In search of illumination: Chinese companies expand overseas

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By Geoff Dyer and Sundeep Tucker
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No takeover battle or asset sale is complete these days without speculation about a possible bidder from China. In the past few months, Chinese companies or government agencies have announced investments in Barclays, Bear Stearns and Blackstone – three of the best-known names in international finance. Chinese mining and energy companies have been investing in everything from copper in Afghanistan to tungsten in Tasmania.

Overseas investment from Chinese groups has nearly doubled this year, according to Thomson Financial. With the dollar weak, the US financial system reeling and China's foreign currency reserves nearing $1,500bn (£727bn, €1,023bn), the flurry of investments has added to the prevailing sense that the geopolitical axis is shifting.

Given that almost all the companies behind these deals are controlled by an authoritarian Communist state with a penchant for detailed planning, the investments can sometimes seem like an organised and relentless strategy of international expansion – "The Big Red Chequebook", as one headline put it.

Yet for all the hype that surrounds what Beijing calls its "go out" policy, there is much less co-ordination between companies and the government than is often perceived. Deals are more likely to be about profits, prestige and skills than foreign policy goals. Chinese investments have also been smaller and more tentative than many of the headlines suggest. Corporate China's confidence is rising but "China Inc" is not about to dominate the world.

"Outside observers often define China Inc as a well-oiled, closely co-ordinated and monolithic group of companies, but nothing could be further from the truth," says Daniel Rosen, founder of China Strategic Advisory, a New York research practice. Deals being undertaken were the product of "a dog's breakfast of different motives".

When China started to encourage companies to invest overseas at the start of the decade, it was often a government-led initiative. In 2001, when he was a minister in the Brazilian government, Roberto Giannetti received a visit from a delegation of Chinese government officials, bank executives and state-owned company bosses. They came with a proposal: to buy Companhia Vale do Rio Doce, the world's biggest miner of iron ore, a commodity central to China's urbanisation.

The approach demonstrated how different parts of the Chinese state were being encouraged to work together to secure perceived national goals. It also contained a hint of naivety: Mr Giannetti replied that CVRD was not the government's to sell as it had been privatised four years earlier.

Yet as the stream of Chinese investments grows, a different dynamic is unfolding. Rather than planning officials, individual companies are the driving force behind most of the recent investments. Large deals still need to be approved by the State Council, the central government's top executive organ, but the companies have their own specific motivations and strategies. "The coming wave of deals is less national strategy, more chaos theory in action," says Stephen Green, a Shanghai-based economist at Standard Chartered, the UK bank.

One sign of this is the competition for deals that can be seen among different companies majority owned by the state, especially in banking and oil. Three Chinese banks – **China Construction Bank**, **Industrial and Commercial Bank of China** and **Bank of China** – have approached Temasek of Singapore in recent months to discuss buying its stake in **Standard Chartered**. PetroChina and Sinopec competed against each other over a pipeline in Sudan, although the government is trying to prevent further bid battles over oil assets.

When Rover, the UK carmaker, went into liquidation two years ago, the administrators received bids from two Chinese car companies – Shanghai Automotive Industry Corporation and Nanjing Auto. Both this year launched almost identical models based on Rover technology in the Chinese market and at one stage were threatening to sue each other in foreign courts over the rights to Rover's intellectual property.

"It is definitely true to say that [Chinese state-owned companies] are all distinctive and somewhat autonomous fiefdoms that set their own agendas," says Arthur Kroeber at Dragonomics, an economics consultancy in Beijing. "There is not some secret cell in the government which has identified the top 50 strategic assets around the world. It is the companies themselves that decide what deals to go after."

A big test of the government's role in overseas investment will be **BHP Billiton**'s bid for **Rio Tinto**. Bankers say several Chinese steel and energy companies are concerned at the consequences of the deal for their access to cheap mineral resources. Officials in Beijing are also said to be worried that the merger would not be in China's interests. But a quick counterbid appears difficult to organise, even if they could raise the money.

According to one senior banker who has met several interested Chinese companies in recent days, "China needs someone in government to bang heads together on this one. The country has enough foreign exchange reserves to buy Rio but no one in Beijing seems to be co-ordinating a response. Just like in the west, it is not easy to get company chairmen in the same room at the same time and get them to easily agree to a concerted response."

Chinese state-owned companies have become more independent from the government because they are financially much stronger. Profits for the state-owned sector increased 35 per cent to Rmb1,220bn ($165bn, £80bn, €112bn) in 2006 and many companies have earnings in foreign currency that they can use to pay for acquisitions while avoiding the bureaucracy of the country's foreign exchange regulator.

Many of the companies have also taken advantage of the boom in Chinese shares to line their war chests. PetroChina, Chalco (an aluminium maker), Shenhua Energy and China Coal Energy have raised more than $1bn each over the past year from share issues. The same is true for the banks. ICBC, considered near-insolvent a few years ago, raised $21.9bn last year in the world's biggest ever initial public offering. This helped the bank fund a $5.56bn bid for a 20 per cent stake in Standard Bank of South Africa in October.

Even in the oil sector, the real influence of the government is not as clear as it might seem. On paper, there is an explicit national strategy to acquire oil assets. With Chinese oil demand surging, energy security has been a much-discussed theme in Beijing. In the face of intense international criticism, the Chinese government has, for example, maintained a strong relationship with oil-rich Sudan.

The government has also given heavy financial backing to its oil companies. Loans from China Exim Bank helped Sinopec acquire a stake in a large project in Angola. Members of the US administration have even accused China of trying to "lock up" energy supplies. "Government financial and political help has been central to Chinese investments in Angola, Sudan, Zambia and Zimbabwe," says Joshua Eisenman at the American Foreign Policy Council.

Yet the behaviour of the companies suggests they are more focused on their own profits than any national strategy. About two-thirds of the oil from China's overseas assets is sold into the global market at the spot price rather than shipped back to China, where the companies would have to sell it at heavily subsidised rates. Even in Sudan, Chinese companies have at times sold much more of their oil production to Japan than they have sent home.

According to Erica Downs, a China energy expert at the Brookings Institution in Washington, some Chinese oil executives doubt that acquiring overseas assets enhances energy security. "However, they will pay lip-service to the idea to demonstrate that they are working to further the interests of the Chinese state," she says.

Zha Daojiong, an expert on Chinese energy diplomacy at Peking University, says Chinese oil companies were looking overseas to boost their revenues and reserves long before government planners began to propose the idea. "To my knowledge, investing to bring energy home was not a policy diktat from the start," he says.

China's overseas forays have also tended to be more modest than headlines suggest. Chinese companies have made few outright takeover bids, favouring instead the purchase of smaller stakes. The political furore in the US over CNOOC's 2005 bid for Unocal is one motive for caution but Chinese companies also know they have few executives with experience of managing multinational businesses. One of the reasons China Mobile abandoned a $5.3bn bid for the Luxembourg-incorporated Millicom last year was the difficulty of running a company with operations in 16 countries – several of which recognise Taiwan rather than the People's Republic of China.

If there is one element that ties together the Chinese investments in financial services, meanwhile, it is a desire to gain experience. A few years ago, the large Chinese banks invited international banks to take stakes in them in an effort to acquire skills. Their own forays are following the same logic. If approved, **Citic Securities**' 6 per cent stake in Bear Stearns will allow it little direct management influence but gives the Chinese stockbroker a window on to Wall Street. Similarly, by buying 20 per cent of Standard Bank, ICBC hopes to learn more about managing a multinational banking business – in what could be a dry run for a bigger bid in Europe or the US.

In resources, there is a similar pragmatic trend. China's mining companies are eager to take part in the ongoing consolidation of the industry but so far most have been content to gain experience through investing in individual projects overseas rather than splashy takeovers.

The fact that Chinese investment is less co-ordinated and more modest in its ambitions than is sometimes portrayed might make it seem less threatening in countries concerned about China's rise. However, there seems little sign that hostility will ease. In October, when Huawei Technologies became a minority partner in Bain Capital's $2.2bn bid for 3Com, the US network equipment supplier, a Republican congressman called it a "direct threat to we free people".

Some of the resistance is motivated by concern about China buying important technology and some by a desire to tame the country's explosive growth. Yet even among people not usually critics of China, there are still huge questions about the transparency of the relationship between the government and its companies.

During the CNOOC bid for Unocal, criticism focused on cheap loans from Chinese banks. Now concerns are being raised about the role of China Investment Corporation, the government's new sovereign wealth fund. China specialists say they are still unclear about what sort of role CIC will play in assisting overseas takeover bids. Even when the companies are taking the lead and pursuing business objectives, the murky ties between the Communist party, the state and its businesses can still undermine trust in Chinese entities.

"The problem with China is not its size or growth but the lack of transparency," says Mr

Rosen at China Strategic Advisory. "The world can handle its magnitude but what it cannot handle is the uncertainty all the time about motives and about how the system actually works."

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