Chinese and Indian Multinationals Out to Conquer the World

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Indian and Chinese companies have emerged in large numbers on the international scene in the past few years, investing more and more heavily in the four corners of the globe. Having a strong presence in the raw materials sector already because of the two Asian giants' high degree of energy dependence, they are also found today in the steel, telecommunications, biotechnology, distribution and household appliances sectors. Such multinationalization of Chinese and Indian firms is a result both of the rapid maturing of their domestic economies (growth rate, domestic market, technological development, profit accumulation) and the globalization of the world economy, which obliges them to invest abroad to continue on the road to catch up with multinationals in industrialized countries. Despite similarities in their multinationalization processes, Chinese and Indian firms still remain strongly influenced by their countries' economic history, devising different strategies and facing different types of obstacles in their internationalization process.

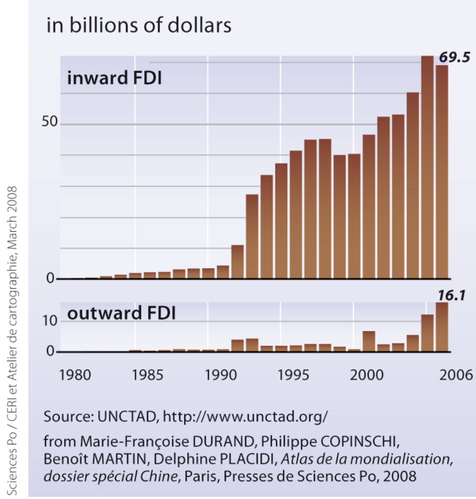
A sharp rise in Chinese and Indian FDI

Regarding Chinese companies, their first foreign direct investment (FDI) operations were made in the 1980s in Hong Kong while it was still under British rule, mainly in the banking and commercial sectors. But it has primarily been since the early 2000s that Chinese FDI has really taken off, particularly in the energy and raw materials sectors. Official figures[1] in fact indicate that Chinese firms entered in

1 It remains difficult to gauge Chinese FDI precisely from official Chinese government statistics. Many operations transit through Hong Kong and are not listed. Moreover, only investments over $1 million appear in the official statistics; this conceals all private firm operations, particularly in Guangdong province, which is beginning to invest in Southeast Asian countries.

2001 a new phase in their internationalization, which has rapidly accelerated since 2005 with $12.3 billion, then $21 billion in 2006.[2] Chinese FDI stock certainly remains at a moderate $78 billion, only 0.6% of the world total. But the Chinese authorities predict a strong increase in annual FDI flows, which could soon exceed $30 billion. By the end of 2006, the Chinese Ministry of Commerce had inventoried slightly over 5,000 Chinese companies that had made investments abroad, establishing nearly 10,000 overseas firms in 172 countries.[3]

figure 63: **Chinese Foreign Direct Investment, 1980-2006**



Source: UNCTAD, http://www.unctad.org/
from Marie-Françoise DURAND, Philippe COPINSCHI, Benoît MARTIN, Delphine PLACIDI, *Atlas de la mondialisation, dossier spécial Chine*, Paris, Presses de Sciences Po, 2008

As regards Indian investments abroad, a few major groups such as Tata, Kirloskar and Birla started investing in the 1960s in neighbouring Sri Lanka and in Africa. But it was during the 1990s that the number of Indian multinationals exploded. Pradhan (2004 a, 2007) reckons that the number of Indian firms with branches abroad has multiplied over 40 times in the space of 20 years between 1986 (208) and 31 March 2006 (8,620). From 1995 to 2006, FDI stock went from $212 million to $8,181 million.

The buyout of the Anglo-Dutch steel manufacturer Corus by Tata in 2007 for $11 billion could usher in a new phase for Indian FDI. Many analysts have traditionally identified two phases in the takeoff of Indian FDI. Before 1990, FDI (by a few private groups allowed to invest abroad) was primarily directed towards the manufacturing, energy and raw materials sectors. Most of this FDI was by the major state-owned corporations. After 1991, a three-faceted tendency took shape: a high rise in amounts invested, sectoral diversification and the arrival of new actors from the private sector, which would soon become the main source

table 3: **Outward FDI per annum, China and India**

	China	India
1990-2000 average	2.1	0.1
2005	11.3	2.5
2006	17.8	9
2007	26	10

Source: Economist Intelligence Unit, 2007.

2 Ministry of Commerce of the People's Republic of China.

3 *China Daily*, 17 September 2007.

table 4: **Annual flow of Indian FDI (US$ billions)**

	India
2003-04	2.2
2004-05	2.5
2005-06	9.7

NB: the Indian fiscal year runs from April 1 to March 31
Source: UNCTAD, *World Investment Report*, 2007

table 5: **Mergers and acquisitions by foreign companies in India and Indian companies abroad (US$ millions)**

	In India	Outside India
2004	1760	863
2005	4210	2649
2006	6716	4740

NB: the Indian fiscal year runs from April 1 to March 31
Source: UNCTAD, *World Investment Report*, 2007

of Indian FDI. But it is probably wise to subdivide the second phase, with a cutoff point around the years 2001-2. Before this turning point, the major Indian industrial groups had undergone a long decade of refocusing on certain core trades after being forced to diversify for nearly 40 years because of investment regulations[4] set up after independence in 1947. Not yet very competitive internationally, in the 1990s these groups preferred to remain on the national market, which was still highly protected. After 1995, the "reverse brain-drain" of returning Indian expatriates gave rise to a very dynamic information technology industry. Some of these companies worked their way fairly quickly up the value chain (Bomsel and Ruet 2001) and ventured into foreign investment during the late 1990s. Companies in the biotechnology and pharmaceutical sectors then followed suit (Huchet, Richet, Ruet 2007). It was not until after 2002 that the major Indian manufacturing groups would truly begin their internationalization process. The restructuring of their activities during the previous decade provided them with considerable financial reserves, and they partly anticipated the pressure of foreign competition on the domestic market, which they knew was bound to grow with the opening-up measures instituted by various governments since 1991.

With all the FDI operations, mergers and acquisitions increased. But until 2006 they remained to the advantage of foreign firms, although Tata Steel's exceptional bid for Corus, followed by Suzlon's smaller-scale but still significant bid for Repower, might foreshadow a new stage.

Investment sector diversification

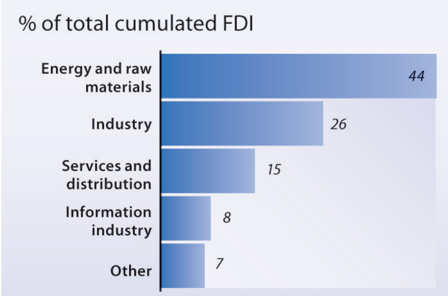
Regarding Chinese firms, the energy and raw materials sectors continue to account for nearly half of the total amount of Chinese FDI in 2006. China's colossal energy needs[5] prompted the Chinese government in 1995 to start restructuring the major state-owned firms operating in these sectors. Then, starting in the early 2000s, the

4 Known as the "Licence Raj".

5 In the year 2006 alone, five new 300 MW power stations came into service every week in China, new production in one year amounting to total French production. See Reuters, 23 March 2007. China became a net importer of oil in 1993.

state encouraged them to invest abroad in order to secure supplies overseas. Activity by Chinese firms in the oil sector has been intensive in Africa, Central Asia[6] and the middle east to the point of feeding obsessive fears that the Chinese firms will oust US and European operators from the African market. Despite an increase in FDI flows from Chinese oil giants, we can expect to see their presence increase even further in the years to come, as the external supply of oil from fields controlled by Chinese firms only amount to 15% of China's total imports.[7] Since 2005, other sectors, such as telecommunications, information technology, consumer electronics and automobile manufacturing have grown rapidly: they now represent nearly 35% of total Chinese FDI. Three firms—Huawei, Haier and ZTE—are particularly active in these sectors. In less than a decade, Haier has for example set up 13 production units, 8 design centres, 22 trade companies and nearly 4,600 retail stores outside China.[8] Chinese FDI is also rapidly increasing in the commercial sector. Chinese industrial firms that do subcontracting for European, US and Japanese multinationals are now trying to work their way up the added-value chain in order to capture a larger share of the profits made on consumer sales in developed countries.

figure 64: **Distribution of Chinese FDI by sector, 2002-2005**



Source: Compiled by Jean-François HUCHET and Joël RUET, from the Chinese Statistics Yearbook, (Zhongguo tongji nianjian), 2006

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The constraints of internationalization related to growing competition on national soil are reflected in the sectoral makeup of Indian FDI today. For instance, in the panorama outlined by the Boston Consulting Group report on the 100 emerging giants, which compared criteria including company size, growth rate and business model performance, 44 Chinese firms and 21 Indian firms are listed. Among the latter are Infosys, Satyam, Tata Consultancy Services and Wipro in the field of information technology in both low added-value activities, such as business processing outsourcing, and high added-value areas, such as organizational consulting and virtual industrial design. Cipla, Dr. Reddy and Ranbaxy in the pharmaceutical industry are making rapid headway in their international strategy by filing numerous patents abroad. The automobile and automobile parts and accessories sectors are multiplying their subsidiaries abroad with Bajaj, Bharat Forge, Mahindra & Mahindra, Tata Motors and TVS Motor Company. Engineering is not far behind with Crompton Greaves and Larsen & Toubro. Many operations

6 China National Petroleum Corporation bought PetroKazakhstan in 2005, for $4.2 billion, the biggest ever operation by a Chinese firm abroad.

7 The remaining 85% were bought on the international market, Kenneth Liberthal and Mikkal Herberg, "China's Search for Energy Security: Implications for U.S. Policy", *NBR Analysis*, vol. 17, no. 1, April 2006.

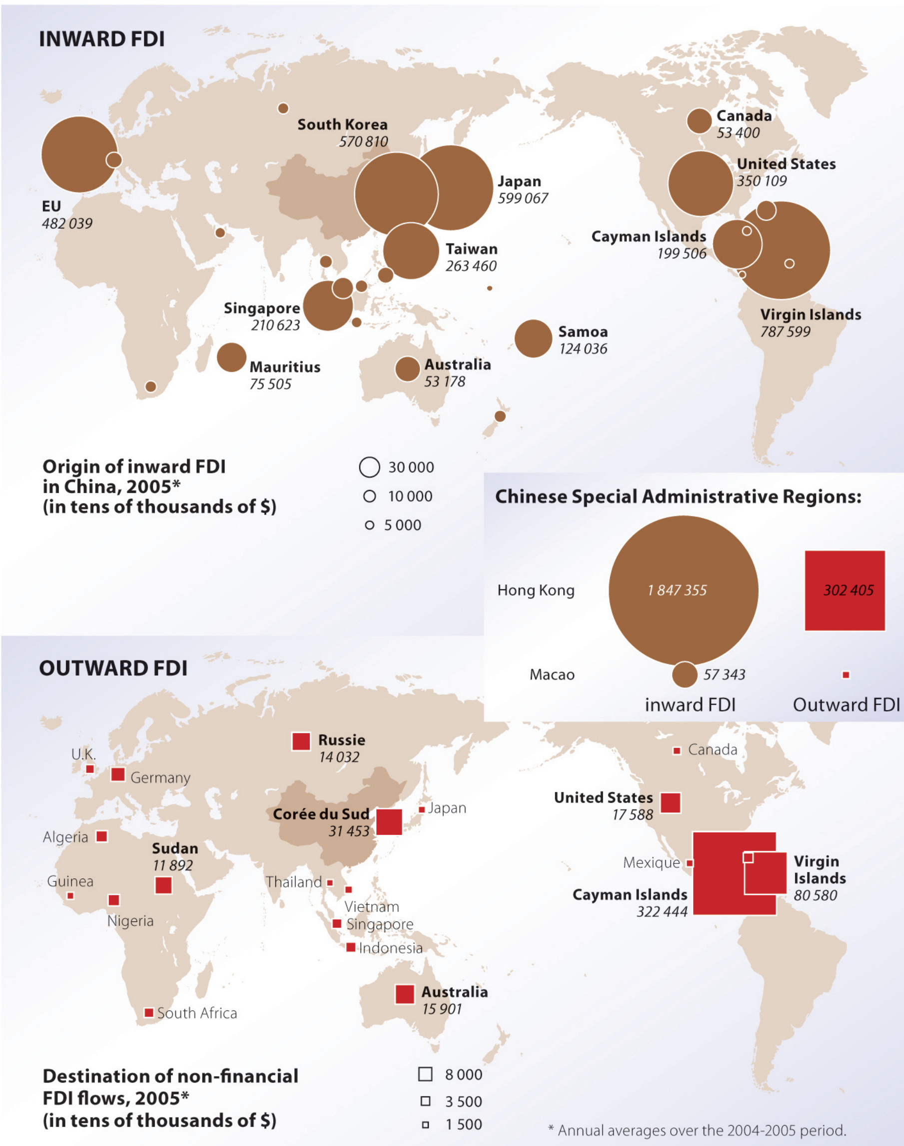
8 *China Daily*, 13 March 2007.

have also taken place in steelmaking, energy and raw materials with Hindalco (nonferrous metals), Tata Steel and the Reliance conglomerate (energy), without forgetting ONGC (oil and gas). Foreign investments in the oil and gas sectors accounted for 19% of the Indian FDI stock in 2006.

Changing geographical patterns in FDI distribution

Asia remains the primary destination for Chinese FDI. Hong Kong still soaked up nearly 48% of all Chinese FDI in 2004 (28% in 2005). If investments made in the tax havens of the Cayman Islands and the Virgin Islands are added, in 2005 the three territories culled a little over 80% of the total amount of Chinese FDI. It thus appears difficult to get a precise grasp on the establishment strategy of Chinese firms abroad since the three territories, acting as they do as tax havens, are often merely a stopover destination. A few notable trends can nevertheless be detected that corroborate the sectoral distribution of FDI with the strategic needs of Chinese firms. The African continent, Australia, South America, Russia, Central Asia and Indonesia are territories coveted today by the major Chinese firms in the energy and raw materials sectors. Since 2003 the search for new technologies in the information industry and new markets in consumer electronics, the automobile sector and commerce has led to a steady increase in Chinese FDI in South Korea ($5.9 billion in 2005, or 4.8% of the total amount), the United States ($2.3 billion, or 1.9%), Europe and Japan. A World Bank (2006) study of Chinese firms' foreign investment plans for the next five years indicate a change in choice of geographical territory: South East Asia, Africa, Northern Europe, Latin America, Eastern Europe and South Korea are the big winners, whereas East Asia, North America, the Middle East and Australia should see a slowdown.

As regards the destination of Indian FDI, a radical change is observed that is clear evidence of an overhaul of the industrial strategies of Indian groups. Before 1990, to mention only those territories for which the share exceeded 5% of the total, the destination countries were, in decreasing order of total FDI stock, Thailand, Singapore, Kazakhstan, Senegal, the United Kingdom, the United States and Indonesia. Developing countries thus were the major beneficiaries. After 1991, the UK was in the lead with nearly 27% of the total, while the US received 25% and the tax haven of Mauritius (which serves as a platform for reinvestment in India) nearly 10%. Although Indian concerns initially sought to secure energy resources and conquer external markets in a context where their growth on the domestic market was tightly controlled, recent dynamics mainly reflect a search for strategic assets: technology, market shares in developed economies, brands and new R&D skills. Like Chinese firms, they are seeking to improve their initial cost advantage on the domestic market by moving up the added value chain. It is thus interesting to note that in the year 2004, for instance, the sectors in which figure 65: **Chinese Foreign Direct Investment, 2005**



Source: Chinese Ministry of Commerce, http://english.mofcom.gov.cn/

from Marie-Françoise DURAND, Philippe COPINSCHI, Benoît MARTIN, Delphine PLACIDI, Atlas de la mondialisation, dossier spécial Chine, Paris, Presses de Sciences Po, 2008

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Indian firms concentrated their FDI in the US were information technology (80%), chemicals (7%) and pharmaceuticals (7%). On the other hand, only 19% of the FDI in the European Union targeted information technology, the rest going to pharmaceuticals (17%), electronics (10%), transport (9%), chemicals (7%) and metal products (6%), the remaining 30% going to a wide variety of other sectors (Milleli

2007). These figures are a very accurate reflection of the industrial specialization of the economies concerned, but also of targeted knowledge and sectoral interaction between Indian industry and the European Union.

The reallocation of Indian FDI destinations thus corresponds to a large extent to a search for new technological skills and brands, naturally leading to an increase in the weight of developed economies among them. But there is also a purely geographical trend due to the need to get closer to the customer, in computer-outsourcing sectors for instance. Thus Indian companies are investing in Eastern Europe and the Maghreb to reach Western European markets, or in Mexico to penetrate the US market. In so doing, Indian firms today are anticipating what is likely to be a major industrial evolution with the digitization of certain design aspects. In May 2007, Tata Consultancy Services announced the opening of an office in Guadalajara. Tata already employs 5,000 people in Brazil, Chile and Uruguay. Wipro itself has subsidiaries in Saudi Arabia, Canada, China, Portugal and Romania, to name a few. Cognizant Technology Solutions has offices in Shanghai and Phoenix, Arizona. At the same time, Indian companies in the information industry are seeking to profit from their cost advantage to dominate the growing outsourcing industry in developing countries: an example is Infosys, which recently bought up back offices in Thailand and in Poland.

The imperatives of globalization and internal transformations in the two economies

Aside from the search for outside energy supplies, factors related to changes in the two countries' domestic economies, and the growing influence of globalization, are also at the root of rapid growth and FDI from Chinese and Indian corporations.

Savings and accumulation of financial capacities

The strong economic growth recorded in each of the two countries has generated a rapid accumulation of corporate savings and reserves that can be mobilized for foreign investment operations. In the case of China, the largest investments are made by the major state-owned companies, especially those operating in monopolized sectors such as energy, raw materials and telecommunications. Only the Lenovo group, made up mostly of private capital, appeared on the list of the 20 largest Chinese investors abroad in 2005. The major Chinese companies, the majority of which are state-controlled, are the most thrifty in Asia, saving about 33% of their profits, compared with 17% for the rest of Asia. Until 2006 they distributed few dividends to the state and even if their profit margin remains slim, the high growth recorded since 2000 has enabled them to accumulate a considerable cushion of financial resources to back their international ambitions. Moreover, the monetary context is particularly conducive to anything that favours getting capital out of Chinese territory. In the face of international pressure for China to revalue its currency because of the unprecedented accumulation of foreign exchange reserves (nearly $1,700 billion), the Chinese government has considerably reduced the restrictions imposed on Chinese firms in their investment operations abroad.

The macroeconomic financial context is fairly different for Indian companies: monetary reserves are much lower and the country has a trade deficit. On the other hand, the structure of the Indian stock market plays a positive role that offsets this disadvantage. Indian companies benefit from their stock market value, linked to their rapid and steady growth (according to an elementary stock market mechanism, which gives them greater value than their Western competitors for an equal turnover because anticipated gains are higher). For instance, the largest acquisition operation made by an Indian group—Tata Steel's takeover of the Anglo-Dutch Corus for $11 billion—was partly made possible by the presence of Tata Consultancy Services in the Tata group,[9] which increased Tata Steel's borrowing capacity. The rising prices on the Mumbai stock exchange for the moment enable Indian groups to issue shares and raise the capital required for their future expansion.

Opening up and competition on national markets

Along with external factors, the increasing globalization of the world economy has obliged Chinese and Indian firms to go international. The opening up of the two economies spells increased competition for their companies on their domestic markets, which were once long protected by high customs tariffs. After WTO accession talks were accelerated (China became a member in 2001), China agreed to drastically lower its customs tariffs, which went from an average 25% in 1997 to 7% in 2005. Chinese groups are now in direct competition with foreign groups heavily investing in China. It is thus no accident that the sectors in which the increased internationalization of Chinese firms is speeding up today are also the sectors in which FDI entering China is the largest (telecommunications, electronics, vehicle manufacture). The search for new overseas markets is by far the primary factor explaining the keenness of Chinese firms to increase their investments abroad.[10]

Indian companies, like their Chinese counterparts, are increasingly exposed to direct competition from major international groups on their own soil. The latter will also benefit increasingly from the same price structures related to the cost of labour in Chinese and Indian territories. These changes will affect both

9 At the time when it took over Corus, Tata Consultancy Services accounted for 50% of the Tata Group stock market value while representing only 16% of its turnover.

10 *China's Outward Foreign Direct Investment*, op. cit.

production and product design. The major Indian groups thus find themselves in a probably more exacerbated situation than their Chinese counterparts in several key industrial sectors. In the vehicle sector, for instance, joint venture arrangements are prevalent in China. In India, the groups that position themselves in car manufacturing know that even if they can sometimes count on joint ventures, these are not long-term partnerships supplanting their own production. Such groups must develop their own models in the long run. Indian groups (Tata and Mahindra & Mahindra) are faced with having to sell vehicles abroad to offset the foreign competition they face. In the field of electronics, it is another reason that prevails. The geographical competence clusters of companies, and their number, are much more limited than in China. Companies face competition from Europe, the United States and Japan as well as China. Indian industry is trying to build competitive clusters outside the computer services or pharmaceutical sector, but competition is stiff in these areas. To tackle it, Indian groups nevertheless have an advantage over Chinese companies. The structure of their capital, which is mainly private, enables them to move faster than Chinese groups in the merger and acquisitions market.

The need to scale up technology and build brand names

In this context of increased competition on their domestic markets, Chinese and Indian firms must also continue to accumulate technological skills and build recognized brand names that free them from segments with the lowest added value in the international division of labour. Lenovo's takeover of IBM's personal computer division, TCL's takeover of Thomson's TV division, and Haier's failed attempt to acquire the US refrigerator manufacturer Maytag are all examples of this strategy. The increase in Chinese FDI in commerce also indicates the Chinese firms' desire to reinforce their presence in international distribution channels and capture a larger share of the added value on products sold to consumers. Galanz, for instance, world leader in microwave ovens with nearly 40% of the world market, supplies its products to nearly 250 firms that resell under their own brand name. Galanz today is seeking to establish its own brand and invest in the distribution and marketing phase, where the larger share of profits is made. The same pattern is found in many industrial sectors, such as the textile and garment industry, shoes, electronics and toys, of which the Chinese have become major producers through subcontracting without managing to reap large profits.

Indian industrial corporations, less numerous but larger than their Chinese counterparts, have generally begun the process of brand building. Brand promotion nevertheless remains confined to a rather small number of countries. To remedy this problem, already well-known brands are seeking to strengthen their recognition abroad. In addition to the computer groups and pharmaceutical firms already known on the international scene, new brands are also beginning to emerge. Some traditional groups such as Tata and Reliance are gradually acquiring a reputation in the infrastructure and energy sectors; others such as Jet Airways in air transport, Suzlon in renewable energy, Bharti in telecommunications and DLF in real estate are following suit.

The risks of these development strategies

While there can be no doubt about the capacity of Chinese and Indian groups to become serious competitors in the long run, they nevertheless suffer from a certain number of deficiencies or disadvantages likely to limit their competitive potential in the short and medium term. Chinese groups suffer from a lack of internationally trained managers, limited knowledge of the European and American legal and administrative environments, a lack of flexibility to put together complex financial operations for mergers and acquisitions, and considerable deficiencies in their system of governance. This last point is perhaps the most worrisome given the size of Chinese FDI in the tax havens of the Virgin and Cayman Islands (52% of the total in 2005). In contrast to the Indian groups, to a large extent privately owned, the fairly inefficient state control over the major Chinese groups that are crumbling under the weight of liquidity could encourage certain Chinese firms to undertake investment operations abroad for prestige or, worse, to facilitate the personal enrichment of company managers.

These weak points are not shared by the major Indian groups. But the stiff competition among the country's firms clearly offers advantages to those who position themselves first in new sectors, new business models and new production niches. This early-bird premium probably justifies the high share price of these companies. As long as the Mumbai stock exchange remains on an upward swing, it will offer significant means to finance expansion abroad. In the event of a drop in confidence on the stock market, the consequences could be harmful for the internationalization strategies of these companies. The channelling of the currently high liquidity of the world financial economy has so far been beneficial to the major Indian groups, but to continue to benefit from it, they will have to demonstrate great precision in their development strategy.

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