Outward Direct Investment by Chinese Enterprises

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Since 2004, Outward Direct Investment (ODI) by Chinese enterprises[1] has seen rapid growth. This paper chiefly introduces general status of growth in China's ODI, analyzes the relevant background and causes. Besides, it also presents three ODI cases, i.e. China National Petroleum Corporation (CNPC), Lenovo Group Ltd., and ZTE Corporation.

Since 2003, Chinese government departments (Ministry of Commerce, National Bureau of Statistics and State Administration of Foreign Exchange) have formally carried out statistics survey on ODI by Chinese enterprises and publicly released annual statistics bulletin. Unless otherwise stated, all the data in the text are quoted from the said gazettes.

1. Scale of the ODI by Chinese enterprises

1.1 General information

- Scale of 2006's ODI by Chinese enterprises
  In 2006, the ODI's flow was 21.16 billion USD, while ODI stock reached 90.63 billion USD.
- The growth in scale of the ODI by Chinese enterprises
  1) During 1994 -2003, the scale of the ODI had been sustained in a comparatively stable status at around 2 to 3 billion USD annually, with fluctuation in some exceptional years.
  2) During 2004-2006, the ODI growth had been sped up. The ODI (by non-financial sectors) had increased from 2.85 billion USD in 2003 to 17.63 billion USD in 2006, with average annually growth rate reached 83.6%.

[1] "ODI by Chinese enterprises" in the text refers to following business activities: the investor in China Mainland founds or purchases an enterprise in other countries, Hong Kong SAR, Macao SAR or Taiwan Province(China) by investing cash, physical assets, intangible assets etc, and thus hold a 10% (or above)shared ownership of the enterprise. The mode of investment include: investment by capital stock, profit re-investment and the investment related to the debt transactions between companies.

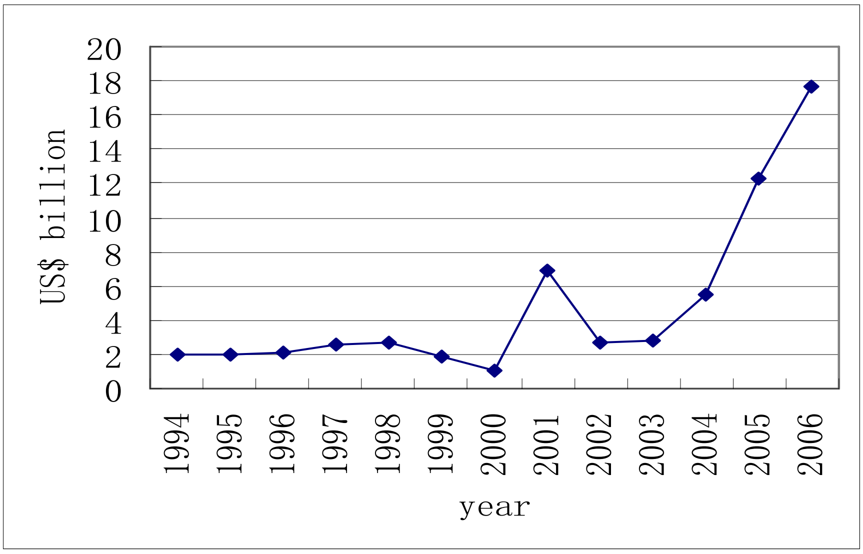

Figure 1: Chinese Enterprises' ODI Flow[2]

- The scale of China's ODI is still a considerable low one

  In 2006, the flow and stock of China's ODI is equal to 2.72% and 0.85% of World's totality respectively, while China's GDP accounted for 5.5% of World's total GDP (conversion is made on the basis of exchange rate quotation in the end of 2006); China stood no. 13 in world (country or region) ranking of ODI flow, while it ranked fourth in the same year's world ranking of GDP. These figures revealed that China's ODI is still at a considerable low level, international competitiveness of the Chinese enterprises is comparatively weak.

1.2 Background and analysis

- China's economy has been developed and it entered the ODI growth stage

  According to Investment Development Path Hypothesis (IDP) presented by Dunning, J.H. (1981，1986，and 1996), a country's FDI (including IDI, Inward Direct Investment and ODI, Outward Direct Investment) has a direct relationship with its economic development level. The developments of country's FDI are divided as 5 stages depending on country's GDP per capita: stage 1 represents status of most undeveloped countries, where there are small-sized domestic markets, insufficient infrastructures, labor shortage and low level of education, underdeveloped commerce and law system, both out-flow and in-flow of capital are quite low; in stage 2, foreign direct investment starts to increase, and thus brings spill-over

[2] Data of 2003-2006 are quoted from statistics bulletins released by China's government, Data of the years before 2003 are quoted from *The World Investment Report* by United Nations Conference on Trade and Development (UNCTAD). Before 2006, the statistics bulletin released by China's government only included data of non-financial industry's ODI, since 2006, the data of f financial industry's ODI have been included.

effects to local economy. Since the local enterprises generally have no advantage in ownership, their ODI is still under a quite low level; in stage 3, the level of IDI is still higher than that of ODI, but since the local enterprises have initially formed their competitive advantages in some sectors and have started to seek for more approaches to enforce their advantage in ownership, the ODI flow is set to rise, the disparity between IDI and ODI is shortening; stage 4 and stage 5 represent the status of developed countries.

Since China's implementation of "Opening up Policy" in 1978, a mass of IDI has been absorbed; meanwhile, the domestic economy has also enjoyed rapid growth for almost 3 decades. China's GDP per capita in 2006 was 2010 USD, ranked in middle-income countries. Grounded by economic development level, China is now in the transition period from stage 2 to stage 3. Due to the unbalanced regional economic developments, some regions are still at stage 2, while some others have already stepped into stage 3. In general, considering China's economic development level, the gap between IDI and ODI is shrinking.

Table 1: Leading Regions by ODI Flow and Stock(2006)

Rank	Region	ODI Stock (US$ billion)	ODI Flow (US$ billion)	GDP per Capita (US$)
1	Guangdong Province	4.17	0.63	3630
2	Shanghai	2.61	0.45	7330
3	Shandong Province	1.1	0.13	3040
4	Beijing(Peking)	0.92	0.06	6410
5	Zhejiang Province	0.7	0.22	4080

Source of data: data in "ODI flow" and "ODI stock" are quoted from government's statistical gazettes on ODI barring financial industry's data, data in column "GDP per Capita" are converted by authors according to exchange rate quotation.

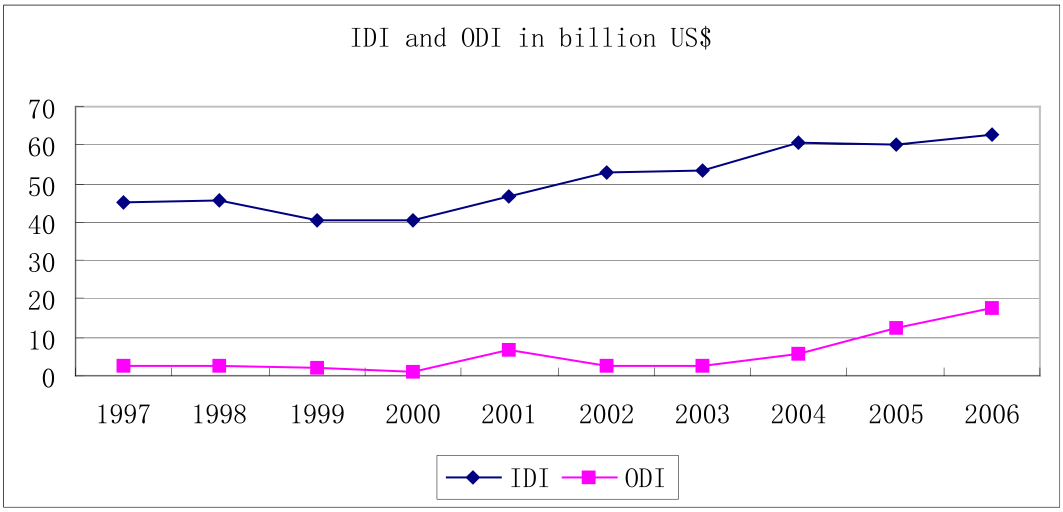

Figure 2: the Trend of FDI in China

source of data: National Bureau of Statistics, Ministry of Commerce.

- The competitiveness of Chinese enterprises is improving.

  Before implementation of “Reform and Opening up” policy, among all types of enterprises in China, state-owned enterprises had accounted for an overwhelming major proportion. During the process of “Reform and Opening up”, private-owned enterprises have been enjoying rapid growth, at present; most of middle/small-sized state-owned enterprises have realized privatization.

  China’s government has continuously carried out policies to reform existing large state-owned enterprises in the past years, the reforms covered separating government affairs from enterprise affairs, introducing multi-ownership, improving corporate governance etc. Most of large state-owned enterprises have been listed (include overseas IPO) with their wholly or partial assets. After the reform, state-owned enterprises are now completely running under the market rules.

  There have appeared some competitive enterprises among civil-owned enterprises, such as Huawei Technologies Co., Ltd. in Telecom equipment manufacture industry, New Hope Group in agriculture industry, etc.

Table 2: Chinese Enterprises (in China Mainland) listed in *Fortune Global 500, 2007*

Company	Rank	Industry	Revenues ($ million)
Sinopec	17	Petroleum Refining	131,636
China National Petroleum	24	Petroleum Refining	110,520.2
State Grid	29	Electric Power (Utilities)	107,185.5
Industrial & Commercial Bank of China	170	Banks	36,832.9
China Mobile Communications	180	Telecommunications	35,913.7
China Life Insurance	192	Insurance	33,711.5
Bank of China	215	Banks	30,750.8
China Construction Bank	230	Banks	28,532.3
China Southern Power Grid	237	Electric Power (Utilities)	27,966.1
China Telecommunications	275	Telecommunications	24,791.3
Agricultural Bank of China	277	Banks	24,475.5
Sinochem	299	Trading	32,109.2
Baosteel Group	307	Metals	22,663.4
China Railway Engineering	342	Engineering, Construction	20,520.4
China Railway Construction	384	Engineering, Construction	18,735.7
China FAW Group	385	Motor Vehicle	18,710.7
China State Construction	396	Engineering, Construction	18,163.2
Shanghai Automotive	402	Motor Vehicle	18,010.1
COFCO	405	Trading	17,953.2
China Minmetals	435	Trading	16902.2
China National Offshore Oil(CNOOC)	469	Petroleum Refining	16,038.9
China Ocean Shipping(COSCO)	488	Shipping	15,413.5

- China has been continuously integrating into global economy ever since its entry to WTO.

  Since China's accession to WTO in the end of 2001, China's markets have been further opened up; flows of FDI have covered almost all sectors. Many foreign companies invested in China to enjoy its low labor cost, favorable infrastructures, stable social and political environment and local markets with rapid growth rate. China has become a major processing and assembling base in global manufacture chain. The volume of China's commodity import and export trade has increased from 620 billion USD (2002) to 1760 billion USD (2006), among which, the volume created by processing trade and that created by foreign-invested enterprises accounted for over 50% respectively. The proportion of China's total volume of commodity import & export trade in GDP (converted to US dollar by using the exchange rate quotation of the same year) has rapidly increased from around 40% to around 65%. This revealed that the degree of China's participation in global economy has been increased rapidly. China's economy has integrated into global economy as an organic component. Along with large scale exchanges of material, capital, personnel and information, China's "opening up" process has created massive demand for transnational utilities and service networks and encouraged Chinese enterprises to invest in these areas.

- China has loosened government's control in ODI since its accession to WTO.

  Since China's accession to WTO in the end of 2001, the government has carried out thorough reforms in ODI management system, the system of policy has been gradually put on a legalized and systematized track, the policy system for overseas investment administration is transiting from one with strict control principle to the one with loose and moderate principle, this tendency is obvious in 3 aspects:

  1) Simplified examination and approval procedure for overseas investment. In respect of foreign exchange administration, foreign exchange risk examination procedure for the investment and the deposit required for guaranteeing back-remittance of profit have been abolished, the profits earned by overseas Chinese enterprises are no longer under compulsory repatriation, in stead, the enterprises are allowed to independently decide whether to convert the profits to enterprises' capital increase or to make it as overseas re-investment; meanwhile, the control on ODI by using purchased foreign exchange has been loosening. In respect of ODI project examination and approval, on the basis of pilot in some regions, Ministry of Commerce issued on Oct. 1th, 2004 "the Stipulations on Approval for Overseas Investment on Enterprises", in which items of files for application were reduced from 10 to 5. The cancelled items include "Certification on Enterprise's Imp. & Exp. Volume," and "Feasibility Study Report". besides, a time limitation for approval procedure was also specifically stipulated.

2) Transparency and neutral stand of the policies have been increasingly emphasized. In recent years, China's government has attached more importance to transparency of rules and regulations. All the examination and approval procedures related to ODI, government's intention in guiding enterprises to certain industries and regions, rules of administration on overseas enterprises have been public released on government's websites. Moreover, Government's service function has been improved, government's websites are more and more utilized for conveying information on overseas investment and cooperation. In the attitude towards enterprises' overseas investment, the principle of "equal treatment without discrimination" has been adopted. Differential treatment based on types of enterprise's ownership was no longer adopted.

2. Target sectors of ODI

Chinese enterprises' ODI are concentrated mainly in six sectors: mining, commercial service, finance, transportation and storage, whole sale/retail trade, and manufacturing.

2.1 General information

- Industrial distribution of ODI flow

  Features of industrial distribution of ODI flow in 2006:

  Mining: 8.54 billion USD, accounted for 40.4% of 2006's total. Major sectors were oil and natural gas mining industry, black metal mining and dressing industry.

  Commercial Service: 4.52 billion USD, accounted for 21.4% of totality, with share holding as major mode of investment.

  Finance: 3.53 billion USD, accounted for 16.7% of totality.

  Transport & storage: 1.38 billion USD, accounted for 6.5% of totality with "waterway transport" as major sector of investment.

  Whole sale/retail trade: 1.11 billion USD, accounted for 5.2% of totality. Major investments go to trade companies.

  Manufacturing: 910 million USD, accounted for 4.3% of totality. Major ODI sectors include manufacturing of telecommunication equipments, computer and other electronic equipments, textile, electrical machine manufacturing, transport equipment manufacturing, wood processing, general equipment manufacturing, black metal smelting and etc.

  Other sectors accounted for a quite small proportion in totality, around 5%.

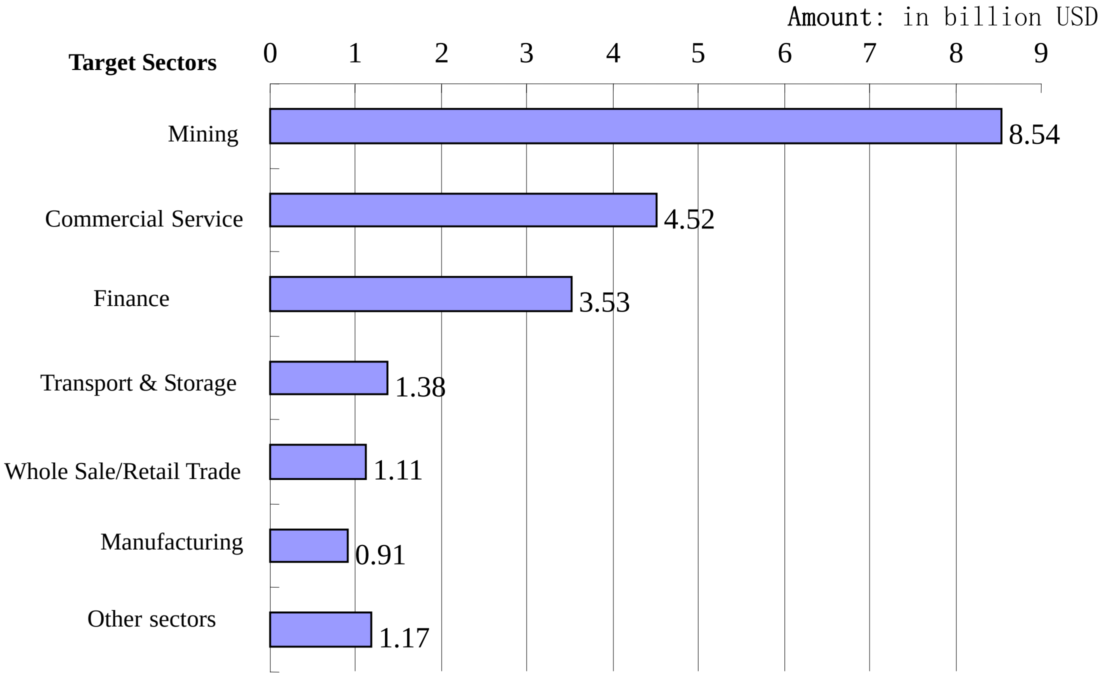

Figure 3: Distribution of Chinese Enterprises' ODI Flow

- Industrial distribution of ODI stock

The features of distribution of Chinese enterprises' ODI stock in 2006 are:
Mining: 17.9 billion USD, accounted for 19.8 % of totality; major sectors were oil and natural gas mining industry, black metal and nonferrous metal mining and dressing industry.
Commercial Service: 19.46 billion USD, accounted for 21.5% of totality. "Holding" is major mode of investment.
Finance: 15.61 billion USD, accounted for 17.2% of totality, among which, Banks' stock amounted to 12.336 billion USD, accounted for 79% of the industry's total stock.
Transport & storage: 7.57 billion USD, accounted for 8.4% of totality with "waterway transport" and "air transport" as major sectors.
Whole sale/retail trade: 12.96 billion USD, accounted for 14.3% of totality. ODI stock was mostly held by foreign trade enterprises.
Manufacturing: 7.53 billion USD, accounted for 8.3% of totality. Major ODI sectors include: manufacture of communication equipment, computer and other electronic equipment, textile, electrical machine manufacture, transport equipment manufacture, medical and pharmaceutical products manufacturing, metal smelting and processing etc....
Other sectors' stock accounted for 10.5% of totality.

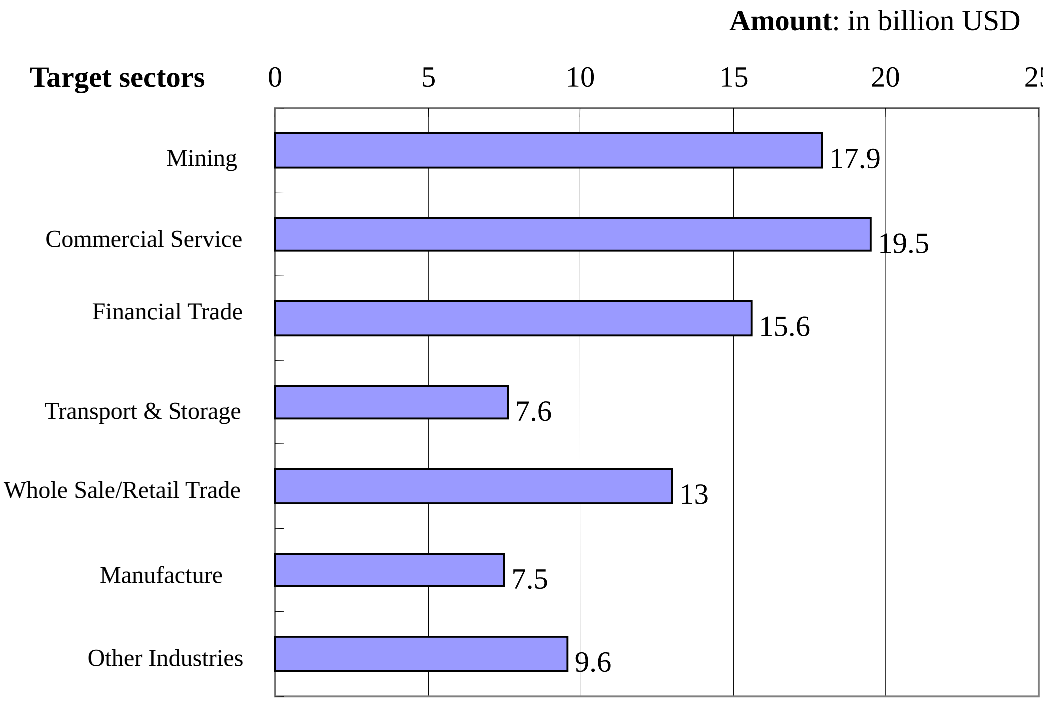

Figure4: Distribution of Chinese Enterprises' ODI Stock, 2006

2.2 Background and analysis

By analyzing the distribution of target industries, we found a close relationship between Chinese enterprises' globalization and their domestic economic activities.

- ODI in mining industry were mainly placed for meeting domestic demand.

  China is a country in relative shortage of natural resources, e.g. in 2006, China's external dependence of iron ore and oil rated over 50% and 40% respectively. Although domestic minerals processing enterprises are able to acquire overseas mineral resources by trade; however, scarcity and monopoly of resources still constantly lead to price fluctuation by a big margin in world's market, there has been a tendency of jumps in recent years. With a view to raising competitiveness, large domestic enterprises in energy industry or mineral processing industry had to take strategic investment in overseas natural resources into consideration. In 2006, ODI flow and stock of mining industry accounted for 40.4% and 17.9% of totality respectively.

- ODI in finance, transport, whole sale/retail trade are chiefly initiated for facilitating cross-border trade and exchange.

  The major mode of Chinese financial sector's ODI was "overseas network" set by state-owned large banks. ODI of transport industry concentrated in waterway transport and air transport. The investments in these industries have extended China's networks of infrastructure to overseas places and facilitated transnational exchange of commodities, capital and personnel.

In whole sale/retail trade, the major mode of ODI was "overseas marketing network" set by foreign trade enterprises for undertaking transnational sale, purchase as well as for providing after-sale service. These investments have directly served China's foreign trade.

In 2006, the ODI flow and stock of above mentioned three sectors respectively accounted for 28.4% and 39.9% of totality.

- ODI in manufacturing remained a considerable low proportion in totality

  ODI in manufacturing shared a quite low proportion in Chinese enterprises' ODI in 2006 with its flow and stock amounting 4.3% and 8.3% respectively. Although the cases of overseas merger and acquisition by Chinese manufacturing enterprises such as "Lenovo /IBM PC division merger", "TCL/Thomson TV division merger"have caused great sensational effect, however, in amount, the industry still shared a quite low proportion in totality.

- ODI in commercial service showed no distinct target of industry.

  Owing to the lack of information on "target industries", some investments placed for tax avoidance (e.g., ODI in Cayman Is.) have been included in "Commercial service industry". Some investors would possibly have regarded those tax havens as transfer stations of investment.

The above industrial distribution revealed that, although Chinese enterprises' ODI is under rapid increase; however, we see no sign of great increase in the enterprises' international competitiveness. Chinese enterprises' ODI is under specific background: the motive of investment is mostly to meet domestic demand and to facilitate China's foreign trade and exchanges. It has a direct co-relation with rapid growth of domestic economy and high growth rate of foreign trade. At the present stage, Chinese enterprises have not got strong international competitiveness although they enjoy some comparative advantages in manufacturing.

3. Target region of ODI

3.1 General information

83% of China's ODI (non-financial sectors) flowed to two regions: Hong Kong, Cayman Is. and British Virgin Is., the flows to other counties/regions are quite scattered.

Table 3: Top 10 Recipients (Country or Region) of China's ODI Flow (Non-Financial sectors), 2006

Rank	Country/Region	Amount（in 100 million USD）	Proportion（%）
1	Cayman Is.	78.3	44.41
2	Hong Kong SAR, China	69.3	39.31
3	British Virgin Is.	5.38	3.05
4	Russia	4.52	2.56
5	U.S.A.	1.98	1.12
6	Singapore	1.32	0.75
7	Saudi Arabia	1.17	0.66
8	Algeria	0.99	0.56
9	Australia	0.88	0.50
10	Mongolia	0.87	0.49

3.2 Background and analysis

- Hong Kong is a window and bridge for Chinese enterprises' globalization.

  In 1997, the involved parties specified major principles for developing economic and trade relationship between returned Hong Kong and Chinese Mainland, i.e., the trade between two regions would be regarded as import and export business, the separate tariff system of Hong Kong would be remained, when making investment in mainland, Hong Kong SAR's enterprises could continuously enjoy "foreign investor treatment", and the investments in Hong Kong SAR by mainland's investors would remain to be regarded as "overseas investment".

  In Asia, Honk Kong SAR always plays roles as financial centre, trade centre and shipping centre. Owing to the high degree of economic integration of Hong Kong and China Mainland, the investment volume in Hong Kong by mainland's enterprises has been a quite enormous one. Mainland's enterprises have not only positively participated in economic activities in Hong Kong, but also frequently regard Hong Kong as a bridge guiding them to globalization, e.g., many mainland's enterprises have either made financing in HK's capital market or set branch offices there for unfolding international business etc.…

- The investment in Cayman Is. or British Virgin Is. might be initiated with multiple motives. When registering in Cayman Is. or British Virgin Is., an enterprise may enjoy some favored treatment such as tax-free, non-foreign exchange control and etc. The two regions were statistically major destinations of China's ODI. There were no data found by us to explain the real motive of the investment in the regions; however, by studying the features of regions' investment environment, we inferred that the following several possibilities would have been existed: regarding the region as transfer station of their ODI; regarding the region as tax-haven or a place for profit transfer; making a registration there might enable the enterprise to realize overseas IPO.

4. Enterprises engaged in ODI

4.1 General Information

The quantitative distribution of enterprises engaged in ODI is quite scattered. As for the distribution by enterprises' legal form, the enterprises with share holding system accounted for 44%, state-owned enterprises accounted for 26%, other forms of enterprises account for 30%. By industrial distribution, manufacturing enterprises accounted for 53.4%, whole sale/retail trade enterprises accounted for 14.3%.

By investment volume, "central enterprises"(namely the state-owned enterprises under direct control of State-Owned Assets Supervision & Administration Commission of the State Council) were major investors of Chinese enterprises' ODI. In 2004, 2005 and 2006, the proportions of central enterprises' ODI flow (non-financial) in totality were 82%, 83% and 86% respectively. Table 4 shows the largest 30 Chinese companies by ODI (non-financial) stock in 2006.

Table 4: China's Top 30 Companies by ODI Stock (Non-Financial Industry), 2006

Rank	Company	Type of Enterprise
1	China Petrochemical Corporation (Sinopec)	Central enterprise
2	China National Petroleum Corporation	Central enterprise
3	China National Offshore Oil Corporation(CNOOC)	Central enterprise
4	China Resources(Holdings) Co., Ltd.	Central enterprise
5	China Mobile Communications Corporation(CMCC)	Central enterprise
6	China Ocean Shipping(Group) Company(COSCO)	Central enterprise
7	China International Trust & Investment Corporation(CITIC Group)	Central enterprise
8	COFCO Limited	Central enterprise
9	China Merchants Group	Central enterprise
10	Sinochem Corporation	Central enterprise
11	China State Construction Engineering Corporation	Central enterprise
12	China National Aviation Holding Company	Central enterprise

13	China Telecommunications Corporation(China Telecom)	Central enterprise
14	China Shipping(Group) Company	Central enterprise
15	China Network Communications Group Corporation(CNC)	Central enterprise
16	Guangdong Yuegang Investment(Holding) Co., Ltd.	Local state-owned enterprise
17	China Power Investment Corporation	Central enterprise
18	Shanghai Automotive Industry Corporation(Group)	Local state-owned enterprise
19	ChemChina	Central enterprise
20	China Minmetals Corporation	Central enterprise
21	Lenovo Holdings Ltd.	State-owned enterprise
22	Shum Yip Holdings Co., Ltd.	Local state-owned enterprise
23	China National Foreign Trade Transportation (Group) Corporation (Sinotrans)	Central enterprise
24	Huawei Technologies Co., Ltd.	Privately-owned enterprise
25	Baosteel Group	Central enterprise
26	China Huaneng Group	Central enterprise
27	Sinosteel Corporation	Central enterprise
28	China Poly Group Corporation	Central enterprise
29	China Nonferrous Metal Mining(Group) Co., Ltd.(CNMC)	Central enterprise
30	Haier Electrical Appliances Co., Ltd.	Collective enterprise

Note: “central enterprise” refers to the enterprise wholly owned or share-controlled by State-Owned Assets Supervision & Administration Commission of the State Council; “local state-owned enterprise” refers to the enterprise wholly owned or share-controlled by State-Owned Assets Supervision & Administration Commission of local level.

4.2 Background and analysis

Through reform, almost all medium and small stated-owned enterprises have been privatized; however, the central government is still controlling and administrating 150-160 large state-owned enterprises. Majority of these enterprises distributed in oil & petrochemical industry, military industry, electric grid & power industry, telecom industry, coal industry, civil aviation, shipping, equipment manufacturing, automobile industry, electronic information, construction, steel industry and etc. By the end of 2006, the sum total assets of these central enterprises reached around 1500 billion USD. Since the central enterprises are centralized in some fundamental industries covering infrastructure construction, raw material supply and equipment manufacturing, they definitely play an important role in China’s economic development.

The reformed central enterprises have realized market-oriented operation. Many large enterprises are listed on overseas stock market with their whole or partial assets, by this step, they have not only realized multi/international-share ownership but also been put under the supervision of the relevant systems set by both domestic and international capital markets. The enterprises listed on overseas markets include: three largest oil enterprises- China Petrochemical Corporation (Sinopec), China National Petroleum Corporation (CNPC), China National Offshore Oil Corporation (CNOOC); four large telecom operators- China Mobile Communications Corporation (CMCC), China Telecommunications Corporation(China Telecom), China United Telecommunications Corp., Ltd.(China Unicom), China Network Communications Group Corporation(CNC),etc.

With a view to developing itself as well as to providing reasonable return to share holders, central enterprise must continuously expand its business scale. Since the enterprises have some inherited advantages in domestic economic competition, they may initiate overseas investment by relying on the advantages. For example, oil enterprises could utilize their domestic market status to make ODI in fields of overseas natural resources, while the domestic bank, air company, telecom company and shipping company could extend their domestic operation networks to overseas places.

5. Mode of ODI

5.1 General information

In 2006’s ODI, 8.25 billion USD were invested by merger or acquisition, thus accounted for 39% of total flow. The amount of non-financial sectors and financial sectors accounted for 7 billion USD (40% of total flow) and 1.25 billion USD (35% of total flow) respectively.

5.2 Background and analysis

Merger & Acquisition (M&A) is a major mode adopted by the investors of western developed countries it their overseas investment. Chinese enterprises are attempting to use this mode in their overseas investment, e.g. TCL merged Thomas TV division, Lenovo merged IBM PC division, etc.

In generally, Chinese enterprises are still in the process of learning overseas

M&A. Some problems have appeared in Chinese enterprises' exploration in overseas M&A. Firstly, lacking of necessary knowledge on overseas social environment and legal system, e.g. shortage of necessary awareness in employment and dismissal system; Secondly, difficulties are existed in enterprises' integration, there are great cultural gaps existing between countries and enterprises, merged enterprises often have difficulties in communication. Thirdly, lacking of knowledge on various potential restrictions set by certain countries for overseas M&A, e.g. when attempted to merge enterprise in USA, China Offshore Oil Corporation encountered some unexpected resistances.

6. Motives for ODI

China is a developing country, Chinese enterprise' international competitiveness is at a relatively low level. In the past 3 years, steps of China's ODI has been fastened, the main cause is the rapid growth rate of domestic economy. Moreover, with China been increasingly integrated into economic globalization, ODI related to domestic economic activities has gradually increased. However, ODI made for participating in international competition by relying on enterprises' own advantages is comparatively small.

6.1 Two major motives for Chinese enterprises' ODI:

- Resource seeking

  Mining industry has always accounted for major proportion of ODI. In 2006, the industry's proportions in ODI flow and stock are 40.4% and 19.8% respectively. Investment objects in the field of natural resources are mainly oil and gas mining, black metal and nonferrous mining & dressing industry.

- Market seeking

  ODI drove by market seeking are chiefly those investments related to foreign trade and exchanges, for example, the investments in financial sector, transport and whole sale/retail trade are all directly related to domestic economic activities. In 2006, all these three industries contributed 28.4% and 39.9% of state's total ODI flow and stock respectively.

  Chinese enterprises in manufacturing industry are initiating their overseas investment by relying on their competitive advantages, though the scale is still very small. In 2006, the industry contributed 4.3% and 8.3% of state's total ODI flow and stock respectively.

6.2 Subordinate motives：

- Assets seeking
  A few enterprises start to merge overseas enterprises holding advanced technologies, e.g. in 2002, BOE Technology Group Co., Ltd. acquired Korea's Hyundai Electronics' TFT-LCD business held by HYNIX Semiconductor Inc.

- Efficiency seeking

  A few companies start to make their overseas investment for avoiding trade barriers, e.g. some manufacturers of consumer electronic products have founded factories in Europe for entering European market.

7. Cases

7.1 Case I: China National Petroleum Corporation

China National Petroleum Corporation(hereafter called "CNPC") is an oil corporation with integrated businesses covering oil and gas field exploration and mining, engineering technologies service, oil refining and oil products marketing. The feature of CNPC's ODI is: a multi-mode is adopted in its overseas oil resource investments.

7.1.1 General status of CNPC

CNPC, formerly a governmental department-The Ministry of Petroleum Industry(in charge of Chinas oil producing), possesses China's most resources of scientific research capacity, qualified personnel, oil and gas in various upstream fields such as oil exploration, mining, producing etc. In 1998, by mode of administrative arrangement, a part of Sinopec's refining and marketing business was incorporated into CNPC to make it an integrative oil company. In April 2000, PetroChina Co., Ltd. (the core domestic assets held by CNPC) was listed in New York and Hong Kong and raised a fund of 2.89 billion USD.

At present, CNPC is the largest oil and gas producer, supplier and overseas resources developer, second-largest crude oil processing and oil products supplier in China. By the end of 2006, CNPC had total assets of 1396.5 billion RMB and 1.013 million employees. In 2006, CNPC's realized revenue was 923.2 billion RMB, total profit was 185.7 billion RMB; domestic crude oil output was 106.64 million tons, accounted for 58.1% of country's total output; crude oil processing output was 115.87 million tons, accounted for 37.8% of state's total output, company's output of finished oil products reached 73.39 million tons, accounted for 40.3% of state's total output. CNPC ranked 39th In "Fortune Global 500, 2006", and 7th in "2006 Global Top 50 Oil Companies" by US-based PIW.

7.1.2 Analysis on company's motive behind ODI

CNPC had two major motives for its overseas investment:

a. Owing to the shortage of domestic oil resource, it needed to acquire some overseas resources. China's domestic crude oil output is expected to be stable in the next decade; while in the succeed 2 decades, it will gradually fall down owing to the limited reserves. As for domestic oil consumption, the demand will keep a high growth rate within a quite long term in future. In 2006, China's external oil dependence rate (net crude oil imports/apparent consumption) reached 43.1%. IEA's report predicated that China's external oil dependence rates may rise to 60% and 76% by 2010 and 2020 respectively.
b. The second motive is to raise company's international competitiveness. CNPC's strategic target is to become a transnational oil enterprise with international competitiveness; however, the journey to the target is still very long. The realization of ODI in focus of resource seeking would help CNPC to improve its unfavorable situation of considerable low reserve replacement ratio (this ratio reflects to a certain extent the company's capacity in keeping sustainable growth). In comparison with global major international oil companies, CNPC's reserve replacement ratio is quite low, less than 100% for the 3 consecutive years since 2001, thus formed a gap between large international oil companies (most of those companies have a ratio of over 100%) .

In brief, the major motive of CNPC's ODI is acquiring overseas oil and gas resources, so as to strengthen its own capacity in oil supply; this is a resource-oriented type of investment. Moreover, along with upgrade of its capacity, CNPC is accelerating its investment in overseas downstream operations, it expected to acquire company's overseas downstream assets through founding joint refining factories, merging integrative oil companies, so as to gradually transform itself into an international oil company.

7.1.3 Major activities and mode of ODI

CNPC launched its first ODI project in 1993 by bid, named as "Peru's Talara Zone 6 and 7 Project," after the project, it has expanded business in Venezuela, Canada, Equatorial Guinea, Sudan and Kazakhstan. CNPC's overseas investments are operated by its wholly owned subsidiary-China National Oil & Gas Exploration and Development Corporation (CNODC). CNODC was founded in 1984, undertaking the external co-operations of domestic oil & gas development. Since 1993, it has taken up ODI operations. Until present, CNODC has established 45 overseas project companies and many overseas local companies (or branch companies), it has nearly 20000 Chinese and foreign employees, quantity of employees dispatched by CNODC are more than 1400.

By the end of 2006, CNPC's ODIs have covered 26 countries in four continents with 65 oil/gas projects; five comparatively centralized oil/gas producing zones lying in North Africa, Middle East, Middle Asia, North & South America and Asia-Pacific are initially formed. At present, CNPC has following overseas production capacity: crude oil- 55 million tons per year, gas- 5 billion cubic meters per year, pipeline transport- 52 million tons per year, oil refining- 11 million tons per year. An industrial chain of industries covering oil/gas exploration & mining, pipeline transport, refining & chemicals and products marketing begin to take shape.

Major modes of ODI: purchase, share, construction bid, joint venture construction.

7.1.4 Achievement of ODI

CNPC's overseas equity output had increased from 500,000 tons by 1997 to 28.07 million tons by 2006, the proportion of overseas output in CNPC's total output had also increased from 0.3% by 1997 to 20.8% by 2006. By the end of 2006, the company had possessed 4.5 billion tons of proven geological oil reserves and 650 million tons of remaining recoverable reserves.

Table 6: Proportion of Overseas Crude Oil Equity Output in CNPC's Total Output

	2000	2001	2002	2003	2004	2005	2006
Output of crude oil(in 10 thousand tons)	11295	11483	11755	12243	12818	12598	13471
Overseas equity output (in 10 thousand tons)	690	831	1011	1288	1642	2002	2807
Overseas Proportion （%）	6.1	7.2	8.6	10.5	12.8	15.9	20.8

Source of data: collected and sorted out by authors.

7.2 Case II: Lenovo Group Ltd.

Lenovo Group Ltd. (hereafter called "Lenovo") is a computer manufacturer ranking 1st in China and 3rd in world. In 2005, Lenovo merged IBM PC division.

7.2.1 Company's general status

Founded in 1984 with initial 11 employees, Lenovo chiefly engaged in technical service and trade of computer. In 1990, the company put out first set of PC with "Lenovo"brand. In 1994, Lenovo was listed in Hong Kong stock market. By 1996, Lenovo's had a largest share in China's computer market. In 1999, Lenovo became one of the top computer companies in Asia-Pacific market. Since 2003, Lenovo has entered into global market. In May 2005, Lenovo merged IBM's worldwide PC business.

Lenovo has more than 19,000 employees world wide. Its headquarter is located in Purchase, N.Y. , USA, two major operation centers were set in Beijing, China and Raleigh, North Carolina, USA. In 2006-2007 fiscal year, the company realized revenue of 14.6 billion USD and a profit of 161 million USD.

7.2.2 Major activities and mode of ODI

In May 2005, Lenovo purchased IBM's overall laptop and desktop business, including worldwide business and business related covering customer management, secondary sales, distribution, direct sales channel of laptop computer, desktop computer; "Think" brand and relevant patent; IBM's joint venture company in Shenzhen(barring X series product line), Guangdong, China and R & D centers located in Yamato, Japan and Raleigh, North Carolina, USA.

The mode of M&A was: Lenovo paid directly to IBM 1.25 billion USD, including 650 million USD by cash and Lenovo's stocks with market value amounting 600 million USD (accounted for 18.9% of Lenovo's total share); besides, by the purchase, Lenovo took on IBM's net debt amounting 500 million USD. Meanwhile, Lenovo acquired 350 million USD strategic investments provided by world's three largest private share investment companies, i.e. Texas Pacific Group, General Atlantic and New Bridge Capital LLC.

7.2.3 Analysis on motives behind ODI

Lenovo's major ODI was its merger with IBM's worldwide PC business in 2005. The major motives can be summarized as below:

First, Lenovo's strategic target is becoming a leader in world's PC market. Since 1996, Lenovo has been a leader in PC market in China and Asia-Pacific (barring Japan). In 2003, Lenovo established its international development strategy, i.e. becoming an international PC company providing services for both worldwide enterprise customers and private customers. Its strategic target is "becoming a leader in global PC market by2010".

Table 7: Evolution of Strategies of Lenovo since Its Establishment

Span	Business Scope	Strategic Target
1985~1989	Computer and products related	Enter into field of computer service
1990~1997	Took PC business as a key, attached importance to distribution by agents	Largest PC manufacturer, agent and service provider of info-products in Chinese Mainland.
1997~2003	Computer, system integration, software, network product, mobile phone and service, etc.	Plural-development in IT industry, become a major network service provider, build up a system of technical innovation.
2003~ Present	Computer, mobile phone	Global leading enterprise in PC field

Source of data: collected and sorted out by authors.

Second, PC market was then under global competition featured by "internationalized manufacturing, homogenous products", the companies having small market share would easily to be washed out.

Third, before M&A, Lenovo was only a regional company standing in 9th in global computer market share ranking, in comparison with those international companies such as Dell and HP, the gap is quite huge. It would be very difficult for Lenovo to approach its target of "becoming a global leading PC company" merely by its own expansion on a fully competitive market. Therefore, purchasing advanced enterprise in the industry could be a short cut.

To sum up, the major motive for Lenovo's merger with IBM's PC business was acquiring brands and sales channels and swiftly enlarges its overseas sales scale, so as to make the company a global PC enterprise.

7.2.4 Achievement of ODI

Since the M&A, Lenovo's rank of share in global computer market had jumped from 9th to 3rd , its annual revenue had raised by 360% after the M&A(to compare 05-06 fiscal year with 04-05 fiscal year), it had risen with spring a global leading PC enterprise.

Table 8: Turnovers and Pretax Earnings by Lenovo, 2005-2006 Fiscal Year

	First Quarter		Second Quarter		Third Quarter	
	Total Amount	Year on Year Increase （%）	Total Amount	Year on Year Increase （%）	Total Amount	Year on Year Increase （%）
Turnover (in 100 million HKD)	196	234	285	404	311	392
Pretax Earning (in 100 million HKD)	5.15	54	5.07	70	4.98	46

Sources of data: financial statements by Lenovo.

The more important achievement was that, by the M&A, Lenovo had transformed itself from a regional company into an international company, this transformation enabled Lenovo to balance its business development within a worldwide scope with Asia-Pacific area as a basement. In Lenovo's 2006-2007 turnovers amounting14.6 billion USD, the Greater China Region contributed 38%, America contributed 28%, Asia-Pacific area (exclude the Greater China Region) accounted for around 10%, Europe, Middle East and Africa amounted about 21%.

Table 9: Regional Distribution of Quarterly Turnovers by Lenovo, 2006-2007 Fiscal Year (In 100 million USD)

	The Greater China Region		America		Asia-Pacific Area (Barring the Greater China region)		Europe, Middle East and Africa	
	Total	Share	Total	Share	Total	Share	Total	Share
First Quarter	13	39	10	29	4.61	13	6.62	19
Second Quarter	14	39	11	29	4.39	12	7.51	20
Third Quarter	16	40	10	26	4.6	11	9.13	23
Fourth Quarter	12	36	9.97	29	4.73	14	7.31	21

Source of data: financial statements by Lenovo.

7.3 Case III: ZTE Corporation

ZTE Corporation (hereafter called "ZTE") is a rising telecom equipment manufacturer. The major feature of ZTE's ODIs is "setting up overseas sales service network and R& D centers by greenbelt investment".

7.3.1 Company's general status

Founded in 1985, ZTE's initial business scope chiefly covered processing of electronic products; the company later launched R & D projects of digital program-controlled switches (PCS). ZTE successfully developed 500-line digital PCS in 1989 and 10,000- line digital PCS in 1995. Since 1996, ZTE has expanded its business from single product line of switches to plural-product lines of switches, transmission, access network, video communication, power supply etc, and has initiated its exploration in international market. In 1997, ZTE was listed in full-circulation A-share market in Shenzhen, China, the funds raised from stock market were used for R & D of technologies covering mobile products, digital products and optical communication products. In 2002, ZTE founded its mobile phone division so as to step into the end market of mobile phone. In 2004, ZTE was successfully listed in Hong Kong stock market. The products and services provided by ZTE has been massively introduced in some developing countries in Asia, Africa, Latin America and East Europe etc. Besides, it has got some business in developed countries' markets.

In 2006, ZTE's had a sale amounting 2.767 billion USD and total assets of 4.573 billion USD.

7.3.2 Background and motives of ODI

The competition in China's telecom equipment market is quite intensive. China has an enormous and fully-opened market focused or partially locked by all of world's major manufacturers. Local enterprises can only get a small share of the market.

There have appeared enormous opportunities for development in international market. Since 1999, bubbles in worldwide network economy have burst and telecom industry has stepped into low tide of development. The growth speeds of almost all international leading companies in the industry such as Lucent, Ericsson, Nortel, Nokia, Motorola etc. have been slowing down, more worse, most of such companies had to encounter huge loss, in succession, they had to reduce the cost by shrinking overseas market lines and large-scaled staff reduction. Meanwhile, they focused on key markets such as China. On the one hand, the low tide had created unprecedented pressure to Chinese telecom equipment manufacturers in domestic competition; on the other hand, it had also provided a rare chance for this manufacturer's globalization. There has appeared the tendency of rapid grow of telecom investment in the countries and regions such as India, South-East Asia, Latin America, East Europe and Africa, in some countries, the growth rate of the investment ever exceeded 20%. Relying on those well-developed technologies such as PCS, access network, optical transmission etc., ZTE has provided just in time the products with high performance-price ratio, so as to meet the demand in some developing countries.

The target of ZTE's ODI is "occupying overseas market". The company's products had occupied a ready market in China, and there exists comparability between the telecom equipment market in China and that in many developing countries, i.e. insufficient infrastructure of the industry and low purchasing power. The growth of the market in these countries is slower than that in China; China's "low cost mode" has erected a good example for these countries; therefore, ZTE's products and business mode could be easily copied to these developing counties.

7.3.3 Major activities and mode of ODI

The company started its foreign trade in 1996. During 1996 -1997, it had mainly exported PCS. During 1998-1999, plural-products had been exported, and overseas scaled contracted telecom project had been initiated. Since 2000, ZTE has started ODI and it has accelerated its ODI since 2004.

ZTE has set up 17 overseas customer service centers providing fast and convenient technical support and engineering service as well as the “7 days x 24 hours” full-time-service for overseas operators and more than 500 customers in over 120 countries.

12 sales platforms and more than 80 sales representative offices have been established by ZTE in overseas market. These networks are engaged in exploitation of local markets.

ZTE have also founded several overseas R & D centers in USA (San Diego, New Jersey, Dallas), Sweden, France, India, Pakistan etc. to form an international R& D network.

The major modes of ZTE’s ODI are: setting up service center, sales representative office, factory, training center, institute, etc. ZTE’s overseas assets now accounts for 10% of its total assets. ZTE has 6500 overseas employees (most of them are local staff), amounting to around 25% of company’s staff.

The company’s overseas investment are mostly scattered in South Asia, South-East Asia, Africa, etc.

7.3.4 Achievement of ODI

The massive ODI have supported growth of overseas earnings as well as the overall performance of ZTE. In 2006, ZTE’s actual earnings on China’s market were decreased in comparison with the last years’ performance. However, overseas earning supported the increase of the whole performance. During 2005 to first half year of 2007, the proportion of ZTE’s earnings in China’s market had been continuously decreased, while the proportion of overseas earnings had exceeded 50%. Asia and Africa’s market had contributed most of ZTE’s overseas earnings, in the next few years, the proportions of other regions’ earnings are expected to be increased.

Table 10: Regional Distribution of Earnings by ZTE
(In million USD)

	Total Earnings	China		Asia		Africa		Other Regions	
		Earnings	Proportion (%)	Earnings	Proportion (%)	Earnings	Proportion (%)	Earnings	Proportion (%)
2005	**2767**	**1778**	64.3	**586**	21.2	**364**	13.2	**381**	13.8
2006	**2953**	**1641**	55.6	**737**	25.0	**328**	11.1	**245**	8.3
First Half Year, 2007	**1953**	**931**	47.7	**510**	26.1	**237**	12.1	**274**	14.1

Source of data: financial statements by ZTE.

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