KPMG
cutting through complexity

毕马威全球中国业务
KPMG Global China Practice

China 360

The emergence of Chinese multinational corporations (MNCs): Local and global implications

(This article is based on KPMG commentary *Dancing with the Dragon: The emergence of Chinese multinational corporations and what this means for the rest of the globe*).*

As China's national economy continues to globalize, it is important to see how this is playing out at the corporate level. A number of Chinese companies, both State-owned and private, are successfully internationalizing operations, in many cases in a matter of a few years.

Some firms have pursued overseas listings, some have entered into joint ventures or cooperation agreements with foreign companies, and others have expanded overseas through M&A, Greenfield investment, or other forms of outbound direct investment (ODI). As a result, the global business community is now seeing a new phenomenon: the Chinese MNC.

* http://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Pages/Dancing-with-the-dragon-O-201309.aspx

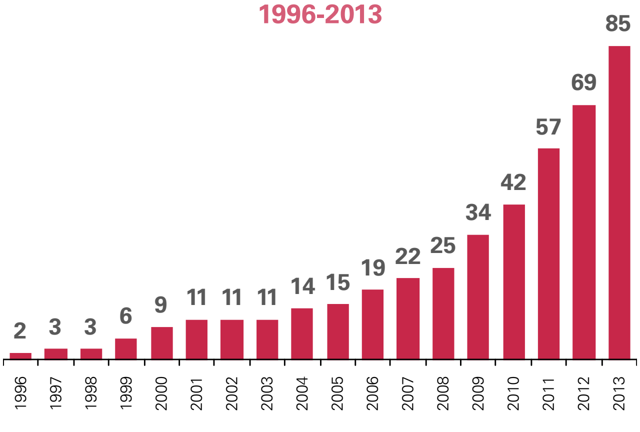
The rise of Chinese multinational companies

Over the last 30 years, as China has pursued policies of economic reform and re-balancing, China's corporations have evolved as well. Large private enterprises have hurtled into being, and even the largest State-owned enterprises (SOEs) have undergone massive change. Many of China's large companies, however, have developed in an environment characterized by strong domestic demand, comparatively low labor and variable costs, and the ability to set market prices due to limited or restricted competition.

These domestic market conditions, and the scale of the Chinese market itself, have helped to propel corporate growth for Chinese companies, with the result that some Chinese companies have quickly risen up the global league tables, to rank among the largest and most successful corporate players in the world.

As can be seen from the chart below, in the past three years alone, the number of Chinese companies in the 'Global Fortune 500' has more than doubled to 85 companies in 2013, versus 42 in 2010. By this measure, China recently overtook Japan, which has 62 companies on the Fortune list, and trails only the US, which still holds the top spot with132 companies.

Chinese Global Fortune 500 Companies, 1996-2013



Source: Fortune China. http://www.fortunechina.com/fortune500/c/2013-07/08/2013G500.htm

Chinese MNCs take advantage of market dynamics

China has long benefited from the flow of foreign direct investment (FDI) demand into the country. In recent years, however, it has been China's outbound direct investment that has garnered attention: ODI represents the willingness and ability of Chinese companies to invest directly in equity and/or assets of foreign companies located outside of China. China, long known as a top investment destination for MNCs, has recently grown its ODI to almost equal the amount it receives in FDI.

This trend started to gain momentum as the global crisis took shape in 2007 and 2008. It was during the global financial crisis, as well as the subsequent European debt crisis, that market prices (both equity and real assets) were pushed downward. Inside China, to mitigate the global financial crisis' impact on China's economy, the government helped lift domestic demand through a variety of stimulus packages, while adjusting policy measures and structural reforms. This helped enable Chinese companies to make purchases at suppressed market prices.

At the same time, the Chinese government has been allowing China's currency, the Renminbi (RMB), to marginally appreciate. Although a stronger RMB has had a clear impact on China's exporters and therefore its net export trade balance, it has also benefited Chinese companies looking to invest outward, by enhancing their purchasing power versus other local currency.

Over the past five years, a combination of factors has provided a tailwind to Chinese companies looking to invest outside of China: they have not only been making investment decisions to buy foreign assets at a time of lower global market prices, but have been doing so with a marginally stronger local currency.

The proof is in the numbers, and the numbers show a clear and sustained trend. China's ODI in the late 1970s was next to nothing, and as recently as 2002, China's ODI was only USD2.7 billion.[1] In just a decade, this figure had grown by leaps and bounds to hit a record USD87.8 billion in 2012,[2] which represents an 18 percent year-on-year increase.

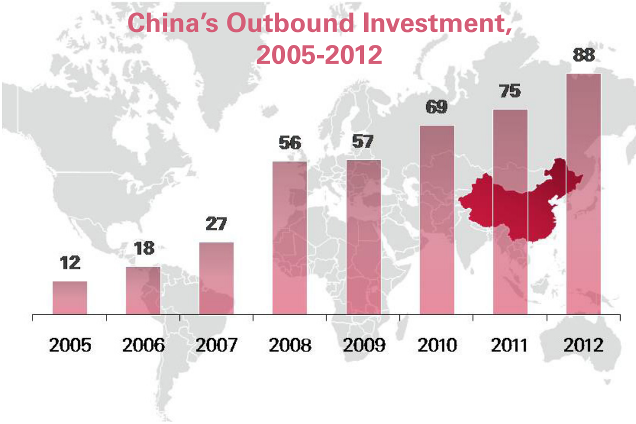
For the first time since its reform, China has become a top 3 outbound investor in global markets.[3] Thus, it is not a matter of 'if' China's ODI will exceed the FDI figure (USD111.7 billion in 2012[4]), but 'when'.

[1] Perkowski, Jack. 'Get ready for more China overseas investment'. *Forbes*, March 10, 2012. http://www.forbes.com/sites/jackperkowski/2012/10/03/get-ready-for-more-china-overseas-investment/

[2] 'China 2012 ODI hits record high'. *Xinhuanet*, September 9, 2013. http://news.xinhuanet.com/english/china/2013-09/09/c_132704494.htm

[3] Wang, Yanlin. 'China among top-3 global investors'. *ShanghaiDaily*, September 10, 2013. http://www.shanghaidaily.com/Business/finance/China-among-top3-global-investors/

[4] 'FDI inflow to China dropped by 3.7% in 2012 to USD111.7 billion, first time since 2009'. *Current Affairs Business News*, January 17, 2013. http://currentaffairs-businessnews.com/2013/01/17/fdi-inflow-to-china-dropped-by-3-7-in-2012-to-usd-111-7-billion-first-time-since-2009/



Sources: *2011 Statistical Bulletin of China's Outward Foreign Direct Investment.* China Statistics Press; 2012 data from the China Ministry of Commerce (*2012 Statistical Bulletin of China's Outward Foreign Direct Investment* remains unreleased at the time of publication)

MNCs with Chinese characteristics

Like earlier waves of fast-growing Asian MNCs from Japan, South Korea and Taiwan, and their contemporaries from India, Brazil and Russia, Chinese MNCs are bound to create an impact on the competitive landscape of the global business world. Competition for talent, capital, resources, consumers, and innovation will become more intense.

When looking at the implication for the rest of the globe, from the ongoing emergence of Chinese MNCs, it is important to remember that most Chinese MNCs have travelled on a different path to get to where they are today. By and large, the top companies in China have had the backing of the State, which means abundant resources, controlled competition, and low variable costs. The same companies that no one outside of China had heard of two years ago, are now making daily headlines on international newswires and even becoming market leaders in their respective fields.

Chinese companies are also choosing diverse industries and sectors to outwardly invest. In the recent past, Chinese companies were known for investing in narrow industries overseas such as engineering and contract projects, energy and power, metals and mining, automotive, and financial services. However, recently Chinese MNCs have been diversifying their reach. Substantial outbound deals have been made in progressive industries such as: consumer goods and services, real estate, or agribusiness industries. For example, Chinese privately-owned enterprise Dalian Wanda Group recently acquired AMC entertainment company in a deal worth around USD2.6 billion, creating the largest theater chain in the world.[5]

Issues and responses for Chinese multinationals

Despite international success stories, some Chinese MNCs have run into international resistance during their M&A transactions. Some of these setbacks can be attributable to local market political resistance, due to lack of corporate transparency. In China's domestic market, these companies may enjoy competitive advantages in terms of access to capital, scale, and de facto monopoly position in certain industries. However, when the focus turns to outbound investment, the ballgame shifts to the firm they are acquiring and the country's rules, restrictions, and transparency arrangements they must abide by.

In addition to the different management style and control characteristics of multinational SOEs, there are some other factors that may hinder the progress of these companies. For example, despite the stellar growth of China's mega companies inside China, they are rarely seen as influential or having strong brands in their respective industries. According to Interbrand's 'Top 100 Brands' list, a Chinese brand has yet to make the list. In contrast, many companies from smaller or emerging economies made the list in 2012, such as Spain's Santander Bank, and Mexico's Corona.[6]

Not only have Chinese companies failed to produce any global leading brands, but Chinese companies were also perceived to lack innovation and creativity. In *Forbes* 'The World's Most Innovative Companies' list, the magazine included only four Chinese companies out of 100 (namely Tencent, China Oilfield Services, Sany, and Zoomlion).[7] In addition, of the 50 companies ranked by *Fortune* as 'The World's Most Admired Companies 2013', none were from China.

[5] Voigt, Kevin. 'China firm buys AMC to form world's largest cinema chain'. *CNN*, May 21, 2012. http://edition.cnn.com/2012/05/21/business/china-amc-wanda-theater/

[6] 'Best Global Brands 2012'. *Interbrand.* http://www.interbrand.com/en/best-global-brands/2012/Best-Global-Brands-2012.aspx

[7] 'The World's Most Innovative Companies'. *Forbes.* http://www.forbes.com/innovative-companies/list/

Although the world has yet to see a truly global 'brand name' from China, Chinese companies are making progress: Gree Electric Appliances is selling its air conditioning products in over 70 countries, while automaker Chery is exporting automobiles to over 50 countries. It is only a matter of time before the world starts recognizing innovative products from China.[8]

Chinese MNCs also lack experience managing a global business. Although Chinese companies may be quite effective at managing their sizable domestic operations, the challenge of running a multinational or global operation requires a different managerial skill set. Some companies simply are not yet 'mentally' ready to be global players; they tend to operate their global business in the same way they manage their domestic business. Managing daily operations overseas, including issues such as working with labor unions in other countries, has proven challenging to Chinese management in the past. In addition, Chinese MNCs have had difficulty bridging gaps in culture, deailing with unfamiliar legal environments, and different compliance landscapes from that of China.

It is likely that Chinese MNCs will make internal adjustments to their operating model, and also explore external-facing strategies, in order to be more effective in running a multinational business. Internal adjustments could include policies to hire or retain local talent to deal with local issues, training that is specific to local country processes, implementing an international rotation program, or setting up an internal government or community relations capability. External-facing strategies may include a systematic process to learn and manage local government expectations of compliance, teaming up with local organizations, such as non-governmental organizations or local community agencies, and bridging culture gaps or mitigating other operating challenges in the local context.

The future of POEs and SOEs on the global stage

Within the next 10 years, the outflow of Chinese overseas investment will touch a wide range of companies, industries, and geographies. Investors will comprise: privately-owned enterprises (POEs) and SOEs. Although SOEs have been behind many of the past 'headline-making' overseas investments, POEs will certainly play a more active role going forward. Compared to SOE companies, POEs are more market driven, flexible, efficient and nimble in decision making, and have clear ownership and incentive structures.

Deal industries will also become more diversified. Despite the continuing wave of large ODI deals in natural resources – oil & gas, coal, iron ore and minerals – future Chinese MNCs are not likely to be from these industries alone. Companies in the energy and resources fields are mainly State-owned, enjoy a monopolistic position in the domestic market, and are tasked with implementing the national strategy of securing resources. By comparison, companies in manufacturing, technology, and services have operated in a competitive environment in the domestic market, and maintain fewer government ties or obligations. They have also developed core capabilities in operations, and accumulated knowledge of the global market by associating with overseas business partners.

Xing Yujing, Secretary-General of China's Central Bank's monetary policy committee notes that "the Central Bank supports the ever-stronger RMB to purchase assets or equity in cross-border transactions", as the currency will offer SOEs and POEs greater global opportunity. In addition, Li Jinzao, Vice-Minister of Commerce, predicted "outbound investment from China will reach USD500 billion in five years"[9]

8 Flannery, Russell. 'China Mobile tops best Chinese brands list'. *Forbes*, July 6, 2010. http://www.forbes.com/2010/07/06/china-top-brands-markets-emerging-markets-omnicom-group.html#

9 'Economy, ODI and currency bring opportunities'. *Xinhuanet*, September 26, 2013. http://news.xinhuanet.com/english/china/2013-09/26/c_132751252.htm

The trend is clear that Chinese MNCs are emerging and making their presence felt all over the world. Whether they will follow the trajectory of MNCs from other countries remains to be seen – it is perhaps more likely that they will build upon their own successes and setbacks, rather than replicate the experience of MNCs from other regions.

Acquiring an understanding of their motivation and behavior will help the global business community better work with them, and create an overall benefit for the global economy. Developing effective strategies to interact and work with these new market participants is critical for the advancement of the world economy; global companies need to rethink their strategy in response to the changes that Chinese MNCs will bring to the competitive landscape.

Contact us

For more information, contact:

Thomas Stanley
COO, Global China Practice
KPMG China
Email: thomas.stanley@kpmg.com
Tel.: +86 21 2212 3884

Robert Ritacca
Research Manager, Global China Practice
KPMG China
Email: robert.ritacca@kpmg.com
Tel.: +86 10 8508 5109

Read on...

For all issues of *China 360:*

Visit www.kpmg.com/cn/China-360
or scan the following QR code: