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Mitchell Silk and Richard Malish

I. Introduction: Go West Young Man

Reminiscent of America’s drive west in search of valuable resources and economic growth, China is pursuing its own manifest destiny with an aggressive outward economic expansion program. The drive spans across many key sectors and touches on virtually every resource-rich country in the world. The drivers behind the program are few and rather simple: China is looking beyond its borders to sate its enormous domestic demands (focusing primarily on energy, minerals and agriculture) and to develop international markets (including distribution and after-market service channels) for its growing manufacturing sector. Spearheading the campaign are a number of increasingly world-class domestic companies. These companies have long held select advantages to their foreign competitors, including access to cheap labor and benefits bestowed by the state, that have allowed them to grow competitive internationally. And over the last few years, Chinese government policy has actively encouraged the global ambitions of China’s corporations and banks. Chinese companies are dominating global exports and a number are starting to purchase significant stakes in foreign assets and reputable foreign companies.

Yet despite the vast potential of Chinese companies to compete globally, there exists an equal number of systemic issues which have hampered Chinese growth. Companies are still held back by issues such as bureaucratic red tape and corruption, a lag in management and international experience and a growing distrust by foreign targets. Banks are hindered in their own growth and in fully assisting the global drive by problems such as non-performing loans and internal

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† The Chicago Journal of International Law expresses no opinion as to the accuracy of this Article’s Chinese citations and references.
restructuring. The resolution of these issues will tell us not whether Chinese companies will take over the world, but when.

II. CHINESE COMPANIES COME OF AGE

The rise of Chinese companies comes during a time of unparalleled growth for the country. China’s economy grew by a top-ranking average 9.9 percent between 1993 and 2004.\(^1\) It accounts for 4 percent of the world economy and its foreign trade is worth $851 billion, the third largest national total in the world.\(^2\) China is predicted to become the world’s biggest economy by purchasing-power-parity as early as 2017.\(^3\)

Fueling China’s growth are a number of national champions\(^4\) ready to compete with blue-chip multinationals in cost and technology. This select few own vast assets, generate healthy profits and many have successfully listed subsidiaries on New York and other top-tier exchanges. Sixteen of these companies made the 2005 Fortune Global 500, an annual list of the world’s leading firms based on revenue, the most of any developing economy.\(^5\) Chinese companies benefit from a high level of research and development, a rapidly growing, but still inadequate, infrastructure of roads, ports and telecoms networks (reducing transaction costs and turnaround times) and an educated and low-cost workforce.\(^6\) The main order of the day for these companies is to digest a great deal of modern technology and make their way up the steep learning curve of acquiring the management skills necessary to compete domestically and globally.

Growing pains notwithstanding, Chinese companies have become sought-after partners for multinational companies. Chinese partners have used these

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5. *Fortune Global 500*, Fortune, available online at <http://money.cnn.com/magazines/fortune/global500/countries/C.html> (visited May 15, 2006). The list runs the gamut of industries, such as old economy companies China First Automotive Works and Shanghai Baosteel Group, China Mobile Communications, China Telecommunications, trading giant COFCO and financial companies such as China Life Insurance and the “Big Four” state-owned commercial banks.
6. Ted C. Fishman, *How China Will Change Your Business*, Inc. Magazine 70, 76 (Mar 2005). China’s research and development expenditures rank third only to the US and Japan, which is extraordinary given the difference in purchasing power.
joint ventures as a platform to develop their own capabilities, cultivate management skills and learn basic international standards. For example, China's semiconductor industry has grown through joint ventures, resulting in the gap between US and Chinese manufacturing technology narrowing from between 7 to 10 years in 1986 to 2 years or less.\(^7\) China can now produce chips that are only one generation behind current technology. Ningbo Bird Company, one of the few private success stories, started out as a contract manufacturing supplier for Motorola and now rivals Motorola in the Chinese cellular handset market. Shanghai Automotive Industry Corporation ("SAIC"), joint venture partner to both General Motors and Volkswagen, plans to sell its own cars in China by the end of 2006 and to export cars to Europe in 2007. SAIC asserted the relocation of technical and R&D facilities along with manufacturing plants to China has "furnished China with conditions and opportunities to independently develop its own international brands."\(^8\)

Chief among China's champions are its oil majors: China National Petroleum Corporation ("CNPC," widely known through its subsidiary PetroChina), Sinopec and Sinochem, each Fortune Global 500 companies, and China National Offshore Oil Corporation (oftentimes operating through its Hong Kong-listed subsidiary, CNOOC Ltd. ("CNOOC")). Each successfully carried out initial public offerings between 2000 and 2002, raising billions of dollars in foreign capital. They have entered into a number of multi-billion dollar joint ventures with foreign competitors. In a sign of growing independence, CNPC recently dropped plans for substantial foreign equity participation in its $18 billion trans-China natural gas "West-to-East pipeline" in 2005. Seeing foreign investors' demands as too onerous, CNPC decided to carry out the project itself.\(^9\)

Chinese competitors have also carved out niche markets in developed countries. TCL Corp is the world's largest TV maker by production volume.\(^10\) Galanz manufactures one out of every three microwave ovens in the world.\(^11\) Haier, a white-goods manufacturer, has offices in more than 100 countries, overseas revenues of more than $1 billion and has carved out more than 50

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\(^8\) Keith Bradsher, Chinese Partner of GM and VW to Offer Its Own Cars, NY Times 6 (Apr 11, 2006).


percent of the US compact refrigerator market and 11 percent in freezers.\textsuperscript{12} Despite the higher costs, it has established twenty-two overseas factories, including one in South Carolina, to avoid anti-dumping fines.\textsuperscript{13} The impressive list goes on.

Not only are Chinese companies investing heavily in overseas production, but they are beginning to snap up established companies in developed countries as well. China’s outbound direct investment (“ODI”)\textsuperscript{14} was $6.9 billion in 2005 and it is predicted to grow by 22 percent a year up to 2010.\textsuperscript{15} By the end of 2004, over five thousand Chinese enterprises had invested directly in nearly two hundred countries or regions.\textsuperscript{16}

Lenovo Group, for example, acquired IBM’s PC business in 2004 and introduced its first eponymous-branded computers into the US consumer market in 2006.\textsuperscript{17} The oil giants have been some of the most active players. In 2005, CNOOC purchased a $2.3 billion stake in an oil and gas field in the Nigerian delta.\textsuperscript{18} In the same year, CNPC acquired PetroKazakhstan, a Canadian-listed company operating in Kazakhstan, for $4.18 billion, the largest overseas acquisition ever by a Chinese company.\textsuperscript{19} China is also investing heavily in oil and mineral assets in Latin America.\textsuperscript{20}

\begin{footnotesize}
\begin{enumerate}
\item Haier ‘Local Resources’ Are Key Overseas, Bus Wk Online (Nov 8, 2004), available online at <http://www.businessweek.com/magazine/content/04_45/b3907008.htm> (visited May 15, 2006).
\item Foreign direct investment (“FDI”) is comprised of equity investment, reinvested earnings (earnings not distributed as dividends and earnings of branches not remitted to the direct investor) and intercompany debt transactions. FDI originating in China and directed outside of the country is herein referred to as outbound direct investment (“ODI”).
\item See Jamil Anderlini, \textit{Showing the World China’s Can-Do Spirit: Lenovo Stunned the Market with What It Could Do with IBM’s PC Business}, South China Morning Post 1 (Apr 21, 2006).
\end{enumerate}
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The growth of these Chinese companies is so substantial that multinationals are now shaping their business plans to counter the China threat. Managers are reading books on how to learn from China’s growth while manufacturers and service providers are outsourcing to China to benefit from its competitive advantages. Others are bracing themselves against the storm. In one example, the planned merger of telecommunications equipment makers Alcatel and Lucent may be driven by the growing threat of Chinese upstarts Huawei Technologies Co. (“Huawei”) and ZTE Corp.21 If Chinese companies are not taking over the world, non-Chinese companies now recognize that they are certainly a force to be reckoned with.

III. STATE SUPPORT FOR GLOBAL EXPANSION

The largest overseas acquisitions have aimed to lock in long-term supplies of strategic resources.22 China’s domestic consumption is growing at astounding rates, and Beijing has adopted a mercantilist energy-security policy, attempting to secure reliable sources of natural resources such as oil, natural gas, metals, ores and coal for domestic use. A key hallmark of the policy is for national oil companies to gain access to overseas oil and gas resources. These companies are also encouraged to outsource operations in order to reduce pollution, preclude surplus capacity and promote international distribution.

Another significant factor driving Chinese companies to expand their global footprint is the acquisition of corporate infrastructure necessary to expand in key markets or to find new markets and grow their business, often due to loss of domestic market share.23 For example, Lenovo’s decision to buy IBM’s computer unit resulted from steady encroachment by foreign brands such as Dell into its domestic market.24 Haier’s 2005 bid for US–based Maytag was an attempt to further penetrate the US market as part of their already successful global campaign. Chinese companies are also looking for brand recognition and

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23 According to a 2003 survey of China’s fifty largest “industry-leading” firms, over 50 percent listed seeking new markets, especially as a result of competitive pressures from multinational competitors, as the overriding imperative for ODI. 20 percent were looking outward to “secure natural resources,” and 16 percent specified “obtaining key technology” as the critical reason for making international acquisitions. Id, quoting a survey from Roland Berger Strategy Consultants.
access to international distribution. By acquiring Thomson’s-RCA’s TV line and Alcatel’s cell-phone business, TCL now owns Western brand names, distribution networks in Europe and a bundle of Western technology.

Beijing is playing a major role behind the scenes to support these efforts, both preparing the nest to hatch an ensemble of national champions to accomplish these tasks and rearing them to spread their wings globally.

A. NATIONAL CHAMPIONS

Like most developed states at some point in their development China has an industrial policy which encourages the growth of a number of globally competitive “national champions.” Japan had keiretsu and South Korea had chaebol, both private conglomerates nurtured by strong government agencies. However, Beijing, wary of a powerful private sector, has nurtured state-owned enterprises (“SOEs”), which today are believed to account for about one-third of China’s economy.

SOEs enjoy a range of benefits from their majority shareholder—chief among them being monopoly status and profitable government contracts. Other benefits include information sharing networks, domestic tax breaks, cheap land and preferential access for public listing. Lenovo received technical assistance for its PCs and servers from the more than fifty-eight thousand staff of its former majority parent, the Chinese Academy of Science. Some SOEs have received support for global campaigns to recruit top executives and assistance with corporate matchmaking. Consequently, ODI by SOEs comprised 43 percent of total ODI by the end of 2003.

25 As of 2005, China had still not placed in Business Week’s list of the world’s top 100 brands, although Haier has ranked in a list maintained by World Brand Laboratory. Top 100 Global Brands Scoreboard, Bus Wk Online (2005), available online at <http://bwnt.businessweek.com/brand/2005> (visited May 15, 2006); Haier Listed in World’s Top 100 Recognizable Brands, China Daily (Feb 3, 2004), available online at <http://www.chinadaily.com.cn/en/doc/2004-02/03/content_302645.htm> (visited May 15, 2006).


27 Frederik Balfour, The State’s Long Apron Strings, Bus Wk 76 (Aug 22, 2005); see Chinese Academy of Sciences, Fact Sheet, available online at <http://english.cas.ac.cn/eng2003/page/about_03.htm> (visited Feb 18, 2006).

28 Sun Min, Foreign Talent to Help Upgrade SOEs, China Daily (June 25, 2004), available online at <http://www.chinadaily.com.cn/english/doc/2004-06/25/content_342426.htm> (visited Feb 11, 2006). For example, when Arcelor, Europe’s top steelmaker, and Tokyo-based Nippon Steel were looking to invest in China, Beijing led them to Baosteel, which needed technological assistance making high-grade steel for car manufacturing. The result is a $785 million state-of-the-art plant in Shanghai that will churn out 1.2 million tons annually of cold-rolled steel for the auto industry. Balfour, The State’s Long Apron Strings, Bus Wk at 76 (cited in note 27).
However, many SOEs are less efficient than their global competitors. They operate in order to maintain social stability, maintaining employment and providing benefits to current and former employees. The economic losses of SOEs rose 56.7 percent to $12.75 billion in 2005, a 16-year high growth rate.\(^2\)

Aware of the burden many SOEs place on the economy, Beijing initiated a process of restructuring in 1998 under the doctrine of “grasp the big, let go the small” (zhuada fangxiao; 抓大放小), focusing its support on and encouraging the consolidation of China’s biggest and best companies.\(^3\) This policy was later refined when the State-Owned Assets Supervision and Administration Commission (“SASAC”) was established in April 2003 as a holding company for large SOEs such as CNOOC’s parent company and nearly 190 other Chinese enterprises. SASAC was given the task to build thirty to fifty of its best SOEs into “national champions,” or globally-competitive multinationals, by 2010. To accomplish this task, SASAC is forcing some of the enterprises under its supervision to merge or transfer assets and is allowing some listed SOEs to transfer part of their state-owned stakes to foreign or domestic strategic investors.\(^4\) Many of the Chinese companies which are making global headlines are beneficiaries of these efforts.

B. GOING GLOBAL

During the early years of the Communist era, China’s central government directly funded all investments in what has been called the “Investment System.” The Central Government was, understandably, focused on major challenges in domestic economic development. To the extent foreign economic issues became relevant, it was more in the area of directing and regulating foreign direct investment (“FDI”) into China, of which there was considerable activity.\(^5\) Yet the Central Government saw outbound investment as secondary and wielded

\(^{29}\) SOEs' Losses Climb 56.7% to US$12.75b, Xinhua Shanghai Daily (Mar 27, 2006), available online at <http://www.shanghaidaily.com/art/2006/03/28/255045/SOEs_039__losses_climb_56_7__to_US_12_75b.htm> (visited Mar 27, 2006).

\(^{30}\) See We Are the Champions, Economist at 12 (cited in note 4).

\(^{31}\) Id. See also SASAC Announces Five Measures to Promote China's SOE Reform, People's Daily (Nov 20, 2003) available online at <http://english.people.com.cn/200311/20/eng20031120_128595.shtml> (visited May 26, 2006).

\(^{32}\) China has gradually opened the door to FDI since the Reform and Open Door Policy was promulgated in 1978. FDI was initially limited to Special Enterprise Zones in select coastal cities. Foreign enterprises were granted preferential treatment, although repatriation of profits was limited. The second phase of the open door policy lifted the ban on foreign capital investment in certain domestic enterprises and loosened the ban on profit repatriation. Tariffs have been reduced throughout this period. The momentum towards greater access continued this decade with membership in the World Trade Organization resulting in the standardization of a large number of China’s laws and regulations and the prospect of further tariff reductions.
control on a piecemeal basis from 1979 until the early 1980s as the State Council
gave case-by-case approval of the few outbound investments. The Ministry of
Commerce’s (“MOFCOM’s”) predecessor agency attempted to create a
standardized procedure for outbound investment by enacting regulations in the
1980s, but a string of state asset losses in Hong Kong real estate and stock
market speculation kept the door from swinging open.33

As Chinese companies established themselves locally, Beijing developed a
policy of zuo chuqu, or go out, often translated as “Go Global.”34 The policy
encourages Chinese companies with comparative advantages to engage in ODI
and acquisitions in a more active manner and enhance their international
competitiveness. Go Global also complements the government’s desire to
relieve inflationary pressures on the renminbi by investing foreign reserves
abroad.35

A number of regulations have been passed to facilitate the Go Global
policy. As China’s currency is not yet freely convertible, measures to facilitate
foreign exchange have been crucial. One of the first regulations to facilitate ODI
was a 2003 circular authorizing certain trial provincial-level State Administration
of Foreign Exchange (“SAFE”) branches to provide final foreign exchange
approval for investments under $3 million (other provincial level offices were
limited to investments under $1 million) and to approve the transfer of
performance deposits and other early stage funds.36 In addition, companies no
longer needed to receive final approval for the transaction before the
performance deposit could be transferred. In early 2005, China increased the
total amount of foreign currency Chinese companies can buy each year for ODI
purposes to $5 billion from the earlier limit of $3.3 billion and SAFE has
announced its attention to eventually eliminate this quota.37

Until 2004, all ODI was subject to examination and approval by the
National Development and Reform Commission (“NDRC”) and MOFCOM in

33 See Zhang, Going Global at 6 (cited in note 16).
34 See Mure Dickie, Starting a Walk on the Wide Side, FT.com (Oct 18, 2005), available online at
<http://news.ft.com/cms/s/94015e54-3fc4-11da-8394-00000e2511c8,dwpuuid=ebc4eb46-
3fc3-11da-8394-00000e2511c8.html> (visited Feb 18, 2006).
35 The renminbi (abbreviated “RMB”) is the official currency of the People’s Republic of China. The
base unit is the yuan.
36 State Administration of Foreign Exchange, Issues Relevant to Further Intensifying the Reform
of Foreign Exchange Administration on External Investments Circular (关于进一步深化外汇管理改革有关问题的通知) (Oct 15, 2003), available online at
37 China’s Direct Investment Overseas Rises to $6.9 Bln, China Daily (Jan 23, 2006), available online at
<http://news.xinhuanet.com/english/2006-01/23/content_4088906.htm> (visited Feb 11,
2006).
A procedure that had not advanced far from the early days of the Investment System. The authorities would examine detailed information about the commercial value, financing arrangements, feasibility and even the technological aspects of each proposed transaction. In the earlier waves of ODI, this approval process was quite cumbersome and introduced a degree of uncertainty in terms of transaction management. Such uncertainty translated into completion risk in the eyes of foreign sellers and worked against Chinese buyers in competitive bids.

In recognition of the importance of certainty in the process and timing as a means to bolster the Chinese corporate’s competitive edge, the State Council issued the Reform of the Investment System Decision in July 2004, which dramatically reformed the process for ODI. Government scrutiny is now generally restricted to investments involving government financing. All other investments are subject to a simplified approval or registration system. Investments subject to the approval system are only required to submit an application report and scrutiny is limited to strategic issues such as economic security, anti-monopoly, utilization of natural resources, environmental protection and the public interest. Experienced sellers now consider completion risk due to Chinese domestic oversight to be a much less significant factor in weighing a Chinese offer. The Chinese legal position is a clear showing of legislator pragmatism in order to bolster Chinese bidder competitiveness.

Another level of support has come in the form of information and guidance. For example, in July 2004, MOFCOM and the Ministry of Foreign Affairs jointly issued the Countries and Industries for Overseas Investment Guidance Catalogue. This Catalogue sets out a list of preferred industry sectors in sixty-eight countries shaped both by Beijing’s impressions of previous endeavors and perceived prospects for future success. Preferred investments benefit from a broad range of incentives offering priority access to financing and foreign exchange, tax concessions and preferential customs treatment. MOFCOM is also establishing an information bank for Chinese enterprises which intend to expand overseas.

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39 Transactions subject to the approval system are detailed in the Catalogue of Investments Subject to Government Approval.


41 Id.
Beijing has also actively promoted Chinese investment on high-level diplomatic missions and has helped Chinese companies secure contracts or exploration rights abroad. China has signed bilateral investment treaties with 113 countries and double taxation treaties with 75 countries. It has also played matchmaker for Chinese companies and their global suppliers and consumers. For example, some four hundred agreements and business deals were signed during Chinese President Hu Jintao's trip to Brazil, Argentina, Chile and Cuba in November 2004. President Hu announced plans to invest $100 billion in Latin America over the following ten years, with $8.5 billion earmarked for Brazil in port, railway, oil, steel and aviation projects and $19.7 billion earmarked for Argentina in railway, oil, gas and construction projects. Several of these agreements have already begun to bear fruit. For example, a preliminary $1 billion agreement between Brazil's state-run oil company Petrobras, the Export & Import Bank of China ("China EXIM") and Sinopec to finance the construction of the Gasene natural gas pipeline in Brazil developed into a formal $239 million agreement in April 2006 for the construction of an initial stretch of the pipeline.

These reforms are the tip of the iceberg and many more reforms are needed to allow Chinese companies to invest abroad with the same ease as companies in the US or other open market economies. Beijing has recognized

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43 See Sun Min, Foreign Talent to Help Upgrade SOEs, China Daily (cited in note 28).


45 Brazil, China Sign Gas Pipeline Deal, Associated Press (Apr 18, 2006); Juliette Kerr, Petrobras Signs Pipeline Contract with Sinopec, Global Insight (Apr 18, 2006). In addition, China announced after the trip that it would invest more than $500 million in Cuba's nickel industry, pursuant to which China Minmetals is currently pursuing a joint venture in the country. Frances Robles, Trade between Cuba and China Soars, Miami Herald 1 (Jan 8, 2006); Eric Ng, Minmetals Closes in on Cuba Project, South China Morning Post 1 (Sept 9, 2005). CNPC committed to spending a further $400 million in developing Venezuelan oil and gas reserves as a result of Venezuelan President Hugo Chavez's visit to Beijing in December 2004 and Chinese Vice-President Zeng Qinghong's visit to Venezuela in January 2005. Congressional Research Service, China's Growing Interest in Latin America 3-4 (Apr 20, 2005), available online at <http://fpc.state.gov/documents/organization/45464.pdf> (visited May 15, 2005).
the task and has affirmed that in the future, the Chinese government "will provide more beneficial conditions for Chinese enterprises to 'go global.'"46

IV. FINANCING GLOBAL EXPANSION

In addition to incentives and non-financial support from the government, Chinese companies have also benefited from access to Beijing's coffers, either through favorable lending by Chinese banks or direct contribution of capital. For example, in its bid for Unocal, CNOOC would have received a $7 billion intercompany loan from its state-owned majority shareholder consisting of a no-interest $2.5 billion bridge loan to have been refinanced through the sale of shares in two years and a 3.5 percent-interest $4.5 billion loan with a 30-year tenor.47 Furthermore, no interest would have been due if CNOOC's credit rating fell below investment grade, contrary to normal market standards.

Under China's planned economy, Chinese banks have traditionally met government policy goals by financing the operations of SOEs, regardless of their profitability or risk.48 The US–China Economic and Security Review Commission ("USCC"), a congressional agency established specifically to investigate and report on the national security implications of trade and the economic relationship between the two countries, argues that these credits "amount to a massive government subsidy for Chinese firms" and that China's $875 billion in foreign reserves, accumulated in large part due to Beijing's long-standing trade surplus with the US, can be used to finance acquisitions abroad.49


47 See John Bishop, CNOOC Using Cash, Loans in Unocal Bid; Goldman/JPMorgan Offer Bridge, Forbes.com (June 23, 2005), available online at <http://www.forbes.com/finance/feeds/afx/2005/06/23/afx2107339.html> (visited May 15, 2006). Inter-company loans are common means of increasing liquidity among corporate group members and typically involve loans from a parent to an affiliate so the latter can either expand an existing facility or make a strategic acquisition. Bridge loans are short-term loans to cover immediate cash requirements, usually lent at a premium, until permanent financing can be arranged.


CNOOC has taken the hardest direct beating for its $6 million bridge loan from state-owned Industrial and Commercial Bank of China ("ICBC"). The loan was even attacked in US Congressional resolutions against the transaction, although there is evidence to suggest it would have been provided at market rates.\(^5\)

Soft credit, driven by lending by China’s state-owned commercial banks ("SOCBs") and policy banks, has always been critical to meeting the ongoing cash requirements of SOEs and is a growing factor in financing global acquisitions. As these banks continue to restructure, harmonize their corporate governance and risk management with international standards and become more experienced in international transactions, they will enhance the competitiveness of China’s global development.

A. STATE-OWNED COMMERCIAL BANKS

Due in large part because of restrictions in the capital markets, Chinese enterprises continue to rely overwhelmingly on commercial banks for their financing needs. The Big Four—ICBC, China Construction Bank ("CCB"), Bank of China ("BoC") and Agricultural Bank of China—currently provide 70 percent of commercial bank financing.\(^5\) Each is a Fortune Global 500 company and each is ranked among the top fifty world banks.\(^5\) BoC recently became the largest bank in Asia, after a large capital injection by Beijing and has 560 overseas offices in 25 countries and regions.\(^5\) ICBC is China’s largest bank by assets and its upcoming Hong Kong IPO, estimated to be worth $10–15 billion, may be the world’s biggest in seven years.\(^5\) CCB, which focuses on infrastructure, recently pulled off a successful $9.2 billion IPO, the world’s  


51 Economist Intelligence Unit, China Finance: Bank Binge Brings Mixed Prospects, Asia Alert (Mar 20, 2006).


largest ever for a bank at the time.\(^5^5\) Meanwhile, the activities of foreign banks in China have been limited in order to protect and nurture the Big Four and other domestic banks. For example, ICBC has some thirty-seven thousand branches and sub-branches across the country, while HSBC, the foreign bank with the largest presence in China, has only twelve branches and eight sub-branches. The assets of all 247 foreign banks still only amount to 1.6 percent of China's total banking assets.\(^5^6\)

The Big Four were originally established in 1984 when China split its monobank system into a central bank, the People's Bank of China's ("PBOC"), and the Big Four as policy-commercial banks. The Big Four assumed the state function of funding SOEs and were essential in assisting the SOEs provide employment and maintain social stability.

In 1995, the new commercial bank law permitted commercial banks to make their own decisions regarding their business operations and conduct business operations without interference from any unit or individual; however, the law simultaneously made clear that SOCBs must lend according to the needs of the national economy, social development and the state's industrial policy.\(^5^7\) During the same year, for example, PBOC directed the Big Four to issue 66 percent of their loans to SOEs, thereby preventing the allocation of such capital to more profitable ventures.\(^5^8\) Later reforms, which included requiring commercial banks to make loans on a commercial basis and banning local governments from influencing their lending decisions, were quickly undermined when the central bank directed the banks to continue to extend loans to SOEs.\(^5^9\) The central bank concurrently retained its ceiling on lending rates. Without

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\(^5^6\) Id.
flexibility on pricing, banks preferred to lend to large, often state-owned, enterprises with relatively established credit records.\textsuperscript{60}

Consequently, banks have invested in uneconomic infrastructure projects and inefficient SOEs which were driven more by the desire to keep people employed than for a return on investment. The country uses $5 of fresh capital for each $1 of additional output it produces, a ratio that is far worse than Western countries and even emerging economies such as India.\textsuperscript{61} While these soft credits have helped boost, or keep afloat, the Chinese economy, they have burdened the Chinese banking system with an estimated $900 billion in non-performing loans ("NPLs")—almost double official estimates and more than the country's $875 billion in foreign reserves.\textsuperscript{62} Many more loans yield only negligible returns. It is estimated that China's GDP would be a staggering $320 billion, or 16 percent, higher if SOCB lending habits improved: $60 billion from cutting costs, improving electronic payment systems and developing bond and equity trading, and the remaining $260 billion from redirecting loans to more productive parts of the economy.\textsuperscript{63}

Despite these inefficiencies and risks in the domestic market, SOCBs have leveraged on their own growing liquidity strength as well as the restrictions on foreign banks to gain experience in large international financings. For example, when capital requirements to meet China's voracious key construction development demand (including power generation, water treatment and supply, petrochemical and transportation) outstripped supply from the foreign capital markets in the mid-1990s, SOCBs stepped up to provide financing both in local currency and later in foreign currency.\textsuperscript{64} In time, Chinese banks began to dominate the US dollar credits in domestic financings.\textsuperscript{65}

\textsuperscript{60} A Stride Toward a Market Oriented Interest Rate Regime, People's Daily Online (Nov 3, 2004), available online at <http://english.people.com.cn/200411/03/eng20041103_162646.html> (visited Feb 11, 2006).

\textsuperscript{61} A Great Big Banking Gamble—China's Banking Industry, Economist 93 (Oct 29, 2005).


\textsuperscript{64} The first notable appearance was in project financing of the Shandong Zhonghua Power Project, where the local banks extended the yuan equivalent of $822 million of total credits of around just
Before long, SOCBs began chasing overseas financings. These credits are perceived to be less risky than domestic financings, thereby taking pressure off the banks' NPL ratio. While ICBC's proposed loan to CNOOC was the most contested of such financings, it was certainly not the first or last to assist Chinese companies go global.

China's commitment under its World Trade Organization membership to remove barriers to foreign investment in its financial sector by 2007 is provoking a seismic shift for the SOCBs which will further have dramatic effects on their global competitiveness. Beijing has invested heavily in the Big Four to prepare them for the shock and make them internationally competitive. Since 1998, Beijing has injected more than $260 billion of its reserves to recapitalize the Big Four and has transferred some $330 billion worth of NPLs out of these banks into specialized asset-management companies.66

Their transformation into joint stock companies and subsequent IPOs will subject the Big Four to greater transparency, tighter supervision and closer scrutiny by regulators and public shareholders. And although the majority of China's local commercial banks are a long way from going public, most have independent directors, have installed better shareholding and incentive structures involving some market discipline, have adopted new risk management systems and have tried to eliminate the conflicts of interest by separating the roles of making and approving loans.67 It also appears that Beijing is trying to reduce the Communist Party's political influence in financial sector regulatory agencies, the PBOC and the major SOCBs.68

Furthermore, many Chinese banks, including all of the Big Four, have brought in foreign "strategic investors" as shareholders. Overseas investors poured $18 billion into the Chinese banking system between late 2004 and 2005.69 The majority of foreign investors are capable of adding bank management experience and technology and improving the credit culture of Chinese banks.70 The Big Four will more easily achieve global supremacy with

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65 Id.
66 A Great Big Banking Gamble, Economist at 93 (cited in note 61).
69 Chi Lo, China's Banking Reform (cited in note 67).
70 For example, Bank of America has sent fifty senior staff to train staff at CCB, in which Bank of America holds a 9 percent stake, and it is reported that ICBC stakeholder Goldman Sachs has
the help of and through cooperation with these international banks which blazed the path before them.

B. POLICY BANKS

Besides the SOCBs, Chinese companies are able to take advantage of favorable financing from China’s policy banks. China formed three policy banks in 1999 as a part of the restructuring of its banking system: China Development Bank (“CDB”) focuses on infrastructure and financing; China EXIM specializes in trade finance; and the Agricultural Development Bank provides funds for rural development. The policy banks accounted for 14 percent of banking assets at the end of 2003.

Despite their primary policy mandates, the policy banks have also stepped into the international financing arena. Both CDB and China EXIM have recently committed to providing easier credit for enterprises going global. CDB provides some projects, such as those that employ Chinese workers or use domestic equipment, with an even lower interest lending rate. In November 2004, NDRC and China EXIM announced that China EXIM would earmark a special portion of the bank’s budget for ODI in some key overseas projects together with at least a 2 percent interest rate discount. China EXIM may also extend the loan period, reduce, or even exempt guarantee funds (generally required to make sure the companies will repatriate their profits back to China) for those enterprises. In 2005, China EXIM received a substantial capital injection to support the bank


Policy banks exist in many countries and assist in macro-economic planning by providing long-term credit at favorable rates by using government reserves.

John Thompson, Governance of Banks in China, in Governance in China ch 13, § 3.3.1, Org for Econ Coop and Dev (2005), available online at <http://www.bergarno.cisl.it/repository/edtde/files/OBJ0000841.pdf> (visited Feb 13, 2006).

Notice concerning the policy on providing credit and loan support for key overseas investment projects encouraged by the State (关于对国家鼓励的境外投资项目给予信贷支持政策的通知), jointly issued by SDRC and ETB on Oct 2, 2004, available online at <http://www.ndrc.gov.cn/zcfb/zcfbtz/zcfbtz2004/t20050613_7160.htm> (NDRC website; Chinese) (visited Feb 11, 2006). The four types of projects that can receive interest-subsidized loans are: (i) overseas development projects that can supplement energy resources; (ii) overseas manufacturing and infrastructure projects that can support the export of domestic technology, products, equipment and labor; (iii) overseas research and development projects that will utilize advanced global technology, managerial skills and talents; and (iv) overseas M&A projects that will enhance enterprises’ international competitiveness and help them develop international markets.

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in these efforts. A China EXIM insider has stated that the bank makes its own credit decisions: “We abide by the principle of independent decision-making and the NDRC does not interfere.” However, where a project is supported by the government, China EXIM may receive interest subsidies from its direct parent, the Ministry of Finance, for loans extended below its own cost of funding—which is more explicit support than that provided to any of the SOCBs or other policy banks.

Well-established companies such as Huawei and newcomers such as Qirui Automobile Co. Ltd. (which plans to enter the US automobile market under the name Chery) have benefited from this more direct form of Chinese financial support. CDB has also penned strategic partnership agreements with a number of SOEs and has committed to provide $8.6 billion in loans for seventeen overseas investment projects. Despite the increasing independence and commercialization of the SOCBs, it is clear that the policy banks are ready to step in and continue to promote the Go Global policy on favorable terms.

V. WHY HAVEN’T THE CHINESE TAKEN OVER YET?

Chinese companies have been spoiled by their parent. They enjoy state welfare, a favorable domestic policy environment and have $875 billion in foreign exchanges reserves at their disposal. Foreign companies have reason to be concerned over the new kids on the block. But despite these favorable conditions for global supremacy, Chinese companies still face numerous domestic and foreign hurdles that stand in the way of their achieving their fullest economic potential.

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74 China Increases Reserves for ‘Go Out’ Plan, Asian Wall St J (July 12, 2005).
76 S&P Rates Exim Bank of China’s Planned Global Notes BBB+, Dow Jones (July 4, 2005).
78 Zhiming, Further Liberalization Key, Caijing Magazine (cited in note 75).
A. BEIJING HAS NOT DONE ENOUGH

Despite China's recent history of a planned economy, including well-designed incentives for FDI into China, China has been relatively hands-off in promoting outbound investment. A number of reforms enacted to encourage ODI have simply dissolved onerous barriers to investment held over from the days of the Investment System. One government official has admitted that "[g]overnment policy, notably 'going global' and its related incentive measures as a push factor, influence Chinese companies' ODI decisions only as a secondary factor."79 The chairman of ZTE has even criticized the lack of state support.80

Part of this insouciance stems from the lack of an absolute mandate for any of China's bureaucratic arms. Unlike Japan's powerful Ministry of International Trade and Industry, Beijing's has never bestowed the power to effectively coordinate ODI to one ministry. NDRC, MOFCOM, SASAC, SAFE and, for financial institutions, CBRC continue to manage ODI at some level. Each has an incentive to continue to regulate ODI in order to participate in the celebrated campaign to Go Global, resulting in multiple layers of sometimes contradictory regulations. For example, in October 2004 NDRC issued rules which prohibit Chinese legal entities from signing definitive agreements until they have obtained NDRC approval, making such conditional bids less attractive to targets than competitive unconditional bids.81 Some commentators have cited the delay and uncertainty of NDRC approval as a cause in China Minmetal's failure to acquire Canadian nickel and copper mining giant Noranda.82

Chinese companies also face additional governmental restraints. Provincial protectionism often prevents companies from consolidating their market position by acquiring competitors in other provinces. Other companies, such as Shanghai Baosteel Group ("Baosteel") in the 1990s, saw a drop in profitability after being forced to absorb its less efficient competitors.83 Most SOEs are unable to reduce workforces because of the premium placed on low unemployment and social stability and SOEs in industries such as coal, crude oil,

79 Jiang Wei, Outward Direct Investment Set to Increase, China Daily 10 (Sept 27, 2005), quoting Yu Jianlong, director of the Economic Information Department of China Council for the Promotion of International Trade.
82 Zhiming, Further Liberalization Key, Caijing Magazine (cited in note 75).
83 We Are the Champions, Economist at 12 (cited in note 4).
electric power, water supply, transportation and trade incur losses because the state sets the prices of their products below market.\footnote{For example, China’s domestic airline industry is hampered by regulated ticket prices, the government is planning to raise landing charges in order to bail out loss-making airports and a domestic jet-fuel monopoly means fuel accounts for an average of 40 percent of costs at Chinese airlines, compared with 24 percent for airlines worldwide. \textit{On a Wing and a Prayer}, \textit{Economist} 70 (Feb 25, 2006).}

**B. CHINESE COMPANIES STILL LAG FOREIGN COMPETITORS**

As discussed above, many SOEs are less efficient than their global competitors, a critical component of long-term economic growth. In 2003, the average profit rate of net assets in SOEs was only 5 percent. About 10 percent of SOEs face deficits.\footnote{\textit{China Plans to Monitor Performance of State Companies}, BBC Monitoring International Reports (Dec 20, 2004).} Excess capacity is becoming an increasing problem. And SOEs continue to hold on to historical “social burdens” such as schools, hospitals, restaurants and other assets unrelated to their main businesses. Under a pilot program in late 2004, CNPC, Sinopec and Dongfeng Motor transferred 796 primary and middle schools, public security organs and 94,000 workers (including retired teachers) to local governments.\footnote{\textit{China’s State-Owned Enterprises Act to Improve Competitiveness}, BBC Monitoring International Reports (Dec 1, 2004).} China plans to establish a way of evaluating the performance of SOEs in order to raise efficiency, but the program is scheduled to begin as late as 2010.

Others suffer from the lack of capable management personnel. MOFCOM stated the acute scarcity of Chinese leadership talent is the main barrier to the global ambitions of Chinese companies. China’s aspiring global champions will need as many as seventy-five thousand globally-capable leaders over the next ten to fifteen years, from a base of only around three thousand to five thousand last year.\footnote{MOFCOM, \textit{Narrowing China’s Corporate Leadership Gap} (May 18, 2005), available online at <http://english.mofcom.gov.cn/article/counselorsreport/asiareport/200505/20050500093533.html> (visited May 15, 2006).} For this reason, Lenovo asked top IBM managers to continue to run the entire company from New York and CNOOC was looking to do likewise.

Most Chinese companies simply lack adequate international experience. Huawei, for example, has had success in the Middle East and Latin America, where it leveraged reduced costs from government financing such as a low-cost $10 billion loan from CDB in 2004 and a $600 million credit line from China
EXIM Bank to promote its international operations. In the US, however, marketing problems, intellectual property suits and human resources blunders have shown Huawei, according to their North America business-development director that they “still have a long way to go to learn about [the US market] Chinese companies must also learn to deal with different management styles and cultures. Legal regimes and regulatory oversight, including capital markets transparency standards, may also be completely “foreign” to Chinese companies in comparison to investors from developed economies.

C. CHINESE BANKS MUST CONTINUE TO REFORM

Despite the emergence of SOCBs and their position as some of the top revenue earners in the world, numerous systemic issues remain and beg to be addressed. China’s banking industry was technically insolvent before its recent restructuring. The Big Four currently report an NPL ratio (as a percentage of total loans) of just under 10 percent and government figures value the problem at $210 billion. However, this ignores the transferred NPLs which have yet to be resolved, “performing loans” which may need to be reclassified and NPLs anticipated from the new loose lending over the past three years. NPLs would be less of an issue if the banks were making profits to counterbalance their liabilities. However, the return on assets generated by China’s banks, at less than 0.5 percent in 2005, is the worst in Asia. Chinese banks are too dependent on loan income (Western banks make a good percentage of their fees from advisory services and related services such as credit cards) and their interest margins are not high enough to cover the risks typical of an emerging economy. The NPL problem reveals a larger problem of inefficient allocation of resources. Interest-rate flexibility and a reduction in government interference is necessary to shift credits away from legacy SOEs to new market players with the potential for greater profitability. The ability of SOCBs to assist in the growth of corporate

88 FutureWei, China Development Bank Offers Huawei Technologies Credit Financing (cited in note 77); Huawei, China EXIM Bank and Huawei Signed $600 Million Export Buyer’s Credit Framework Agreement (cited in note 77).

89 Christopher Rhoads and Rebecca Buckman, Trial and Error: A Chinese Telecom Powerhouse Stumbles on Road to the US, Wall St J A1 (July 28, 2005).

90 The CBRC reported that average problem loan ratio of the mainland’s Big Four state banks and twelve joint stock lenders for the first time fell below 10 percent in 2005. However, adding back a RMB 705 billion non-performing loan carve-out by ICBC in June 2005, the lenders would have seen a net increase of RMB 206.5 billion of NPLs (analysts often add back such one-off carve-outs to show the underlying trend of NPL generation, hence the lenders’ ability to sustain the low NPL ratios without further bailouts). Mainland Lenders Cut NPL Ratio to under 10%, South China Morning Post 3 (Jan 19, 2006).

91 A Great Big Banking Gamble, Economist at 93 (cited in note 61).
China is highly dependent on the resolution of the NPL problem and other systemic issues.

Despite foreign investments in China's bank and financial services sector in recent years, minority investment is generally limited to 25 percent and the banks are still accountable only to the government, thereby precluding the development of a truly commercial culture. Bank management has traditionally been selected from inside the ministerial system and their mandate is not to return shareholder value or even to protect the interest of the owners, but rather to yield to a variety of pressures from the Central Government, the Communist Party or local governments. Additional oversight is also needed to preclude further corruption scandals which have plagued the SOCBs at all levels. The China Banking Regulatory Commission ("CBRC") discovered irregularities involving RMB 767 billion at mainland banks in 2005, resulting in 1,205 financial institutions being penalized and 6,826 bank officials reprimanded. CBRC has even accused 1,228 of its own staff of being involved with $10.4 million in irregular funds in 2005.

There have been a series of improvements in regulation, including the establishment of the CBRC in 2003 to take over the PBOC's oversight of SOCBs. There have also been substantial improvements in critical areas of asset classification and provisioning and capital adequacy. To the extent these reforms are successful, they will assist Chinese banks to grow and compete internationally. The reforms are also necessary under the laws of foreign jurisdictions, such as the US Foreign Bank Supervision Enhancement Act of 1991 ("FBSEA"), to establish and upgrade overseas representative offices and branches to facilitate more integrated support to Chinese multinationals.

Lastly, the dependence on and overwhelming issues involved in China's banking system have overshadowed the need for alternative financing options. Modern global economies equally rely on functioning capital markets as banks to help raise capital and efficiently allocate it for sustained economic growth. In 2005, China's two stock exchanges were considered the world's two worst in terms of performance. Beijing suspended IPOs in May 2005 to stabilize the

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92 Thompson, Governance of Banks in China, at ch 13, § 3.3.1 (cited in note 72).
93 China Banking Graft Seeping Into Regulatory Body, Agence France Presse (Feb 20, 2006).
market as it trickles some $250 billion worth of government-owned holdings into the market. Recent reforms are promising, although they are too nascent to judge whether the market will see substantive short-term benefits.

D. FOREIGN POLITICAL RESISTANCE TO CHINESE INVESTMENT

The outbound expansion of Chinese companies has been couched in a policy of “peaceful emergence.” However, Chinese ODI has raised ire throughout the world, espionage scandals aside.

The backlash against China’s emergence has been particularly acute in the United States. In 2004, only $120 million, or about 2 percent of the total $5.5 billion, of new Chinese ODI was directed towards the US, compared to US FDI in China that was almost $4 billion and accounted for 6.15 percent of China’s $64 billion total FDI in 2004. But that small slice of investment has attracted the most substantial objections. Such challenges create an increased completion risk that forces Chinese companies to compensate sellers with what has been termed a “Chinese buyer premium.”

Some of the objections to Chinese investment in the US have been largely driven by “economic nationalism” of competing bidders and vested interests of the acquisition targets. The same factor which attracted Haier to Maytag—the latter’s brand recognition in US homes and market penetration—equally hurt Haier’s chances of success as the bid attracted greater public scrutiny. Haier is majority-owned by the Qingdao city government and the firm’s chief executive, Zhang Ruimin, is a ranking member of the Communist Party. Despite

97 See China’s Peaceful Development Road, People’s Daily (Dec 22, 2005), available online at <http://english.people.com.cn/200512/22/eng20051222_230059.html> (visited Feb 11, 2006) (the policy was later dubbed “peaceful development” after criticism that the original slogan itself could be seen as provocative). The Chinese Government has formulated this policy to allay fears of a “Chinese invasion” and counter the image developed by previous espionage scandals and attempts to acquire military technology through the acquisition of interests in US high-tech companies. See The Cox Report (1999), US House of Representatives Select Committee on US National Security and Military/Commercial Concerns with the People’s Republic of China, available online at <http://www.house.gov/coxreport/> (visited Feb 11, 2006).

98 Zhang, Going Global at 12 (cited in note 16).


100 In a high-profile case in 2004, the State-owned Assets Supervision and Administration Commission ruled that Haier was owned by the Qingdao government. Richard McGregor, Chinese Plan to Boost Power of Managers Sparks Backlash, Fin Times 2 (Dec 15, 2004).
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Maytag’s weaknesses and the fact that Haier was arguably overpaying, critics argued that state ties could give the firm unfair financial support.\(^{101}\)

The majority of contested Chinese acquisitions, however, have invoked issues of national security. Section 721 (the “Exon-Florio provision”) of the Defense Production Act of 1950\(^{102}\) provides authority to the US President to suspend or prohibit any foreign acquisition, merger or takeover of a US corporation that is determined to threaten the national security of the US. Review of any such merger or acquisition is delegated to the Committee on Foreign Investment in the United States (“CFIUS”). The Committee has thirty days to decide whether to investigate a case and an additional forty-five days to make its recommendation. Once the recommendation is made, the President has fifteen days to act.\(^{103}\) Although CFIUS’s reviews are confidential, it is believed CFIUS has received more than fifteen hundred notifications, of which twenty-five resulted in full investigations. Of these twenty-five cases, thirteen transactions were withdrawn upon notice that CFIUS would conduct a full review and twelve of the remaining cases were sent to the President.\(^{104}\) Of these twelve transactions, the only transaction that was prohibited was the acquisition of aerospace parts manufacturer Mamco Manufacturing Company by state-owned China National Aero-Technology Import and Export Corporation (“CATIC”) because of concerns that CATIC might gain access to technology through Mamco that it would otherwise have to obtain under an export license.\(^{105}\)

In 1995, two Chinese companies, San Huan New Materials and China Non-Ferrous Materials, in partnership with two US investors, purchased Indiana-based Magnequench. At the time, Magnequench made 85 percent of the rare-earth magnets used in precision-guided weapons or “smart bombs” supplied to the US military. CFIUS approved the sale on the condition that the company’s manufacturing facility would remain in the US. However, in 2003, the

\(^{101}\) Ben White, *Whirlpool Presents an Unsolicited Bid to Buy Rival Maytag*, Wash Post A7 (July 18, 2005).

\(^{102}\) Section 721 of the Act codified at 50 App USC § 2170 (as amended by section 5021 of the Omnibus Trade and Competitiveness Act of 1988, Pub L No 100-418).

\(^{103}\) For information on CFIUS, see US Department of the Treasury’s website at <http://www.treas.gov/offices/international-affairs/exon-florio/> (visited May 15, 2006).


Chinese owners shut down Magnequench’s Indiana production plant and moved equipment to China, a move many in Congress bitterly remember.\textsuperscript{106}

In 2003, Hong Kong-based Hutchinson Whampoa made a joint bid with Singapore Technology Telemedia to acquire Global Crossing. US officials raised concerns that foreign ownership of Global Crossing’s fiber-optics network might make the US government vulnerable to eavesdropping from overseas and certain of Hutchinson Whampoa’s operations were reported to have ties with the Chinese People’s Liberation Army. Hutchinson Whampoa withdrew from the bid upon CFIUS’s decision to review the transaction (Singapore Technology Telemedia eventually completed the acquisition).\textsuperscript{107}

In 2004, Lenovo’s $1.7 billion acquisition of US–based IBM’s personal computer division made it through CFIUS’s gauntlet.\textsuperscript{108} Lenovo is majority-owned by Legend Group, which itself is majority-owned by the Chinese Academy of Sciences, China’s top scientific research body. The transaction was challenged by congressmen arguing that the deal would result in the transfer of sensitive technology to a potential US rival and that it would result in certain US government contracts involving PCs being fulfilled by the Chinese government. After closed-door negotiations with CFIUS and reports of various concessions, the deal was allowed to proceed.

However, it was CNOOC’s $18.5 billion bid for US–based Unocal in 2005 that was the most contentious attempted acquisition. CNOOC is a Hong Kong-listed firm, 70 percent of which is owned by China National Offshore Oil Corporation, an unlisted Chinese SOE. Over forty US congressmen protested the CNOOC–Unocal deal on energy-security concerns.\textsuperscript{109} Four bills were introduced in Congress that directly sought to obstruct or prohibit CNOOC’s bid for Unocal.\textsuperscript{110} Accusations of unfair advantage also plagued the dialogue.


\textsuperscript{107}Congressional Research Service, \textit{China and the CNOOC Bid for Unocal} at 13 (cited in note 104).

\textsuperscript{108}IBM kept a 13.4 percent stake in the combined company. See Simon London and Mure Dickie, \textit{Lenovo Begins Full Integration of IBM PC Unit}, Fin Times 33 (Sept 30, 2005).


\textsuperscript{110}HR 344, 109th Cong, 1st Sess (June 29, 2005) (expressing the sense of the House of Representatives that a Chinese state-owned energy company exercising control of critical US energy infrastructure and energy production capacity could take action that would threaten to impair the national security of the US. Calls on the President to make a thorough review if the deal takes place); HR Amdt 431, 109th Cong, 1st Sess (June 30, 2005) to Transportation, Treasury, Housing and Urban Development, the Judiciary, the District of Columbia, and Independent Agencies Appropriations Act, 2006, HR 3058, 109th Cong, 1st Sess (June 24, 2005) (prohibits the use of funds from being made available to recommend approval of the sale of Unocal to CNOOC); S 1412, 109th Cong, 1st Sess (July 15, 2005) (a bill to prohibit the merger,
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Chevron, the competing bidder, and numerous congressmen voiced concerns that the financing was an unfair government subsidy.111

In explaining why it withdrew the bid, CNOOC stated that the company had

given active consideration to further improving the terms of its offer, and would have done so but for the political environment in the US. The unprecedented political opposition that followed the announcement of our proposed transaction, attempting to replace or amend the CFIUS process that has been successfully in operation for decades, was regrettable and unjustified.112

CNOOC's CEO later even stated that it would be willing to ask Beijing to reduce its majority stake in the company to remove future political obstacles to overseas acquisitions.113

US criticism has not stopped the Chinese M&A spree, especially in other parts of the world where Chinese money has generally been more welcome. During the congressional debates over the CNOOC bid, congressmen noted that blocking the deal would merely push China into making more acquisitions or supply arrangements elsewhere in the world—possibly with countries adverse to US interests.114

But signs of discontent are appearing outside of the US as well. In Latin America, local politicians argue against contracts with loans tied to the execution of projects by Chinese contractors, extraction of local resources and loss of

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111 Steve Lohr, The Big Tug of War Over Unocal, NY Times C1 (July 6, 2005); CNOOC Drops $18.5 Bln Unocal Bid Amid US Opposition, Bloomberg (Aug 2, 2005); Ben White, Shareholder Advisory Firm Backs Chevron Bid for Unocal, Wash Post D1 (Aug 2, 2005). Furthermore, the Commissioner of the USCC criticized the fact that the governor of China's central bank helped assemble the acquisition financing. Statement of Carolyn Bartholomew (cited in note 50).


114 Congressional Research Service, China and the CNOOC Bid for Unocal at 5–6 (cited in note 104).
economic free will. Many question how well the multi-billion dollar letters of intent President Hu signed with Latin American countries in 2004 will materialize into formal investment. For example, Baosteel’s celebrated announcement in 2004 of plans to build a $2.5 billion steel mill in Brazil with Europe-based Arcelor has been put on hold due to world steel prices; however the investors have also been put off by two years of waiting for zoning approval and concerns over Brazilian plans to levy a tax on machinery imported for the plant.

The acquisition of PetroKazakhstan also lit nationalistic fires in Kazakhstan, where a proposal was introduced in parliament to revoke the company’s licenses to remove oil and gas from the country. In December 2002, after being formally invited to bid for Slavnet, Russia’s ninth biggest oil company, Sinopec was forced to drop out after the Russian parliament passed a resolution opposing the acquisition. Minmetals’ bid for Noranda prompted some members of Canada’s Parliament to review whether the Investment Canada Act, which requires government reviews of direct acquisitions worth more than C$237 million, needed updating.

VI. CONCLUSION

Since moving towards a market economy, Beijing has fostered its state-owned companies to grow large domestically and spread their wings overseas. SOCBs are learning to allocate capital efficiently, a boon to both their own balance sheets and to borrowers, and strategic investments by foreign investors are bringing in expertise to help turn the banks into truly commercial enterprises. Chinese companies are preparing themselves to stake their claims in the global marketplace. Yet despite the beneficial conditions for expansion, Chinese companies have been hampered domestically and internationally. On the domestic front, Chinese regulatory oversight continues to restrict foreign investment. Political and social considerations preclude efficient allocation of resources, thereby dragging down both productivity and bank profits. Chinese companies also lack management capabilities and international experience to effectively deal with issues such as different corporate cultures and the demands


116 See Trade & Investment, Latin American Special Reports (cited in note 44).

117 Mark O’Neill, Small Firms Look Abroad as CNOOC’s Unocal Bid Stalls, South China Morning Post 2 (July 12, 2005).

118 Robert Thompson, Resources Should Not Be Foreign-Controlled: CEOs: 42% Want Greater Limits, Financial Post (Ont) 2 (Dec 13, 2004).
of foreign legal and regulatory regimes. Foreign countries and competitors have also fought tooth-and-nail to keep Chinese companies from moving into their backyard.

China is actively pushing to address these issues. China’s Go Global policy is still nascent, and the next few years we should see continued refinement of the ODI framework. One commentator has stated, “one proof of the genius of the Chinese businessman is that he can succeed in a system that has so many restrictions.” Imagine what will happen when these restrictions are removed! Beijing’s ability to promptly and efficiently tackle these issues is crucial to the future role of Chinese companies in the global marketplace.

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119 Ted C. Fishman, *China Inc.* 65 (Scribner 2005), quoting Zurui Tang, economic investigator at Peking University and INSEAD.