By Ben Simpfendorfer

Looking for China's future MNCs

Chinese firms are expanding globally; but it's still early days, and the hype is greater than the reality. There have been success stories; but Chinese firms face major challenges and it is the the next wave of private-led investment that will deal better with the challenges of internationalization. Slower growth might even encourage some of the country's better firms to look for opportunities abroad.

The rise in China's outbound investment is a divisive subject. On the one hand, some worry that Chinese multinationals will emerge as powerful competitors by leveraging their economies of scale and cheap funding. On the other hand, many firms are excited about the opportunities to collaborate with Chinese partners in their home markets.

For the most part, however, the hype is greater than reality, and subsequent waves of investment will be very different to the one the world is currently witnessing.

The best place to start is by benchmarking China's current performance as a foreign investor, and so comparing China's largest non-financial multinationals to those in the rest of the world is instructive. For a start (and unsurprisingly) Chinese companies are heavily involved in either extracting resources or shipping them home or building support infrastructure.

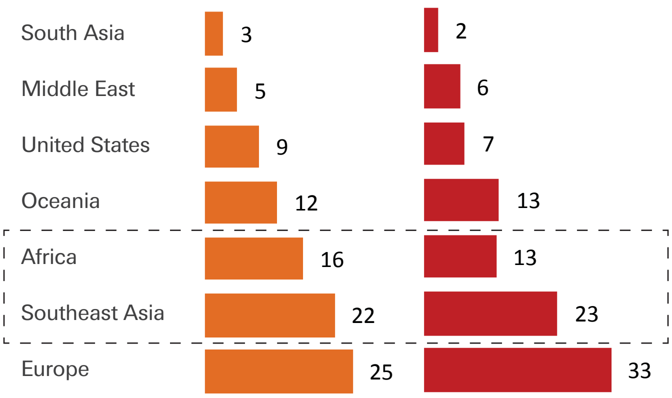
That's true of other emerging markets too. However, included among the top 100 emerging market multinationals ranked by foreign assets, of which China accounts for nine, are firms such as Malaysia's Genting, Hong Kong's Shangri-La, and South Africa's Naspers. Such service sector firms are only just emerging in China, and may perhaps form the next wave of outbound investors.

Indeed, there are tentative signs that China will follow in the footsteps of other emerging markets. Take the recent joint-venture between Tencent, China's largest social networking company, and PT Global Medicom,

China's outbound investment

China's outbound investment data shows that flows to Africa, Southeast Asia, and Europe dominate, albeit the data is adjusted to exclude the large amounts of money flowing through offshore centres.

Percent share of total stock (2009-11) and flow (2011), excluding Hong Kong, British Virgin Islands, and Cayman Islands.



Source: CEIC; SRA

Indonesia's largest media group; or Wanda's purchase of AMC Entertainment, the second-largest US cinema chain. (A global travel group would be a logical next target as Chinese tourists spend freely.)

Most interesting though will be the next wave of private-led investment, such as FosunPharma's recent purchase of Israeli-based Alma Lasers or Gree air-conditioning's production plants in Pakistan and Vietnam. They are important as private-owned firms may be more nimble to identify local partners and internationalise, if only because they lack the resources and government relations of the large state-firms.

Internationalisation is especially critical. Unctad data shows that for the typical global multinational, foreign staff and sales account for half of the total; few Chinese firms, especially the large state firms, could yet claim the same. For example, exports account for just 5 per cent of total sales for the Chinese auto sector, a figure far below Korean and Japanese producers in their early years.

It will also be important to ask whether Chinese companies, both state-and private, are investing abroad as an 'offensive' strategy, or 'defensive' reaction.

For those Chinese companies not involved in the resource business, many are investing abroad in response to rising production costs and fierce competition at home, according to official surveys. For second-tier companies, the results can be mixed as they struggle to adapt to local conditions, no different than would a second-tier company from America or Europe.

Take the Chinese construction companies in Saudi Arabia who had scooped up deals in the past decade. The major players, such as China State Construction Engineering are still competitive, but lesser known names chasing profit margins appear to be pulling out of projects or not bidding at all as project sponsors impose higher-quality requirements on them.

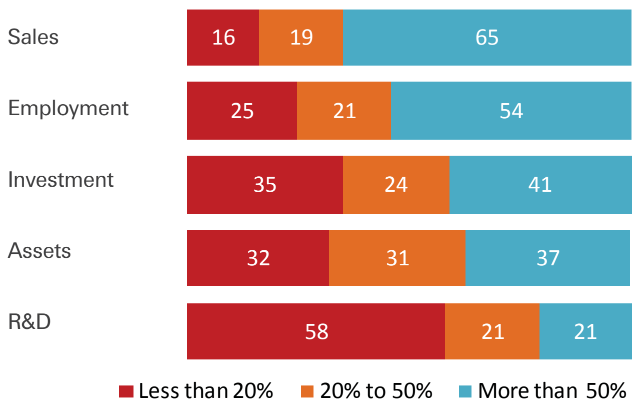
To be fair, some Chinese companies are maturing fast. Focusing on the companies that are successfully internationalising as an offensive strategy will help pick the winners from the losers. Huawei and Haier are good examples. However, for foreign companies looking to tie-up with more bite-sized Chinese counterparts, it is the lesser-known and privatly-owned companies that will be of greater interest.

For now, unfortunately, the best private companies may see more opportunities at home then abroad. Indeed, their investments may be made primarily to bring technologies back into China rather than build-out a global network. However, that will change if China's trend growth slows over the coming decade and opportunities at home dry up.

MNC internationalization trends

The typical MNC employs over half its staff in foreign markets..

Percent of respondents

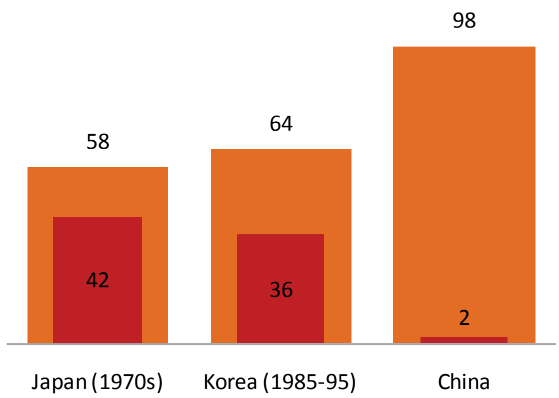


Source: UNCTAD

Foreign versus domestic auto sales

For Korean and Japanese auto markers, foreign markets accounted for more than one-third of total auto sales even during their early phase of development.

Percent of total sales



Source: CEIC

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