CHINESE SOES VS CHINESE PRIVATE COMPANIES IN INTERNATIONAL MARKET

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ABSTRACT

The opening of China to the world began in 1979 under the leadership of the Chinese leader Deng Xiaoping and, in a way, that was the beginning of the international development for Chinese companies, slowly but surely it became a significant competitor in international market. The process of internationalization started in the 1990s through various infrastructure projects that were conducted by Chinese state-owned enterprises in Africa and Asia. After their expansion abroad, Chinese private companies started to work overseas at the beginning of a new millennium. Their first investments were in IT industry in the United States of America and they purchased some of the world's most recognizable brands. Nowadays, Chinese companies are among the leading investors globally. On prestigious business lists, such as Forbes and Fortune 500, they occupy high positions in all categories. Slowly but steadily, they are leaving behind big global players from the US and the EU. Primarily, the progress has been achieved because the Chinese companies enjoy great support from the Chinese Government, which provides support to them both on financial and diplomatic level. The aim of this paper is to show how Chinese private and state-owned enterprises behave in the international market and point out the similarities and differences of their strategic approach (both through individual cases and through a comparative analysis of two case studies). The authors will elaborate on the dominant areas and investment branches for both types of companies, and also what problems those companies encounter in international business market.

***Keywords**: China, private companies, state-owned enterprises, international market, strategy*

1. INTRODUCTION

China implemented its opening-up policy in 1979 under the leadership of the leader Deng Xiaoping, along with the process of internationalization of Chinese business operations. Primary foreign investment markets for China are the countries in its immediate neighbourhood, such as Taiwan, Hong Kong and Myanmar, while in the mid-1980s it expanded to the rest of the Asian continent. Interestingly, these investments were exclusively made in the energy and transport sectors and they never reached more than few hundred million US dollars, which is relatively low compared to the current investments. The first significant steps of Chinese companies in the international market were recorded in the early 1990s when there were considerable investments in the African continent. Chinese state-owned enterprises (SOEs)[1] dominated through infrastructure projects in the countries such as Ghana, Chad, Congo etc., slowly but steadily, enabling business operations to other Chinese entrepreneurs. By the beginning of the new millennium, there was steady expansion of both the Asian and the African markets, in particular, investing in the water, mining and mineral resources sector.

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[1] A state-owned enterprise (SOE) is a legal entity that is created by the government in order to partake in commercial activities on the government's behalf. It can be either wholly or partially owned by the government and is typically earmarked to participate in commercial activities.

In this period, for the first time Chinese companies exceeded the value of one billion US dollars for an individual foreign investment, which captured global attention. The beginning of the new millennium brought about the first changes. Actually, Chinese companies started expanding their business operation to other continents, getting interested in modern business segments as well. Global players got introduced to Chinese private companies, which through their investments primarily in the IT and real estate sectors in the USA and Europe, slowly but surely, have been entering the world's sphere of interest. This consistently growing trend has been noticed over the next fifteen years; therefore, nowadays Chinese companies are among the leading global companies that can compete with the giants from America and Europe. Furthermore, this is supported by the fact that the Chinese companies are taking over leading positions on eminent lists such as Forbes or Fortune 500. The aim of the paper is to demonstrate the behaviour of Chinese private and state-owned enterprises in international markets, to point out similarities and differences in the strategic approaches, to show the problems they encounter, i.e. to display their dominant areas and investment areas both in individual cases and historic perspective, as well as through a comparative analysis of two case studies.

2. THE RISE OF CHINESE COMPANIES IN INTERNATIONAL MARKET - HISTORIC PERSPECTIVE

One of the key aspects of the growth and development of Chinese companies in the international markets is the economic modernization of China itself, which through foreign direct investments immensely encouraged the growth and development of its domestic companies in the early 80s of the 20th century. By encouraging already modern and reputable companies (from America, Europe, and Japan) to invest in China, Chinese companies became acquainted with business operation of these companies in the international markets. Although former Chinese authorities severely limited foreign investments of their state-owned enterprises, some initial experience was acquired in the 80s and 90s of the 20th century. The gained experience was based primarily on investments in the energy sector, through infrastructure projects and certain initial investments in the stocks and shares of large world giants. Simultaneously, foreign investments in China were enlarging and the development of Chinese companies was taking place in the international markets. Chinese state giants began to work on large infrastructure projects in Asia and Africa, primarily thanks to the enormous diplomatic and financial help of the Chinese government. The amount of these investments varies from 50 million US$ to 1 billion US$. It is invested in energy, water resource management, transport and increasingly in agriculture. Economic relations with the neighbouring countries in Asia are improving significantly, and the trust of African countries is building up (https://www.imf.org/external/pubs/ft/op/232/). However, in 2000 there was a major turning point in the operations of Chinese companies in the international business markets. The Chinese government decided to launch a new type of business strategy called "Go out policy".[2] One of the key reasons that led to this strategic initiative is the huge accumulation of foreign exchange reserves in China. Some of these reserves were invested mostly in low-yield assets such as American bonds that provided a low but safe return on capital. The other part of these reserves was used to invest and promote Chinese state-owned enterprises globally. The emphasis was on investing in traditional economies and infrastructure projects, primarily in Asia and Africa, but with the steady entry of Chinese companies into the EU and America markets. Increasing investments were made in the stocks and shares and acquisition of foreign companies, to acquire the latest technology and modern management skills.

[2] **Go Out Policy** (Going Global Policy) is China’s current strategy to encourage its enterprises to invest overseas (est. 2000). For more references about “Go Out Policy” see: Zakić, K**.,** Radišić, B. (2017**),** "The Results and Challenges of Chinese "Go Global" Policy", Review of International Affairs, Vol. LXVI, No. 1160, Institute for International Politics and Economics, Belgrade.

Gradually, the framework of traditional economy was becoming less dominant and Chinese companies made significant investment by taking over world-renowned brands to raise their global status. Chinese private companies went global in 2003 when they were allowed to invest in the international business markets in compliance with the decision of the Chinese government. Although Chinese state-owned giants such as CNOCC, State Grid, China Power Investment and China Railway Construction were still dominant, whose individual investments were already well over 1 billion US$, Chinese private companies were developing constantly. The first investment was definitely the acquisition of IBM's segment by Lenovo, which marked the start of large-scale private investment by private Chinese companies in the international markets. This acquisition took place in 2005[3], when the IBM Personal and Tablet PC segment was purchased for 1.75 billion US dollars. After the acquisition, Lenovo became a recognizable brand that recorded big sales jumps and its global market share has been growing for years.
According to Global Investment Tracker, the amount and the number of Chinese investments abroad was constantly increasing in the period from 2005 to 2017. Initially, there was an average of 20 to 30 investments totalling around 30 billion US dollars; in 2016 they reached the peak amounting to 342 transactions, with annual amount of 247 billion US $.

Table 1: The biggest individual overseas acquisitions of Chinese companies

Year	Company name	Quantity in Billions US$	Transaction Party	Sector/Country
2017	Chem China (SOE)	43.06	Syngenta	Agriculture/EU Switzerland
2012	CNOOC (SOE)	15.1	Nexen	Energy/NA Canada
2017	CIC (SOE)	13.79	Logicor	Logistics/EU G.Britain
2008	Chinalco (SOE)	12.8	Rio Tinto	Metals/Australia
2017	HNA (private)	10.3	CIT Group	Transport/USA

Source: The authors' research is based on: China's Top 500 Enterprises and China Global Investment Tracker

Although in terms of the total number of investments and their height (Table 1) SOEs still dominate, primarily thanks to the enormous support of the Chinese Central Government, which has 102 companies under its protectorate, China's private companies have statistically the largest number of acquisitions. This primarily relates to investments in the IT sector, the real estate sector, the entertainment industry and the investments in the field of finance (stock and shares of banks and insurance companies) in the EU and America, where the individual average of private companies is slightly above 2 billion US$. The leading private Chinese investors, Dalian Wanda, HNA Group and Anbang Insurance Group are among the top ten, with global

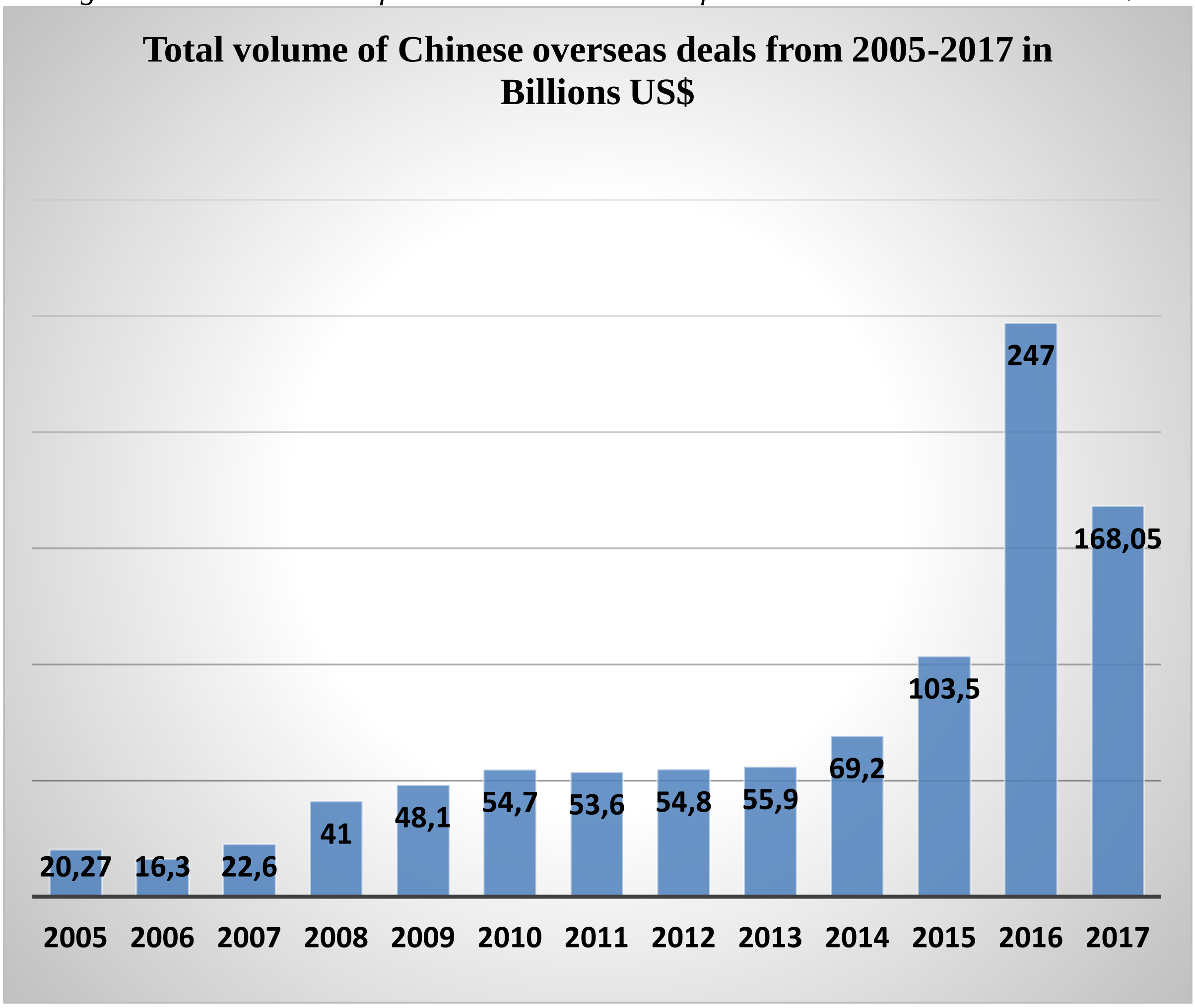
[3] The *acquisition* strategy relates to the purchase of the company that is being integrated and as such becomes a part, i.e. a unit of the company that has initiated the purchase. The acquisition process takes place between the companies that are different in size and can be hostile and friendly. For more references about the strategies that Chinese companies are using when going abroad see: Zakić K., Radišić B. (2017), "Strategies of Chinese Companies when Entering Global Market, Economic and Social Development", 21st International Scientific Conference on Economic and Social Development, Belgrade, 18-19th May 2017, (pp. 169-180), Varaždin Development and Entrepreneurship Agency in cooperation with John Naisbitt University, University North, Faculty of Management - University of Warsaw.

investments exceeding a figure of 100 billion US $ over the past eight years (Collier, 2018, pp. 11-14).

3. MARKET APPROACH (SOES VS PRIVATE COMPANIES)

Over the last twelve years, Chinese overseas investments have been steadily increasing; in the period from 2012 to 2017 they reached record levels both in terms of deal values and the volume of transaction. (Figure 1)

Figure 1 - Total volume of Chinese overseas deals from 2005 to 2017 in Billions US$

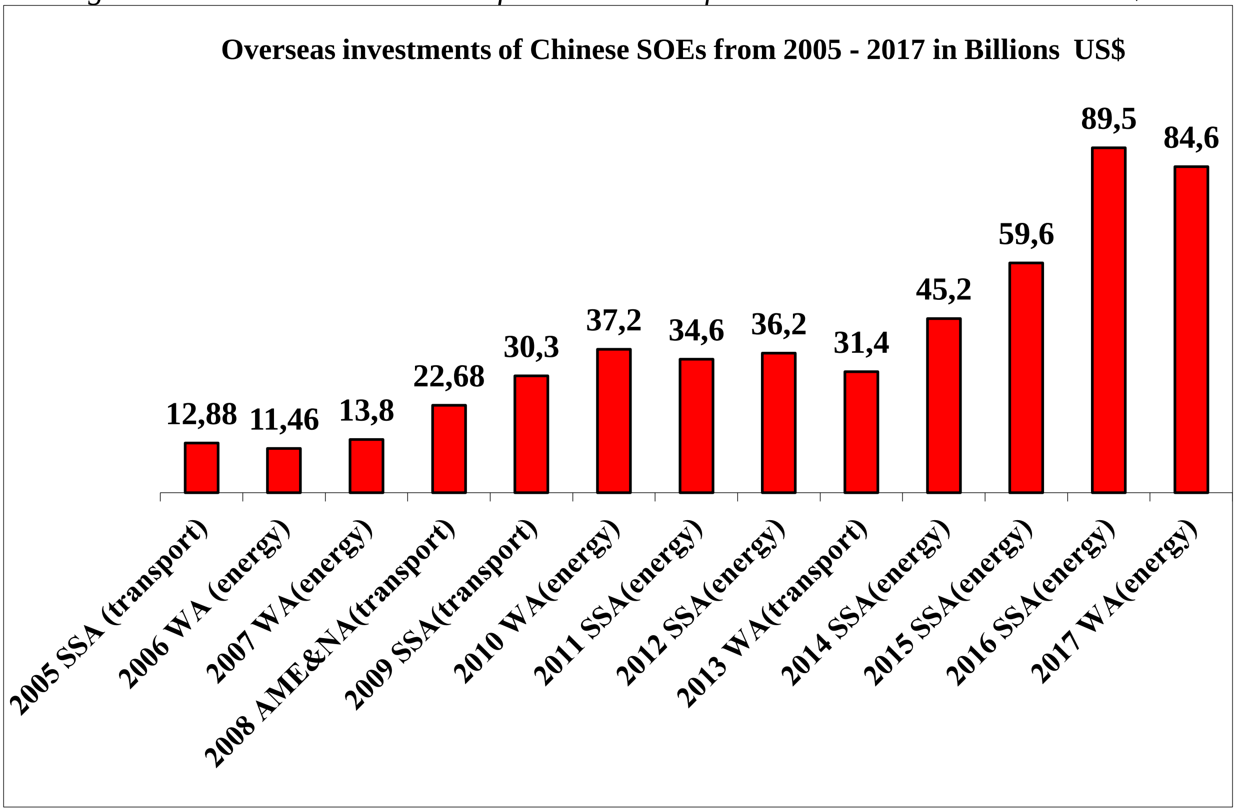


Source: The authors' research is based on China Global Investment Tracker, Bloomberg, RHG Group

Although the strategic choice of acquisition[4], as a primary way of acting in the international business market, is common both for SOEs and private Chinese companies, there are some differences regarding the choice of geographical areas and business segment. As it was already mentioned in the previous chapter, SOEs have been present in the international business markets for more than a decade compared to Chinese private companies, thus their way of business operation is quite different. SOEs investments are based exclusively on traditional aspects of economy (Figure 2) and they do not differ a lot from their primary activities, unless the Chinese Central Government approves it.

[4] Note: The acquisition strategy is present in over 97% cases for the analised period from 2005 to 2017, when nearly 3,000 investment transactions were conducted.

Figure 2 - Overseas investments of Chinese SOEs from 2005 to 2017 in Billions US$[5]

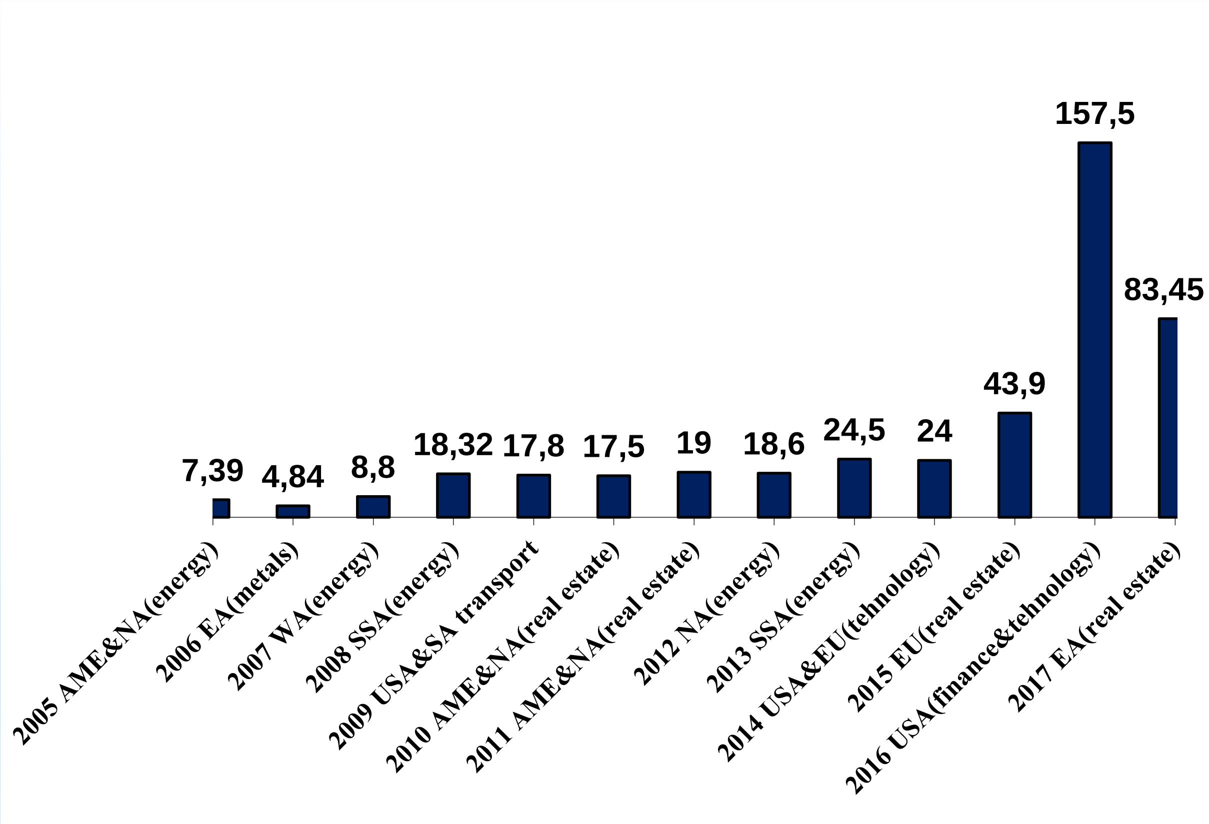


Source: The authors' research is based on China Global Investment Tracker, Bloomberg, RHG Group

The Figure 2 clearly depicts that the primary areas of SOEs are Sub-Saharan Africa and East Asia. Initial overseas investments started off in these regions. Namely, over the past 25 years, the Chinese government has established fairly good economic and political relations in the countries of Africa and East Asia, and thus their companies win almost all important projects in these regions. The two most dominant sectors are the transport sector and the energy sector. In the transport sector, major infrastructure projects are the construction of railways and highways. These are large projects for Sub-Saharan Africa, where the countries such as Kenya, Zambia, Chad and Nigeria dominate, having an average investment of approximately 2.5 billion US$. The most important infrastructure projects are the construction of the railway in Nigeria 2014 (the investment worth 6.8 billion US$), and the construction of the road and railway in Chad in 2011 (the investment worth 5.63 billion US$). The contractor in both projects was the Chinese state-owned enterprise China Railway Construction. As for the energy sector, it is certainly the most dominant sector for SOEs, and the main investment regions are East Asia and Sub-Saharan Africa as well. It is invested heavily in the countries such as Malaysia, Indonesia and Laos; however, over the past few years, the investments in the countries of former USSR, the EU and the South American countries have become more frequent. The amount of these investments is on average 3.5 billion US dollars, while the main investors are two state-owned Chinese enterprises SINOPEC and China National Nuclear (http://www.aei.org/china-global-investment-tracker/). Chinese private companies began their internationalization process in 2003 when the Chinese government decided to allow the private sector to go international. The purchase of one part of IBM by Lenovo was the first major investment, resulting in the constant global increase of Chinese private investments (Figure 3).

[5] **Note: EA** - East Asia, **WA** - West Asia, **AME&NA** - Arab Middle East and North Africa, **SSA** - Sub Saharan Africa

Figure 3 - Overseas investments of Chinese private companies from 2005 to 2017 in Billions US$[6]



Source: The authors' research is based on China Global Investment Tracker, Bloomberg, RHG Group

In their first years of operations in the global market, Chinese private companies were the same as SOEs, investing mostly in the traditional economy (energy, metallurgy and transport sectors), choosing their primary destinations in the Arabian Peninsula and East Africa, while the Asian Continent and Sub Saharan Africa were the second choice. However, the real boom in the global market was experienced in 2009 and 2010, when Chinese private companies attracted global attention by acquiring a number of transport companies which were affected by the US crisis, as well as the property in Qatar, UAE and Saudi Arabia. This trend was slowly declining the following two years, so they directed their forces slowly to North America and Sub-Saharan Africa where more and more funds were invested in the energy sector (mostly oil investments, with an average investment of around 3 billion US$). Unlike SOEs, they do not enjoy the overwhelming support of the Chinese government, except when it comes to some extremely large investment. On the contrary, they are constantly monitored by the Chinese state due to certain suspicious investments primarily in Africa and East Asia. Over the last three years, Chinese private companies are well-known for their investments in the US and the EU. It has been invested in the entertainment, IT, finance, real estate and sports sectors. The average cost of the investments amounts to just over 4 billion US$, and the largest investors are HNA Group, Wanda Group, Anbang, Ping An, etc. (https://knoema.com/pvvzaxg/china-global-investment-tracker). As compared with SOEs, private companies are constantly expanding their business segments (they do not operate only in their primary business); they often change investment regions and tend to make risky investments, especially in the field of entertainment and finance.

[6] **Note**: **EA** - East Asia, **WA** - West Asia, **AME&NA** - Arab Middle East and North Africa, **SSA** - Sub Saharan Africa, **SA**- South America, **EU**- European Union

The record amount of investment was157.5 billion US$ in 2016, which would probably never repeat, as the Chinese government introduced the control of investment in early 2017; primarily due to the disrupted diplomatic relations with the United States, but also because of a number of suspicious transactions in the field of finance and technologies ending up in US courts.

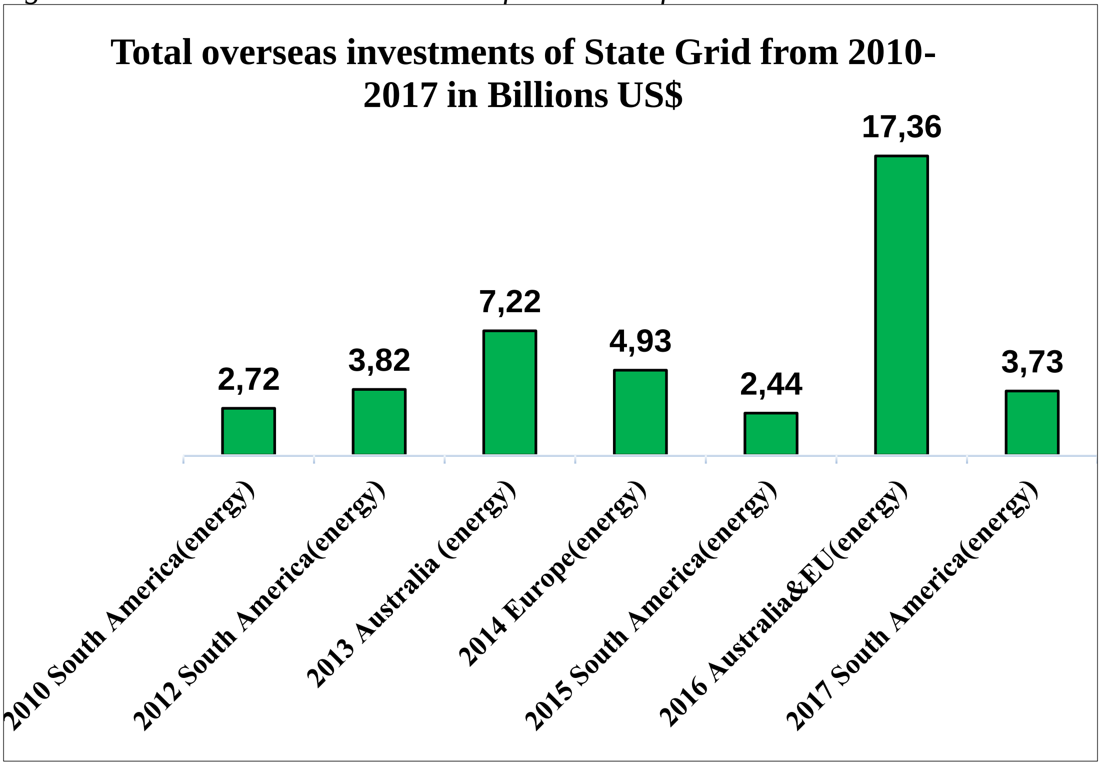
4. CASE STUDY (STATE GRID INT. VS WANDA GROUP)[7]

State Grid International was established in 2008 as a subsidiary of one of the largest state-owned enterprises. The complete power network of NR China is under its protectorate, thus being the largest utility company in the world. On the prestigious Fortune 500 list, the enterprise is currently on the second place with annual revenue of 316 billion US$ immediately behind the US Walmart retail chain (http://fortune.com/global500/). State Grid Int. started its internationalization process in 2008 when it bought 40% of stakes in Monto Oro for 1.58 billion US$, the largest power company in the Philippines. Its expansion into foreign markets continued in the following two years, when it bought the parts of electric plants in Brazil and Portugal with the assets share of 25-50%. From 2012 to 2014 it received global attention when it made a lot of acquisitions in South America, East Asia and, particularly, in Australia (Figure 4). After purchasing 20% and then 60% of Singapore Power Corporation totalling 4.6 billion US dollars, State Grid became one of the most powerful electric companies in the world, having under its control over 60% of the electric networks in Asia, South America and Australia. It continues its overseas investments in Europe in November 2014 by purchasing 35% of the Italian private company CDP Reti, one of the largest electricity retailers in the EU for $ 2.5 billion US dollars. This event particularly alarmed US competitors who are known for buying shares in such companies in the EU. It should be noted that the company set a record when it comes to foreign investments in 2016, which amounted to 17.36 billion US dollars. The trend continued in 2017, only in a lesser extent, primarily due to the control of foreign investments by the Chinese government. Nevertheless, it acquired 95% of stakes in CPFL Brazil, the largest private electric company in South America for just over 3 billion US$. State Grid International has become one of the leading global players in the field of electricity in a very short time. According to its ten-year plan and with constant investment in infrastructure and R&D segment, along with the support of the Chinese government, it aims to become the global leader in electricity supply by 2030.

Figure following on the next page

[7] Note: for this part of the paper several sources were used: http://www.stategrid.com.cn/sites/sgid/en/en_index.jsp, revised 25.04. 2018., https://www.bloomberg.com/profiles/companies/0612934D:CH-state-grid-international-development-ltd, revised 25.04.2018., https://www.wanda-group.com/overseas_holdings/, revised 26.04.2018., https://www.wanda-group.com/about/, revised 26.04.2018., https://rhg.com/research/chinas-state-investment-surge-stimulus-or-statistics/, revised 26.04.2018.

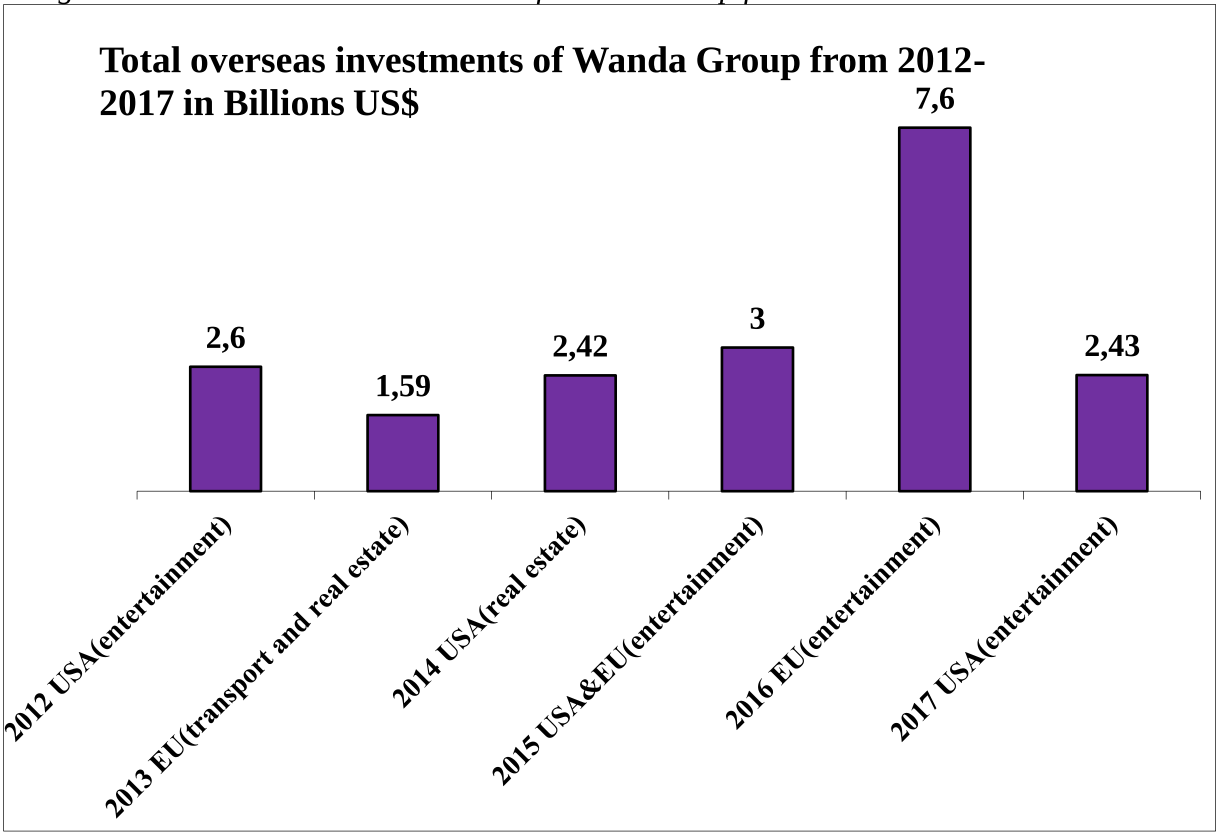
Figure 4 - Total overseas investments of State Grid from 2010 to 2017 in Billions US$



Source: The authors' research is based on China Global Investment Tracker, Bloomberg, RHG Group

Wanda Group was established in 1988 and it is one of the largest Chinese private conglomerates dealing with real estate, finance and management, the cultural industry and, recently, the entertainment industry. It is one of the best employers whose prime goal is the education of young experts. Every year the company offers internships to over 200 thousand best students to work in four different business segments, many of them get employed here. On the prestigious Fortune 500 list it is currently on the 380th place, making a progress every year. Its internationalization process began in 2012, when it purchased AMC Entertainment the second largest cinema chain in the world for $ 2.6 billion (Figure 5). The investment proved to be very successful because in the following three years the company recorded a steady increase in the revenues along with its Wanda Group - one of the largest movie theatre chain operators in the United States. In the following two years the company continued its expansion in EU countries (by purchasing Santander in Spain and Sunseeker luxury yacht manufacturer in the UK). By purchasing the Legendary Entertainment Group in 2016, Wanda Group received global attention. Namely, many American filmmakers rebelled against Chinese capital in Hollywood; the acquisition was, however, made at a cost of 3.5 billion US dollars. This event had a positive effect on the group itself, primarily due to the rise of share price in the international stock exchanges of about 9%. The same year, the company also bought 50% of the French Auchan retail chain for $ 1.73 billion US, which is also very well-known brand in China. Nowadays, Wanda Group is one of the world top investors in the field of entertainment, media, real estate, etc. The growth and development of the company is due to enormous investments. Furthermore, it is a diversified company in terms of operating in more industries and markets. This is largely due to the fact that the parent company is in China, and although being a private company, it is constantly recording its revenue growth, and in that way improving the image of its brands worldwide. As for the future, the company's management certainly plans to expand primarily in field of entertainment in the US and EU, but also in the field of real estate in the Arabian Peninsula and East Asia.

Figure 5 - Total overseas investments of Wanda Group from 2012 to 2017 in Billions US$



Source: The authors' research is based on China Global Investment Tracker, Bloomberg, RHG Group

5. CONCLUSION

The expansion of Chinese state-owned and private enterprises has been gradual, both under strict control and support from the Chinese government. The investments were first in traditional forms of economy, and in recent years, Chinese companies have significantly expanded their scope of business. The Chinese government has recently limited the expansion of Chinese capital with a prior strategic preparation and decision at the state level. It is evident that the Chinese capital over the last two years has been mostly directed to the countries participating in the initiative One belt - one way (that is, New Silk Road). The idea is to strengthen the cooperation between the China and the countries of Asia, the Middle East, Europe and Africa through various forms of projects. To sum up, Chinese state-owned enterprises are limited by the Chinese government in terms of where, when and under what conditions they can invest. Chinese private companies have greater freedom of choice, but recently, there have been additional restrictions regarding the countries they can invest in. Both types of enterprises choose mainly acquisitions as the main form of overseas investment, and one of the reasons is certainly having a greater degree of influence and control, than in mergers or strategic alliances. Through these investments, Chinese companies are certainly enhancing their reputation than they had in the 1990s, and it can certainly be expected that state-owned and private enterprises will continue with this strategy, as it favours the development of the Chinese economy.

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