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China's Outbound Investment Strategy Becomes Clearer

Over the last several years, China's regulators have made increasingly significant changes to the policies that guide outbound investment from China to foreign markets. In mid-April, China announced its most recent round of rules which made outbound investment that much easier for Chinese companies. The changing role of the National Economic Development and Reform Commission (NDRC), historically one of China's most important regulatory and policy-making bodies, points towards greater latitudes for how Chinese companies can pursue outbound investment opportunities. For all the hand wringing that has surrounded China's overseas investments, the reality as Marc Szepan, Co-Director of the Economy and Business Research Group at the Mercator Institute for China Studies (MERICS) in Berlin, points out, "China's outbound investment volume as a share of global cross-border M&A activity is actually less than their share of global GDP."

In a mid-April MERICS report, Szepan noted that, "For the full year 2013, worldwide cross-border M&A deals amounted to USD 737.8 billion … China's outbound M&A volume of USD 63.3 billion accounted for merely 8.6 percent of global cross-border M&A deals by value. During the same time, global M&A activity backed by private equity firms totaled USD 374.3 billion. *In other words, M&A activity by the global private equity industry alone was almost six times*

larger than the entire outbound M&A deal value of all Chinese firms." (emphasis mine)

As China's economy has grown, in particular because its growth and (thus-far) relative stability when compared to other more developed countries, is enviable, many assume that China's outbound investment strategy is born of strength. While China has been successful pursuing government-led foreign investments that tie together offerings from its domestic champions such as Huawei with deals that allow China privileged access to natural resources in another country (typically within a region that suffers from the so-called "natural resource curse"), thus far this strategy has not translated to consistent success by Chinese firms in their pursuit of stand-alone foreign investment deals. Where China's coordinated and government led outbound investment strategy may be a strength, it is much less of one for China's companies. According to Szepan, "China's outbound investment strategy is often a story of catching-up. Quite often, Chinese companies are less searching for new markets, but instead looking for technology they do not have, know-how their companies recognize they need, and input resources not readily available domestically. If they had these things, they would not need to buy them."

A review of the high profile deals Chinese firms have been able to successfully close in the UK, US and EU over the past several years reveals an important trend: Chinese companies were not getting good deals, most were overpaying for those targets they could successfully bring to a close, and many transactions were going at a premium because the domestic target required some sort of compensation for regulatory risk. The combination has meant that even when a Chinese company is successful closing a deal in a foreign country,

most of the times they are only able to buy companies that represent a business with a second or third tier technology platform. This is why the most recent reforms in China are so important: they decrease counterparty risk as seen from the firm being acquired and should, in theory, allow Chinese businesses to work on a more even playing field relative to non-Chinese competitors. If successful, these reforms will allow both the number and quality of outbound Chinese M&A deals to grow.

China's first round of overseas investments was, as mentioned earlier, characterized by an emphasis on access to natural resources the country does not have access to within its own borders. Now, however, China's companies are becoming more aware of their need to upgrade technologies and diversify from too heavy an emphasis on domestic sales' growth. What Chinese companies may lack in know-how over particular technologies or services they make up for in readily available capital. This makes Chinese firms interesting potential partners for industries and national economies where access to capital continues to be a problem post the 2008 financial crisis. One of the most un-threatening areas where this is going to happen over the course of the next two years is as Chinese capital finding its way into American and European senior living.

In the domestic American and European senior care sectors, a number of large Chinese real estate and life insurance companies have been quietly searching for strategic investments to make in the American and European senior care segments. Their motivations range from a desire to learn more about the financing models that underpin senior care facilities in the US, to basic insights on how to operate assisted living communities. In addition to being potential

partners that are strategically motivated to understand how American operators handle senior living developments, Chinese investors offer the potential to be more patient sources of capital than some of the available commercial options, in particular post 2008. The question is whether, simply because of the growing crescendo of fears about China's perceived rise and its potential threat to western interests, whether China will be limited to sectors like senior care that present little in the way of potential conflicting interests, or if even this sort of sanguine in-bound investment strategy will be curtailed.

In other markets outside the US, Chinese investments in European companies have illustrated a willingness to be more patient relative to their expectations about return on capital, a tolerance for dealing with unionized labor, and in general a longer time horizon than what other more traditional sources of capital have been comfortable offering. Whether or not this holds if China's financial system continues to struggle and Chinese companies need to either liquidate their foreign holdings or extract cash from their newly acquired assets remains to be seen. As seen from the Chinese point of view, in many ways these sort of investments are easier to make in Europe than in the US, if only because the optics of Chinese money are so different. Szepan points out that "in Europe there is less in the way of emotional cross-fertilization between commerce and geo-politics when it comes to how China is viewed. For the EU, the relationship with China is largely commercial; in the US it is much more both a commercial and geopolitical relationship."

Across the US, governors, mayors and strategically minded businessmen have recognized the next stage of Chinese involvement with the American economy is likely going to be

built on the back of strategic investments into local businesses and communities. While these stakeholders are individually aware of the risks in pursuing Chinese money, they also recognize the potential rewards, especially in communities that have a basic need to invest in infrastructure if they are to sustain themselves into the next decade. There are already promising signs that Chinese investment in the US is becoming an important economic factor that holds the potential to further unite the two countries; however, it has to be noted that American political attitudes towards China in general widely range, and at their worst harbor deep misgivings informed less by anything specific China has done, and more because China's economic rise stands as a proxy for many concerns Americans have about their own political and economic futures.

In its most beleaguered form, these fears about China's rise remind many of similar fears the US held about Japan. Then, it was Japan's rise that seemed to perfectly capture America's economic malaise. Now, it is China's rise that embodies not only economic frustration, but perhaps equally important, our sense of helplessness over America's political system. This makes China's ascent today different, at least as seen from American eyes, than Japan's in the 80s. As China's outbound investment strategy becomes clearer, and subject to fewer internal roadblocks, it is important that America not turn away from China as a potential investment partner. If America does, it is likely a signal both of unwillingness to allow China to continue to integrate further into the American economy but even more important, economic and political frustrations that have nothing to do with China and everything to do with America.