The Globalisation of Chinese Capital

Ilan Alon
Rollins College, ilon@rollins.edu

Follow this and additional works at: http://scholarship.rollins.edu/as_facpub
Part of the International Business Commons

Published In
http://scholarship.rollins.edu/as_facpub/99

This Article is brought to you for free and open access by Rollins Scholarship Online. It has been accepted for inclusion in Faculty Publications by an authorized administrator of Rollins Scholarship Online. For more information, please contact rwalton@rollins.edu.
The globalisation of Chinese capital

Ilan Alon

The globalisation of Chinese capital will be one of the hallmarks of 21st-century economics, shaping debates over state capitalism, ‘free’ markets and international institutions. China internationalised its product markets and upgraded its manufacturing prowess towards the end of the 20th century by allowing inward foreign direct investment (FDI) and by promoting export trade. This was supported in part by cheap labour, and resulted in growing trade surpluses with key trading partners—particularly the US. Outward FDI was discouraged in order to preserve foreign reserves, and together these policies have helped China accumulate significant amounts of capital, now making it a multi-trillion dollar reserve holder.

During this period of increased inward foreign investment, Chinese companies were encouraged to establish joint ventures with multinationals and to absorb Western technology by working with Western firms. Multinationals, in turn, saw these joint ventures as an opportunity to enter the Chinese market, lower their manufacturing costs and outsource some of their production activity, focusing on ‘higher value-added’ activities. China quickly evolved into the manufacturing hub of the global economy, working across a wide variety of industrial sectors. Despite creating a niche as a world leader in original equipment manufacturing, Chinese companies are no longer satisfied with this position in the value-added chain. Profits reside with the design and brand owners, which are often Western multinational companies. So although China has received employment and investment benefits from Western investors, it has not reaped a proportionate share of the profits.

Chinese companies are now armed with plentiful hard currency at a time when the global community is hungry for international capital. Cash-starved multinationals can sell their brands, channels of distribution, know-how and customer bases, thereby allowing Chinese multinationals to develop advanced capabilities in technology, design and branding. With this backdrop in mind, China’s Twelfth Five-Year Plan has put a number of parameters in place to allow Chinese multinationals to gain global ground. This includes a number of plans to further economic reform and opening, to position Hong Kong for a leadership role in global finance, and to increase research and development spending as a percentage of total GDP. The plan also envisages that China will move up the value-added chain in strategic industrial clusters, modernise key industries and invest in infrastructure, all the while encouraging Chinese companies to ‘go global’.

State-owned enterprises (SOEs) are vital to China’s advancement in technology and globalisation and will play an important role in achieving these objectives. They are
directed to seek out investments in natural resources to fuel economic growth, invest in new technologies and find international markets for Chinese goods. Chinese firms are not only market- and resource-seeking investors, like their Western counterparts, they are also interested in strategic assets and investments in know-how so as to move from manufacturing-led to knowledge-driven growth. And while the recent global economic environment has certainly facilitated China’s desire to ‘go global’, Beijing’s monetary policy—and its exchange rate policy in particular—has also affected China’s economic prospects.

China’s currency, the renminbi, is increasingly involved in international settlements and contracts, and is already considered among the world’s most stable currencies. Demand for Chinese goods has facilitated support for its exchange rate, which is currently semi-fixed against the US dollar. If China’s fixed exchange rate regime were eliminated, the renminbi would likely appreciate anywhere from 20 per cent to 50 per cent, giving Chinese investors an immediate advantage in buying international assets. Although the peg is unlikely to be abandoned in the near future, international pressure on China to appreciate the renminbi will intensify, especially with imports worsening the balance-of-payments situation and harnessing GDP growth rates in many countries around the world. This means the renminbi is likely to appreciate against the dollar in the medium to long term, further fuelling outward investment when the change takes place.

The rise of Chinese multinationals has inflamed global fears about China ‘taking over’ the world. It is true that Chinese companies with global ambitions are on an international buying spree and that international mergers and acquisitions are on the rise. But current concerns about China’s future world domination are exaggerated; Chinese outward investment as a percentage of overall GDP is much lower than that of most developed countries and its share of global outward FDI is less than 2 per cent.

The great majority of Chinese international investment is carried out by state-owned companies, and their motivations can seem suspect to political figures in host countries. Consequently, Chinese companies effectively end up paying a premium over other bidders in order to offset this political uncertainty, which in turn serves to limit the economic benefits of any potential deal. In 2005, for example, Unocal accepted Chevron’s takeover bid instead of CNOOC’s offer because the premium offered by the Chinese SOE was too low to offset US congressional concern over the purchase. Given that much of Chinese outward FDI is state led, domestic as well as host government involvement will likely complicate international transactions and the perceived intentions of each side.

A 2011 study gathered data from top executives of leading SOEs, representing 20 diverse industries, to determine their motivations for investing overseas and to clarify
the extent of this investment. The first primary push factor propelling the internationalisation of Chinese SOEs is the central government’s ‘go global’ policy and related incentives, while the second relates to the business strategies adopted by enterprise leaders. Most SOEs are pursuing business potential or access to natural resources, although about 20 per cent of the sample sought brands and technologies. The largest portion of China’s outward FDI goes to Asia (24 per cent) and most of this to Hong Kong. Africa and Europe both receive around 20 per cent, while investment in North America accounted for about 11 per cent. Subsidiary and representative offices were the most likely modes of entry into these host economies; Chinese SOEs seem to prefer investments in wholly owned or predominantly owned facilities, and most future investments are expected to focus on the expansion or upgrading of existing facilities (44 per cent) or new greenfield investments (38 per cent).

Research on international mergers and acquisitions, meanwhile, is quite clear: most fail to create value for shareholders. Will the Chinese experience be different? Despite government support, Chinese companies are likely to suffer major losses from acquisitions abroad due to a lack of internal capability and resistance from foreign governments. Although Chinese companies have developed excellent manufacturing capabilities, their skills in technological development, marketing and branding, and international management remain weak. Many international managers do not speak English and have little experience in dealing with foreign regulations, cultures and business norms. Integrating the competencies of acquired companies requires a dynamic absorptive capacity that many Chinese firms lack. It is one thing to buy a company possessing certain technologies, but it is quite another to retain the talent required to further develop and apply these technologies after the acquisition.

As Chinese SOEs and private companies increasingly ‘go global’, questions will also arise about the practices of these firms both within China and abroad; the involvement of the Chinese government in the promotion of investment; and the contrasting political, economic and management systems—or ideologies—of each party. China’s pool of labour will likely become more expensive and the renminbi could well appreciate, meaning China will shift from export to foreign investment modalities of internationalisation. In the next decade, Chinese outward investment as a percentage of exports, GDP level and global outward FDI will also significantly expand, in turn raising questions about sovereignty, control of economic resources (particularly natural resources), reciprocal treatment and the application of international rules.

Whether China will be able to continue developing its state sector abroad will largely depend on how these companies, and China more generally, are perceived by others in the future and how Chinese investors address these questions. Governance of SOEs based on Communist Party political leadership may embolden foreign leaders in democratic and free-market countries to reject acquisition attempts and to block full
engagement. It is hoped that reactions to the ‘China threat’ or the ‘China challenge’ will be informed by data and logic rather than propaganda and perceptions. But it is not yet sure how China will react to the current debates over trade, investment and development, and whether Chinese management approaches, as well as its economic and trade policies, will spill over to other countries seeking to steer away from the Washington Consensus and from those management systems developed in the West over the last century. In any case, China is likely to dominate Asia’s economic landscape in the 21st century. Chinese historical and cultural ties to Asia, along with its physical proximity and economic attractions, will be key to elevating China’s regional power base in the years to come.

Ilan Alon is Cornell Professor of International Business and Director of the China and India Centers at Rollins College. He is also a visiting scholar and Asia Fellow at Harvard University. His two most recent books on China include Chinese International Investments (Palgrave, 2012) and A Guide to the Top 100 Companies in China (2010).