chinese outbound M&A, January 1999 – June 2005



Source: Own calculations based on Dealogic data (data as of July 7 and 8, 2005).

Figure 4: Target region (no. of deals) of Chinese outbound M&A, January 1999 – June 2005



Source: Own calculations based on Dealogic data (data as of July 7 and 8, 2005).

3 Policies supporting the "going out" strategy

Although recent M&A activities on the part of Chinese companies have brought this phenomenon to the attention of the international media, their global expansion via ODI actually started soon after China embarked on the road to an outwardly orientated market economy. Since 2001, however, which was the year when China became a member of the World Trade Organisation (WTO), the support of the overseas expansion of Chinese companies became a major concern for the Government. In order to size the opportunities the WTO entry and the closer global economic integration offered to the Chinese economy, the Government wanted them to become internationally competitive players. With explicit reference to China's forthcoming accession to the WTO, the former Ministry of Foreign Trade and Economic Cooperation underlined the importance of overseas investment as follows:

> By "Going Global", the enterprises can invest and set up factories overseas, better utilize the domestic and foreign markets and resources, further expand the export of equipment, materials and labour service and create new export growth points. Thus we can enhance the level of China's opening to the outside world. (MOFTEC 2001)

A number of policies were designed to help companies to invest abroad. Before presenting these policies in more detail, a short look at the Government's motivation to support the "going out" strategy (*zou chu qu*) is necessary.

In her analysis of the *zou chu qu* strategy as a new focus in China's foreign economic policy, Fischer (2002: 12-13) argues that the motivation of the Government and the companies to pursue this strategy is not necessarily one and the same (see table 4). For the Government, access to overseas natural resources, China's geopolitical positioning and the strengthening of its national competitiveness count as basic motives which explain economic policy support. Fischer suggests looking at the specific role the State plays in the Chinese economy compared to Western economic systems in order to understand these motives. The Government's role in the economy is based on the idea that the State should have strong influence on the economy and direct control over large (State-owned) companies. Allowing (State-owned) companies to invest abroad would mean a loss of control over their operations and increase the illegal flight of capital. Therefore, the Government installed a host of bureaucratic hurdles and barriers for outward investment that explain why the officially reported Chinese ODI volume remained rather small during the 1990s.

With closer integration into the global economy and China's accession to the WTO, the Government realised, however, that economic power and international competitiveness were the most important sources of international influence, and that globally operating companies were of crucial importance in achieving those goals. According to Fischer, there was another reason for the Chinese Government changing its restrictive ODI policy. Faced with a growing number of anti-dumping complains from its major trading partners, direct investment became an attractive vehicle with which to explore foreign markets. Therefore, outward investment and the support of the global expansion of large (State-owned) companies were added to the overall programme of foreign economy policy.

Securing access to natural overseas resources and turning the country into a global player are goals that are closely related to the self-perception of the Chinese Government (and the Chinese Communist Party) and its role in the economy. Basically, they believe that they have the mission of restoring China's place in the international arena and developing the country into one of the leading powers (or maybe *the* leading power) of the world (Garver 2005). Government support of (State-

owned) companies' overseas investments in oil, gas and mining activities is part of China's national energy strategy (Hieber 2004: 401-4; Bajpaee 2005), which itself is an expression of economic nationalism.

Table 4: Motives of the Chinese Government and companies for "going out"

Government	Companies
- Access to overseas natural resources - Geopolitical positioning - Increase of national competitiveness	- Access to overseas markets - Foreign technology and brand names - Local distribution networks

Source: Based on Fischer 2002 and supplemented by the authors.

The policy instruments for supporting the State-led approach to ODI include 1) decentralisation of decision-making authority from the central government level (MOFCOM) to the local level (Iyengar 2004), 2) information on overseas market development, 3) access to foreign currency, and 4) direct and indirect subsidies. In October 2004 MOFCOM announced that the local departments of commerce would be given the right to examine and approve applications relating to local enterprises' overseas investment. In order to simplify the application and approval procedures, the number of documents was reduced. In addition, the approval was no longer based on feasibility reports (Hong Kong Trade Development Council 2004). In contrast, for outbound investment made by "domestic residents" strong restrictions were introduced by the State Administration of Foreign Exchange (SAFE) in January 2005 in order to stop illegal capital outflows (JonesDay 2005).

The setting up of a database on foreign countries' investment environments by the Ministry (MOFTEC, the predecessor of MOFCOM) aimed at facilitating the companies' investment decision-making process. The database includes information about investment laws, taxation policies, the market environment, investment opportunities, etc. As a complement to this Internet-based service, the Ministry organised a number of training programmes on foreign investment environments and foreign languages. In addition, the Chinese Government concluded bilateral agreements on investment protection and avoidance of double taxation with most countries and regions (MOFTEC 2001).

One of the crucial policy steps to support the "going out" strategy was the relaxation of foreign currency control. In January 2003, SAFE decentralised the right to approve access to foreign currencies for companies investing abroad, moving authorisation from the central to the local level. Companies were also allowed to retain profits made in overseas investment projects without having to report how they wanted to utilise these profits. The new regulation was first applied to companies from Zhejiang, Guangdong and Shanghai. Firms from Jiangsu, Shandong and Fujian were included in a second phase as well (C.a., 2003/1, Ü 20). Still today, easy access to foreign currency for Chinese companies is limited to 24 trial areas in which local bureaus for foreign exchange are authorised to handle any deal valued below US$ 10 million, which is much higher than the previous deal value of US$ 3.3 million. In addition, the total value of foreign currency made available for Chinese companies' overseas expansion was significantly increased in May 2005. Instead of a yearly quota of US$ 3.3 billion, SAFE decided to enlarge the quota size to US$ 5 billion in 2005 (C.a., 3/2005, Dok 33).

Direct and indirect subsidies played another role in the support of the "going out" strategy. Easy access to bank loans from State-owned banks helped to secure deals in industries regarded as very important for the national economy. According to some reports on the acquisition of Ssangyong Motors by Shanghai Auto, a share of 66 percent of the acquisition was financed by preferential loans by three State-owned banks (*China Daily*, 4.11.04; PricewaterhouseCoopers 2005).

The Export-Import Bank of China, which is one of three State-owned non-commercial banks,[4] offers special loans to Chinese companies for overseas expansion. At the beginning of November 2004, the State Development and Reform Commission (SDRC) and the Export-Import Bank of China issued a joint circular on the establishment of a special loan programme to facilitate investment overseas. According to a report by the Xinhua News Agency the circular said that by granting preferential policies, the

> [...] companies will undertake mergers and acquisitions more easily in a bid to sharpen their international competitive edge and explore international markets. (XNA, 1.11.04)

Political and financial support for Chinese ODI gives Chinese State-owned or State-related companies an advantage over Western market-orientated companies, because they are not required to earn an adequate return for their owners. And they might not even be forced to pay back their debt to State-owned banks. Therefore, their cost of capital is virtually zero. Regarding M&A investments, for instance, this puts them in a position to offer higher bid prices because they can calculate investment returns with a substantially lower discount rate than their Western competitors.

4 Chinese companies' quest to become global players

As Chinese companies get more competitive, they start to seek alternative ways of achieving corporate growth. The reasons why Chinese companies expand their busi-

[4] The other two banks are the State Development Bank and the Agricultural Development Bank.

Table 5: The ten largest outbound acquisitions by Chinese companies (01/1999 – 06/2005) US$ million

Announcement Date	Deal Status	Acquired Stake	Bid Value Euro million	Target Name	Nation	Chinese Bidder
23.06.05	Preliminary discussions	100%	15,255	Unocal	USA	CNOOC
08.12.04	Completed	100%	1,303	IBM (Personal Computer Business)	USA	Lenovo
11.06.2001 + 26.09.2002	Completed	100% (80% +20%)	1,154 (765+389)	Hyundai Display Technology Inc - Hydis	South Korea	BOE Technology
21.06.05	Pending	100%	1,050	Maytag	USA	Qingdao Hai'er
18.01.02	Completed	86%	672	Repsol-YPF (Indonesian assets)	Indonesia	CNOOC
24.10.03	Pending	13%	593	Oil & Gas Assets (Gorgon Liquefied Natural Gas Field)	Australia	CNOOC
27.07.04	Completed	49%	419	Ssangyong Motor	South Korea	Shanghai Automotive Industry
09.06.05	Pending	100%	370	PetroChina International Ltd	Indonesia	CNPC, PetroChina
24.08.02	Completed	5%	358	Woodside Petroleum Ltd	Australia	CNOOC
15.04.02	Completed	10%	298	Devon Energy Corp (Indonesian oil and gas assets)	Indonesia	PetroChina

Source: Dealogic.

ness via ODI are basically the same as Western companies', although some factors play a more crucial role than others. Fischer (2002: 13) points out that low production costs and the extension of the life cycle of products are less important in the strategies of Chinese companies wishing to invest overseas. In contrast, due to their high dependency on exports, access to foreign markets and market exploration are the key drivers of Chinese ODI. Acquisitions of international companies with relevant know-how, brand names and distribution networks are necessary steps for Chinese companies that aim to get a larger market share (Reisach 2005: 2).

At the beginning of the "going out" strategy only State-owned companies – "foreign trade corporations" under MOFTEC and under other ministries or provincial governments – were allowed to invest overseas. Hong and Sun (2004: 8) argue that their business strategies were based on political and not on commercial considerations:

> The key decisions on overseas investments, such as choices of location and sector, were mainly determined by the consideration of enhancing China's political and economic influence and expanding China's international trade relationships rather than maximizing market profit.

Due to the political background of most Chinese companies operating overseas, resource seeking, especially with a view to natural resources, has been their key strategic consideration. Up until today, investment in resource-seeking activities has made up a considerable share of total overseas investment. According to ODI statistics from MOFCOM and NBS, 48.4 percent, or US$ 1.38 billion, of the total investment volume in 2003 was reported to have been absorbed by the mining sector and for the exploration of oil and gas (MOFCOM/NBS-Report 2004). State-owned companies in these industries such as SINOPEC, Petrochina, China National Offshore Oil Corporation (CNOOC), China National Petroleum Company (CNPC), China National Chemicals Export and Import Corporation, China Metals and Minerals, Shanghai Huayuan Group Corp. and Baosteel have invested in about 14 countries, including Indonesia, Kazakhstan, Myanmar, Sudan, Nigeria, Yemen and Brazil (UNCTAD 2003: 7-8; Hong/Sun 2004: 10). Table 5 shows the largest M&A transactions (by deal value) during the last six-and-a-half years, the majority targeting natural resources.

China's growing energy needs have translated into a more aggressive search for energy resources on the world stage over the last few years and turned the country into a competitor in the eyes of other large energy consumers, especially the USA. The first confrontation with US energy interests took place when CNOOC officially announced that it planned to take over Unocal, an American oil company, in June 2005. National security fears over the Chinese bid for Unocal were aroused in the USA. Congressmen requested the US Treasury Department to consider whether CNOOC's takeover would pose a security risk owing to the transfer

of Unocal's technology and assets and called for a review of the Chinese Government's financial involvement in this deal (ST, 28.6.05). In addition, Unocal's board recommended that stockholders should vote in favour of the Chevron merger (SCMP, 21.7.05). However, due to CNOOC's access to cheap loans from State-owned banks and its parent owner (the Chinese Government), the company is able to offer higher prices than Chevron (*The Economist*, 30.6.05).

The acquisition of strategic assets, especially technology and brand names, represent two other important reasons for Chinese companies' outward investment. In the late 1990s, firms in certain industries, especially electronic appliances and machinery, started to expand their overseas market presence. Among those companies that have acquired stakes in foreign companies or set up productions sites, we can find Konka Electronics, Skyworth, Chonghong Electronic Group, Guangdong Midea Group, Huayi Shanghai, TCL, Huawei Technologies and Hai'er, China's largest household appliance manufacturer. One of the business strategies of Chinese companies is the acquisition of bankrupt companies with well-known brand names: TCL bought Schneider Electronics (Germany), Huayi Group (Shanghai) acquired Moltech Power Systems (USA), BOE Technology absorbed Hynix Semiconductor's flat panel display unit (South Korea), to name just a few. In addition, there have been strategic ventures between Chinese and overseas companies such TCL's television and DVD operations with Thomson (France) or Huawei Technologies with Siemens, NEC, Matshushita and Infineon (UNCTAD 2003: 5-6; Hong/Sun 2004: 13-14). For TCL, one of the largest firms in China and a conglomerate in the TV, mobile phone, computer and white-goods industries, the reasons for investing in overseas markets are similar to those of other Chinese companies in the consumer goods industries. They lack the technical expertise to sell products on developed markets, an appropriate distribution network and a recognised and trusted brand for foreign consumers (Bernstein 2004: 13).

Hai'er, China's largest home appliance company and a firm famous for its washing machines, refrigerators and dishwashers, has already started to spread its wings by setting up about 30 overseas factories over the last few years. The recent bidding for Maytag, a troubled icon of the American home-appliance industry, was part of Hai'er's strategy to expand into the US and EU market. Maytag, the third-largest American appliance producer, had come under strong cost pressure and suffered from falling profits in recent years. With the takeover of Maytag, the maker of Hoover vacuum cleaners, Amana appliances and Magic Chef ovens, Hai'er would have been able to considerably enlarge its range of products and own a well-known brand company in a key market (IHT, 22.6.05). However, Hai'er called off its takeover bid at the end of July, leaving the deal to the US company Whirlpool. To some observers, who believe that Hai'er was taken aback by the heated discussion about the takeover of Unocal, this example shows that overseas acquisitions are not only a matter of money, but also involve politics and public relations (SCMP, 21.7.05).

5 Prospects of Chinese ODI

A closer look at the performance of overseas M&A by Chinese companies shows that there is still a long way to go. So far TCL has been unable to turn around the TV operations it bought from Thomson. Moreover, the outdated brand Schneider is not repaying the purchase price yet. D'Long, a diversified Chinese company, has become an example illustrating the drawbacks of an aggressive acquisition strategy; the company bought Murray lawnmowers and parts of Fairchild Dornier, for instance, and ended up not being able to repay its debts.

Copeland et al. (2000: 152) have pointed out that in general, many acquisitions are not successful for the buyer with regard to the returns. They argue that price overvaluation and poor after-acquisition management have been the main reasons for M&A failures. These failures are usually caused by overly optimistic market expectations and synergy estimations, an unsatisfactory due diligence process, excessive pricing in competitive tender offers, and poor merger integration. These arguments might be transferable to the situation of Chinese overseas M&A as well. These problems are amplified by the specifics of cross-border transactions. For instance, cultural differences affect business practices and styles, causing significant differences in ways of approaching a potential target, the role of an advisor or an agent, negotiation style, pricing methods and the reluctance or readiness to reveal information in the due diligence process. Distance in time and space between the acquirer and target complicates communication efforts further and hinders integration into the acquiring firm. Cultural effects especially reveal themselves in human resource management (e.g. the role of unions, management style and the compensation gap to the home country). Other after-acquisition problems can be due to poor knowledge of the local business attitude and the specifics of the local market.

There is now a vast amount of literature on the difficulties foreign companies are encountering in China. Vice versa, similar problems can be expected when Chinese companies target foreign countries. Pointing out the differences in the business environment and the resulting behaviour of managers, *The Economist* (30.6.05) argues that

> [...] China's political system makes its managers particularly unsuitable for running complex, global companies that demand consistent strategies. In an environment of regulatory inconsistency, corruption and political patronage, Chinese companies have tended to pursue short-term returns and excessive diversification rather than long-term technological development. And rather than build networks of suppliers and customers, they have preferred to curry favour with bureaucrats and party officials.

Another problem Chinese companies are already faced with, especially when investing in the US and Europe, is related to ongoing discussion of the "China threat". In some countries, the national media report about acquisitions made by Chinese companies quite

critically (see the examples at the beginning of this paper). Even though there might be no good economic reason to refuse the CNOOC bid for Unocal, it is quite likely that Unocal's shareholders will do so under increasing public pressure.

Due to Chinese companies' lack of experience with capital market-related acquisitions and knowledge of the local market, the importance of legal and financial advisors with relevant expertise will further increase in the future. Advisors are usually ranked by deal value and/or number of deals. Both Dealogic and Thomson Financial provide so-called league tables for the M&A industry. For the purpose of this paper, the Dealogic data set (01/99-06/05) is used to create a ranking in order to get an indication of the financial advisors Chinese companies trust most. All together, 41 financial advisors were involved in outbound transactions (including target companies in Hong Kong). At the top of the list there are the two global investment banks, Goldman Sachs and Merrill Lynch, both of whom were involved in eight transactions. There may be several reasons for this. Firstly, when it comes to large-scale, stock market-related transactions, investment banks are the advisors of choice. Secondly, their international presence allows them to staff their teams in accordance with the needs of cross-border deals. All of the major Wall Street banks have hired Chinese-raised, but US-educated bankers (*China Daily*, 19.7.05). Thirdly, investment banks use league tables as a marketing instrument and therefore actively report their activities to Dealogic. Other, more specialised regional advisors might not be aware of this tool.

Table 6: Top ten financial advisors in cross-border transactions (mainland China bidder, non-mainland China target; 01/99-06/05)

Pos.	Advisor's Name	No. of Deals	Deal Value (Euro million)
1	Goldman Sachs	8	4,047
2	Merrill Lynch	8	3,552
3	Credit Suisse First Boston	6	2,260
4	JP Morgan	6	1,743
5	Citigroup	5	1,999
6	UBS	4	1,195
7	Access Capital	4	45
8	HSBC	3	882
9	Calyon	3	811
10	Rothschild	3	397

Source: Own calculations based on Dealogic data.

Our analysis of Chinese ODI, especially the international M&A activities undertaken by Chinese companies, has shown that neither the number nor the size of transactions justifies the "China threat" mentality found in many media reports. Basically, Chinese companies use the opportunities offered to them in the process of globalisation. However, the strong involvement of the Government as the owner of State-owned companies investing overseas can be assessed more critically because it could result in a State-led strategy of "going global", thereby distorting competition in global markets.

The future development of Chinese ODI depends on a number of factors, in particular the dynamics of the domestic Chinese and global market. Resource-seeking and access to markets and new technology will certainly remain important drivers for China's ODI. With domestic competition further increasing, the expansion of overseas market shares via M&A will become even more important for Chinese companies in the future than now (Reisach 2005: 2). The recent relaxation of China's capital controls and the first revaluation of the Chinese currency on 21 July 2005 will help enhance the purchasing power of Chinese companies and help them to gain a larger market presence.

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