Chinese OFDI: Bolder, Wiser and More Strategic

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With China’s rapid economic ascent and subsequent transformation into a market-based economy, Chinese companies are now expanding abroad and going global not only per the government’s mandate, but also to reduce their reliance on China’s economic growth by expanding into new markets. At the same time, market forces are inducing them to acquire or gain access to sophisticated technologies through strategic mergers and acquisitions (M&A), at increasingly favourable prices, to raise their level of competitiveness. China’s overseas acquisitions in the non-financial sector, which reached a record USD 60.1 billion in 2011, will continue as increasingly sophisticated Chinese buyers seek bargains amid the downturn among developed economies, especially in Europe (see chart below).

Over the short term, the ongoing euro zone debt crisis will create multiple opportunities for active Chinese investors, giving them easier access to technologies they have long coveted in the European and other developed markets. Our article in this issue, China in Europe: Cash, Debt and M&As, dives further into this trend. But what are the new driving forces behind the current wave of Chinese OFDI? And what are the strategies being employed by Chinese companies to successfully close deals in the natural resources and industrial sectors, which continue to comprise the bulk of Chinese OFDI deals? (see chart below)

Shifting focus

As China’s economy moves into a new phase, the focus of Chinese investment abroad is also shifting, with greater attention being placed on advanced manufacturing, technology and science-based industries. Unlike the initial wave of overseas investment led by China’s dominate state sector in their purchases of mining and energy companies in resource-rich regions, current M&A activity is emerging as a key enabler of consolidation, growth, market positioning and the acquisition of strategic assets and expertise. Forward-looking Chinese companies now consider overseas investment as a viable approach towards moving up the value chain by gaining access to foreign brands and technology. Likewise, while global leaders in the heavy machinery sectors have a significant presence all around the world, they mostly come from developed countries. However, leading Chinese construction equipment makers such as Sany Heavy Industry are quickly catching up, displacing previous industry leaders from the top 10 in terms of sales through both organic growth and strategic acquisitions (on next page).

Chinese companies have also shown a bigger appetite for relatively riskier assets compared to their peers from developed countries. In other words, Chinese companies are beginning to realise the intangible benefits from making purchases overseas. But why exactly are Chinese becoming bolder, looking for acquisitions outside their own borders? It is becoming increasingly well-known that Chinese companies are not only concerned about becoming bigger and increasing their market share in the short term, Chinese companies are...
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China National Offshore Oil Corporation (CNOOC), China’s largest offshore oil and gas producer, has shown a particular interest in Chesapeake Energy’s assets, investing USD 3.43 billion since October 2011 in two separate deals. In these deals, Chesapeake (the second-largest US natural gas supplier and most active American natural gas driller) gets a cash boost to help pay back its USD 10.3 billion debt load and remains the operator of these projects, lessening the likelihood the deals will face regulatory opposition. In exchange, CNOOC gains exposure to the complicated shale gas extraction technology it lacks. In other words, China is forgoing ‘big splash’ investments and opting for smaller, more strategic assets under the radar.

So what’s driving this quest for shale gas technology? Chinese energy companies are racing to meet China’s aggressive production growth forecasts to power the country’s fast-growing economy. In fact, Beijing recently announced it would invest USD 13 billion to switch the city’s coal-fired power plants and heating facilities to natural gas in a move aimed at addressing public concern over the city’s poor air quality, with other cities sure to follow. Likewise, according to the Energy Information Administration (EIA), China is believed to have vast reserves (36 trillion cubic metres) of natural gas trapped in shale rocks, a quantity roughly 12 times the size of China’s conventional natural gas deposits. In June 2011, China National Petroleum Corp (CNPC), the country’s largest energy producer and PetroChina’s parent, formed a joint venture with Shell to improve its own shale-gas well drilling efficiency. Subsequently, in March 2012, the firms announced their partnership had reached new heights with the signing of a production sharing contract to develop a shale gas block in China, the first such deal in the country. Increased domestic demand along with untapped shale gas reserves is strengthening the competitive rivalry among China’s energy giants, forcing them to buy strategic assets overseas from their existing partners in order to become more competitive in China.

China’s construction equipment manufacturers have also shown a keen interest in acquiring new technologies through foreign acquisitions (see chart below). At the beginning of 2012, Sany announced that it would acquire Putzmeister, a German Mittelstand company and also the world’s largest manufacturer of high-tech concrete pumps. Together with Citic PE Advisors, a Chinese private equity company, Sany will acquire all of Putzmeister for USD 473 million, with Citic retaining a minority shareholding. This follows Zoomlion’s...
(Sany’s domestic rival) purchase of Italian concrete pumps maker CIFA back in 2008. Following Sany’s announcement, speculation has grown that XCMG is preparing to bid for full control of Germany’s Schwing GmbH, the world’s second-largest concrete machinery manufacturer while Guangxi Liugong Machinery Co. recently unveiled plans to acquire the engineering machinery unit of a Polish company, Huta Stalowa Wola SA, for USD 62 million. However, simply stating Chinese construction equipment manufacturers are solely after technologies would be inconclusive.

China’s increasingly globally competitive construction gear makers are not only buying production capacities and technology; they are also after brand recognition and established distribution networks, which will China realise its three-year goal of becoming the world’s top exporter in the USD 150 billion global market for equipment such as bulldozers, excavators and forklifts. Their post-acquisition strategies are also changing. Zoomlion became the first major Chinese construction gear maker to retain a foreign management and production team when it bought CIFA, a move that extended its presence to more than 70 countries. Similarly, when announcing the Putzmeister deal in January, Sany stated that Germany would become its new headquarters for concrete machinery outside China. The country’s largest bulldozer-maker, Shandong Heavy Industry Group, also said this year it would keep the management and production base of its latest acquisition Ferretti in Italy, to build up its technological know-how. Globally ambitious Chinese firms are realising that the value of acquired assets lies not only in patented technologies, but also in the intrinsic value a company possesses in its management and employees. Likewise, with employment sagging in Europe, Chinese moves to retain jobs are welcomed and will likely make regulatory approval easier.

Political and corporate hurdles

Chinese companies have their own unique hurdles when attempting to make acquisitions abroad, often dealing with unfavourable political environments which adds another obstacle for Chinese companies to win bids, even if cash is not an issue. In one of the most cited cases of strong government opposition to potential Chinese takeover, in 2005, CNOOC withdrew its USD 18.5 billion bid for Unocal due to strong opposition from US government regulators and politicians. Looking back, among other factors, the failure of the case could be attributed to a relative lack of diplomacy and common understanding between the two countries at that time, which made it nearly impossible for the Chinese government and companies to drum up reputable counter arguments to stem opposition and address concerns. Nowadays, it can be argued that China’s central government and its leading figures are more versed in the ‘art of diplomacy,’ which often spills over into the business arena. Nowadays, state visits by China’s leaders are accompanied by high-profile trade and investment deals. It can be argued that environmental changes are also making it easier for Chinese companies to seal attempted deals overseas. For example, CNOOC’s recent investments are now aligned with global efforts to curb greenhouse gas emissions and also reiterate the U.S.-China Shale Gas Resource Initiative announced in 2009, a policy which simply did not exist four years prior.

At the corporate level, the major hurdle for potential Chinese investors is that some foreign companies have blatantly showed an unwillingness to transfer technologies or brands to Chinese companies, in a futile attempt to retain long-term competitiveness. For example, the planned purchase of Swedish car maker Saab by China’s Pangda Automobile Trade Co. Ltd. was aborted after General Motors Co blocked the deal. Likewise, historically, the engineering expertise and strong brands of German Mittelstand companies are highly attractive to potential foreign buyers but tight family control has been a barrier to widespread Chinese takeovers in Germany. Nonetheless, in addition to Sany’s recent purchase, other German Mittelstand companies now in Chinese hands include Waldrich Coburg (Beijing No. 1), a maker of milling machines, and Dürrkopp Adler (Shang-Gong Group), a maker of industrial sewing machines, which suggests the notion that once reluctant overseas investors are warming up to Chinese investors. In addition to shifting perceptions and attitudes, Chinese companies are beginning to circumnavigate these prejudices by buying the foreign assets of other companies, a trend which can clearly be seen in recent Chinese deals throughout Latin America.

A sign of things to come

Relative to the size of its economy, China’s overseas investments remain quite modest. The total stock of investment abroad rose to 5.3% of China’s GDP in 2011, up from just 2.6% in 2001, but it remains well below the average of 27.7% for OECD countries. Moving forward, Chinese enterprises will not only have the money, but also the motive and opportunity to spend an additional USD 560 billion on overseas investments in the next five years. Chinese companies are taking advantage of the crisis, acquiring strategic assets overseas which will empower them to move toward the frontier of global competition. Additionally, the People’s Bank of China recently released the most detailed public proposal yet for loosening the government’s strict capital controls, a move which will only spur Chinese companies to buy up far more American and European assets, which have become more affordable by the global financial crisis.

However, doing deals with China is complex and can pose special integration challenges for both sides due to cultural, business and political differences. For Chinese companies and their new partners, the key lies in maximising synergies once the above obstacles are overcome. Looking ahead, Chinese companies will have more tools, more experienced and seasoned M&A professionals and a greater overall understanding of the complexity of cross-border M&A processes, a good recipe for success in future Sino-foreign M&A deals.

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