

A Closer Look At The 3rd Wave

While both of the first 2 waves (Export and FDI) had a "selling" motif and thus the tendency to please buyers with value discounts, the 3rd Wave can be characterized by "High Value-add" and "Acquisition". High value-add in terms of higher skills and higher margins. Acquisition as in acquiring resources, both natural and man-made, both tangible and intangible. A higher RMB helps in this case...

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Photo Credit: Shawn He

Many are probably already familiar with the scale and impact of the first two waves carrying China's economic rise, namely, trade (mostly in exports of low value-add products) and inbound foreign direct investment, or FDI (so far mostly in funding low-cost manufacturing operations).

In those situations where the motif was a 'selling' one for China, the buyers always demanded, and in most cases, received, "good value" for their bargain – be it labor, materials, property, currency, or whatsoever...

In fact, the listing frenzy in the past few years of Chinese companies in overseas stock exchanges can also be viewed as a 'proactive' form of inbound investment. As of the end of 2005, the average P/E of all the overseas-listed Chinese companies represented a 20% discount when compared with their domestic counterparts. A good bargain?! Absolutely. Same difference.

As China gradually moves up the development "food chain", its taste for FDI is being upgraded too -- at least at the Central Government level, with local exceptions of course, as always...

No longer blindly begging investment, it now not only says no to 'dumb' (i.e., low-tech and low-skill), 'shortchanging' (high energy- and resources-consuming) and 'poisonous' (high polluting) capital, it also begins to 'tax' those already in by stripping their VAT export rebates (and with outright taxation in certain cases). Replacing them are the high-tech, high value-add darlings, as exemplified by the recent installation of Airbus's and GlaxoSmithKline's plants in Tianjin. The former is Airbus's largest overseas; The latter? The largest. Period.

Unlike the first 2 waves, the 3rd wave which is now quickly gaining momentum is underscored by outbound investment, a 'buying' scenario.

Nowadays many can readily point to such high-profile names like Haier who now has 2 plants in S. Carolina employing thousands and Lenovo who acquired IBM's PC business a couple years ago. But perhaps few are aware that, following 'Main Street' (i.e., stores) and Wall Street, China is now going 'K Street', the heart of American political lobbying. For example, CNOOC became one of lobbying industry's biggest patrons during their bid for UNOCAL in 2005, ahead of many traditional heavyweights like GE...

In fact, the failed CNOOC deal in a way foreshadowed the mainstream of what was to come, namely, acquisition of natural resources and strategic assets.

The first category includes energy, metals and minerals, chemicals, forestry products, etc. Following numerous oil deals in Africa, China's largest coal company Shenhua's planned acquisition in Indonesia and Australia is another recent example.

Aside from investment in infrastructure such as roads, railroads and power plants, which are usually associated with deals in the first category above, China's acquisition of strategic assets also includes technology, brand equity and distribution channels, as illustrated by the Lenovo deal mentioned above and most recently, Huawei's proposed acquisition of 3Com.

Although perhaps less apparent, under this outbound investment wave a trend of 'reversed' Chinese vertical integration is rushing to this shore as well. You may spot many signs; from the mushrooming business centers and wholesale malls everywhere targeting Chinese firms wanting to set up marketing & sales operations, to those ever frequent inquiries from established Chinese manufacturers -- however immature and ill-prepared they may seem at times -- about setting up US plants to do final assembly.

Finally, Chinese financiers are too joining the fray. Latest examples include the Chinese sovereign wealth fund's \$3bn investment in the US private equity firm Blackstone and the decision to allow Chinese citizens to trade overseas stocks and the 3 QDII mutual funds recently approved (2 already launched) to specifically invest in overseas stocks.

While the quoted reason for the former move was to seek higher returns for the country's coffers, the overriding objective might have very well been a strategic one. On the other hand, although in the near-term the second move might have also been designed to serve an important purpose of helping the government divert pressure from such "headache" as an overheated domestic stock market), its longer-term goal -- i.e., reaping pure monetary returns for Chinese private investors, may lead to yet another tide to surge in the foreseeable future...

A strong RMB would fit in this picture nicely now that a cash-rich, FDI-picky China is on a global shopping spree.