

China firms abroad: no venture, no gain

Poor image and security concerns are no deterrence for them

By TAN JIN SAN

CHINA is well-known as a cheap source of labour and materials, and as Asia's number one destination for foreign direct investment. However, in recent years, a growing number of Chinese companies have been muscling their way overseas to find new technology and markets to fuel China's growing economy.

TCL's takeover of Thomson, RCA and Alcatel last year and the acquisition of IBM's personal-computing business by Lenovo have proven that Chinese companies are becoming powerful players that are buying quickly into foreign markets.

On paper, the successful overseas acquisitions by Chinese enterprises seem impressive: Beijing-based PC maker Lenovo bought the PC division of IBM in May. TCL Communications, one of China's largest producers of cell phones, formed a joint venture last year that gave it control of Alcatel's handset unit. And sister company TCL Multimedia Technology Holdings took over the TV division of Thomson Corp, the French outfit that controls the RCA brand in the US.

Yet in reality, not all acquisitions of foreign companies have gone smoothly. The high-profile ventures of Chinese enterprises overseas seem to be plagued with problems: In July, Haier Group, China's largest appliance maker, and its two private equity partners dropped out of the US\$1 billion-plus bidding race for Maytag Corp.

In June this year, China's CNOOC attempted a takeover of California-based Unocal Corp, whose key attraction for China is that 70 per cent of its production units are located in the Asian region. This again raised suspicion among American politicians about economic and energy security. Despite CNOOC giving a number of pledges to allay concerns, including promising that most of the oil and gas produced by Unocal in the US will still be sold there and that most Unocal jobs in the US would be retained, the Congress in the US passed a law requiring a government study of the Chinese bid.

New territories

The deal was disrupted and Unocal was eventually taken over by US-based Chevron for US\$18 billion. If the deal had gone through for CNOOC, it would have been the largest overseas acquisition by a Chinese company. This level of ambition would mean that China is entering territories traditionally perceived well within the American sphere of influence. And the Americans are not taking it well.

Similarly, American politicians were concerned about national security in Lenovo's bidding to buy IBM's personal-computing business for US\$1.75 billion in December last year. Three Republican congressmen insisted that the deal could result in advanced US technology and corporate assets falling into Chinese hands. The takeover was subjected to a long review by the US government and the deal stalled, only to be completed in May this year.

An unflattering image and the nagging implication of politics will always follow Chinese companies in their acquisitions in the West, but there seem to be more advantages in the unexplored territory that the Chinese companies do not mind expanding and paying big money for. For example, it would usually take 20 years and very deep pockets to make a Chinese company a known brand in America, and they don't want to wait; they would rather buy.

Also, going global is about increasing the scale of production so Chinese companies can get better deals on raw materials, while establishing a brand for which consumers will pay a premium. In a way, the necessity to expand overseas is a question of survival.

However, analysts question whether China can succeed in its global reach. While Chinese companies excel at tapping inexpensive domestic labour to imitate successful goods at low cost, few have contributed much in the way of innovation.

With Chinese companies gaining a reputation for high-tech hardware, why is China not also a

software power? Perhaps the reason is that in the mainland, there are no software companies that can compare to hardware powers such as Lenovo and Huawei. For years, Beijing has tried to build up the software industry. But with piracy rates of about 90 per cent, it's extremely difficult for software companies to make the kind of money they need to grow into global powers.

Even though it is still early, some of the cross-continental deals have run into difficulties. Probably the hardest hit is TCL. In May, Alcatel withdrew from the TCL venture, and for the first nine months of 2005, TCL Communications lost US\$166 million on sales of US\$513 million, with losses coming mainly from the company's mobile communication and colour television units.

In the third quarter of this year, TCL Corp reported a net loss of US\$55.3 million, as compared to a net loss of US\$45 million in the previous quarter. In October this year, although TCL's mobile phone shipments to markets outside of China increased by 40 per cent, shipments in China dropped by 43.2 per cent.

Some analysts say the way TCL has handled its acquisitions have raised questions about the international expansion of other Chinese companies. TCL might have appeared to bite off more than it can chew, by wanting to run its show and cutting so many deals in so short a time. It is a costly lesson learnt for TCL in judging their ability to turn around the losses of the businesses they acquired.

The chairman of TCL Communication, Li Dongsheng, had promised a full profitable year in 2006 after restructuring and acquiring an international management team, and by launching products backed by the low-cost manufacturing structure on the mainland.

In Lenovo's case, they clearly think they have a better shot at making their deal with IBM a success by retaining key IBM personnel. It's too early to give an answer on the Lenovo/IBM deal, but it might shape out to be a different story from problem-plagued TCL. In a way, Lenovo is carrying out the transition methodically - it recognises its executives do not yet have the experience to lead Lenovo.

So it is buying the one thing from IBM that cannot be commoditised, that China can't produce more cheaply and more efficiently: superior management. American executives were brought in from IBM to mentor Chinese executives in the new office in Purchase, New York.

Although IBM's sale to Lenovo cleared the national security review, the high profile of the Chinese takeover attempts has not done anything to improve the image of Chinese brands and companies. The probe by the US government into the IBM-Lenovo deal has already sown some negative perceptions into the minds of some of IBM's corporate PC clients.

In a survey done by Merrill Lynch, almost half of IBM's customers said that they might change to another brand after the deal. After CNOOC finally dropped its bid to acquire Unocal in early August, chief executive officer Fu Chengyu admitted that CNOOC's lack of an image in the US and the fact that the West's perception of China is still somewhat negative may have contributed to their failed bid.

Chinese companies suffer from a bad image because they are believed to have inferior management and are slow in adopting Western management and financial practices, which is the main impetus behind Lenovo's 'buying' of management from IBM.

Security concern

Also, Chinese companies have a comparatively low level of experience with large-scale cross-border merger and acquisition transactions, as evidenced in only a few Chinese companies having professional Merger and Acquisition departments. There is also a wary sentiment among many in the West about Chinese companies taking over their own because despite two decades of reform and privatisation, some Chinese companies are still ultimately controlled by the government. This creates concerns regarding national security to be raised whenever a Chinese company attempts a major foreign takeover.

The situation is reminiscent of two decades ago, when Japan was the economic giant from the East that was on a spending spree acquiring US assets. Today, the big spender is China. The major takeovers by Chinese firms with huge spending power affirms the world's most populous nation's rising economic influence and its goal to be the central force on the world stage.

The spat over CNOOC is an indicator of the growing unease felt in developed economies, but especially in America, as more and more Chinese companies have looked abroad for expansion and technological know-how.

An increasingly assertive China is making its presence felt, its companies flush with cash and its government desperate to maintain its economic growth. It seems that notwithstanding poor image and security concerns, there is no stopping Chinese companies from venturing abroad. Undeterred by the American snub, PetroChina Co, the nation's biggest oil producer, is in discussions with its parent company about buying Calgary-based PetroKazakhstan Inc assets through a joint venture.

One way or another, there will be more of such deals in the coming year, but Chinese companies, wiser from the experience, will surely handle them in a more cautious way.

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