Overseas Expansion of Chinese Business: Lessons and Challenges

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Making Sense of Three Recent Expansion Cases

LENOVO
IBM PC

LENOVO (New)

Timing
Inadequate PR & Brand Promotion
Post-Merger Integration Concerns
Insufficient Overseas M&A Experience
Public Resistance
Multinational Business
Veto on Capitol Hill
Insufficient Media Exposure

China's (re-)emergence: from manufacturing and exporting to overseas expansion
China’s Outward Foreign Direct Investment (OFDI)

China’s OFDI has increased sharply over the last 25 years, with 3% compound annual growth rate (CAGR).

China’s Global Business Profile

There has been an increasing presence of Chinese enterprises in the global elite club.
China’s Outward M&A

China’s Outward M&A by sector, 2005

<table>
<thead>
<tr>
<th>Industry</th>
<th>Natural Resources</th>
<th>Telecoms</th>
<th>Industrials</th>
<th>High-tech</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financials, %</td>
<td>4%</td>
<td>0%</td>
<td>7%</td>
<td>23%</td>
<td>44%</td>
</tr>
</tbody>
</table>

Recent history has been marked by some high-profile successes— and failures.

China’s Outward M&A by sector, 2005

Completed Deal

<table>
<thead>
<tr>
<th>Chinese Acquirer</th>
<th>Target Company</th>
<th>Country</th>
<th>Price ($ Mn)</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lenovo</td>
<td>IBM PC</td>
<td>USA</td>
<td>1750</td>
<td>PC</td>
</tr>
<tr>
<td>TCL</td>
<td>THOMSON N</td>
<td>France</td>
<td>559</td>
<td>Home Appliances</td>
</tr>
<tr>
<td>China Minmetals</td>
<td>NOVADA</td>
<td>Canada</td>
<td>5,000</td>
<td>Mining</td>
</tr>
<tr>
<td>CNOOC</td>
<td>Nigerian Oil</td>
<td>Nigeria</td>
<td>2,700</td>
<td>Oil</td>
</tr>
<tr>
<td>AIG</td>
<td>MG ROVER</td>
<td>Britain</td>
<td>8.7</td>
<td>Auto</td>
</tr>
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</table>

Failed Deal

<table>
<thead>
<tr>
<th>Chinese Acquirer</th>
<th>Target Company</th>
<th>Country</th>
<th>Price ($ Mn)</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>CNOOC</td>
<td>UNOCAL</td>
<td>USA</td>
<td>3.50</td>
<td>Oil</td>
</tr>
<tr>
<td>HAIER</td>
<td>MAYTAG</td>
<td>USA</td>
<td>1280</td>
<td>Home Appliances</td>
</tr>
<tr>
<td>China Mobile</td>
<td>MILICOM</td>
<td>Luxembourg</td>
<td>5,300</td>
<td>Telecom</td>
</tr>
</tbody>
</table>

Enterprise Overseas Expansion: A Snapshot of Two Cases

Leading Chinese enterprises have dramatically increased the international composition of their corporate portfolios.

% of International Revenues

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Hurdles for Overseas Expansion

Overseas Expansion Hurdles: Talent

“China will require 75,000 top-level executives with global experience by 2010, about 70,000 more than it has now. Without them, the future is uncertain.” (McKinsey & Co.)

How effectively can Chinese enterprises deal with talent shortage and escalating competition for talent as they expand aggressively overseas?
Overseas Expansion Hurdles: Brand

- The top 100 global brands: US (51), Japan (8), Korea (3), China (0).
- Building a brand takes time and considerable investment with no immediate tangible returns.
- Building a global brand requires a different mindset from what it has traditionally taken for a Chinese enterprise to be successful.

How easily and quickly can Chinese enterprises overcome the global branding hurdle?

Overseas Expansion Hurdles: Politics

"Undue Fears of China Inc?: As we see more Chinese companies seeking mergers, the political factor will get bigger." (Global Envision, 10/21/05)

"Wake Up to the Chinese Threat: It's time for the sleeping giant (US) to wake up and respond to the very threatening rise of communist China" (The Hill, 06/28/06)

- Do not underestimate potential socio-political resistance to overseas expansion, which is a natural part of the battle between incumbents and newcomers.
- Perceived invading/retaliating, or winning/losing, will create more obstacles on the political front.
- Chinese enterprises need to proactively manage political and regulatory concerns.

The double-edged sword of the Chinese government: How involved should it be, and what role should it play, in overseas business activities?
Overseas Expansion Hurdles: Culture

China: 5,000 going on 25

- China’s “re-emergence” and the West’s “unreadiness” create a gulf.
- The dual challenge for Chinese enterprises is to develop a forward-looking global business model while connecting to Chinese history.
- Clearing cross-cultural hurdles and bridging cross-border social practices should be high on corporate agendas.

How can Chinese executives blend “people based” and “system based” management styles in globalization?

Overseas Expansion Hurdles: Financing

"As more and more Chinese companies are going abroad to compete, the difficulties in financing their overseas operations prevent them from growing bigger and stronger."

(China’s State Administration of Foreign Exchange)

How can Chinese enterprises secure financing to fulfill their global ambition? How can they balance the interests of diverse stakeholders in China and overseas?

<table>
<thead>
<tr>
<th>Year</th>
<th>Company</th>
<th>Capital Raised ($ Mn)</th>
<th>Exchange</th>
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<tbody>
<tr>
<td>2006</td>
<td>Bank of China</td>
<td>12.00</td>
<td>HK</td>
</tr>
<tr>
<td></td>
<td>China Construction Bank</td>
<td>9.227</td>
<td>HK</td>
</tr>
<tr>
<td></td>
<td>China Shenhua Energy</td>
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<td>HK</td>
</tr>
<tr>
<td></td>
<td>Bank of Communications</td>
<td>2,185</td>
<td>HK</td>
</tr>
<tr>
<td></td>
<td>China COSCO Holdings</td>
<td>12.27</td>
<td>HK</td>
</tr>
<tr>
<td>2004</td>
<td>Ping An Insurance</td>
<td>18.39</td>
<td>HK</td>
</tr>
<tr>
<td></td>
<td>SMIC</td>
<td>18.03</td>
<td>NYSE</td>
</tr>
<tr>
<td></td>
<td>Air China</td>
<td>12.38</td>
<td>HK</td>
</tr>
</tbody>
</table>
Concluding Thoughts

• Management know-how, managerial talents, and brand are imperative for Chinese global business expansion.
• Cross-border M&A is a new ball game for Chinese enterprises, and it often takes time to determine the true winner (or loser).
• Setbacks are part of the process of overseas expansion, and one should learn from the process.
• Chinese enterprises need to look from the “local” viewpoint and appreciate the domestic socio-political concerns.
• The right timing, prudent speed, and alignment of business savvy and socio-political sensitivity are particularly vital for securing overseas business deals.

Thank you

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