

The Role and Characteristics of Chinese State-owned and Private Enterprises in Overseas Investments



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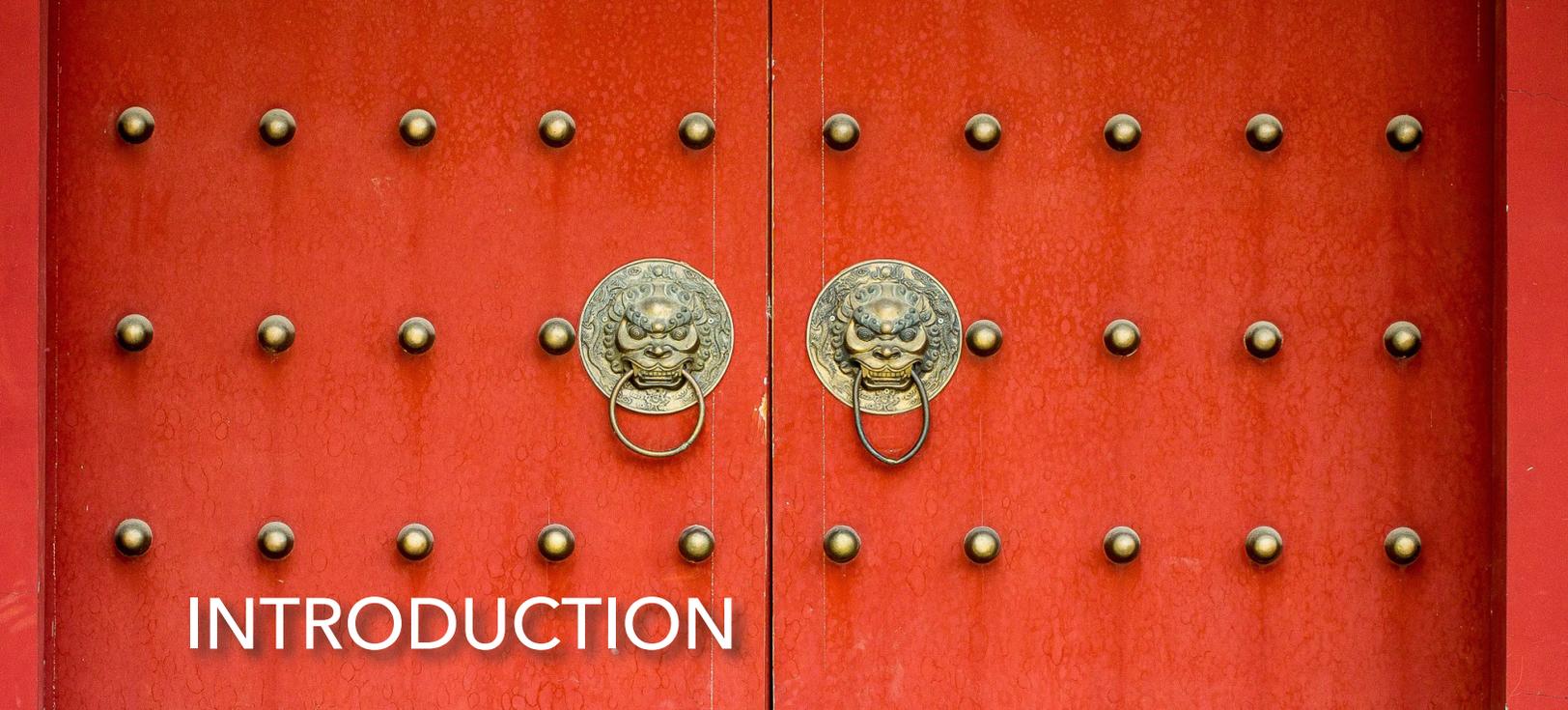
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INTRODUCTION

The latest official statistics from China's Ministry of Commerce (MOFCOM) indicate that mainland China's outbound investment flows reached US\$107.84 billion in 2013.¹ Chinese state-owned and private enterprises are active in multiple sectors around the world, including energy, natural resources, telecommunications, manufacturing, construction, real estate, and agriculture, among others. In addition to this investment, China has dispersed over RMB 345.63 billion (US\$55.39 billion) in overseas aid since the 1950s.²

Historically, SOE's have dominated China's overseas investment, but the role of the private sector is increasing rapidly. This paper looks at China's state-owned enterprise

(SOE) reforms and the rise of the private sector, and considers how approaches to overseas investment are evolving. It provides an overview of the differing structures, governance mechanisms, approaches, and regulations that apply to Chinese SOEs and private enterprises and how this impacts on their overseas investments. Three case studies are provided in order to illustrate the evolving strategies utilized by Chinese companies when investing overseas, and the appendix includes a summary of key regulations and guidelines that apply to overseas investment and finance.



OVERVIEW OF CHINESE ENTERPRISES

As part of the "Going Global" policy, Chinese companies and banks have invested in many different sectors in nearly all corners of the world. Over the past few years, Chinese actors have increasingly invested in the Balkan region, including the coal sector in Bosnia-Herzegovina. Photo courtesy of Friends of the Earth.

While China's overseas investment has historically been dominated by SOEs, the role of the private sector is increasing rapidly. As recently as 2005, SOEs accounted for 83 percent of outbound investment flows.³ However, statistics from MOFCOM indicate that in 2013 SOEs were responsible for less than 44 percent of overseas investment.⁴ In 2006, SOEs held over 80 percent of total overseas investment stock - this had dropped to 55 percent by 2013.⁵ According to a MOFCOM official quoted in the China Daily in 2012, outbound investments by private enterprises will eventually surpass those of SOEs.⁶

Private companies and SOEs perform a variety of functions in China's overseas investment. They may play the role of financier, investor, developer or contractor, and sometimes a single project may have multiple Chinese actors involved. For example, the Lower Russei Chhrum hydropower dam in southwest Cambodia was developed by a Hong Kong-based

subsidiary of state-owned *China Huadian Corporation*.⁷ The project received financing from the *Export-Import Bank of China*,⁸ and Huadian sub-contracted construction work to several companies, including two other Chinese SOEs, *Gezhouba*⁹ and *Sinohydro*.¹⁰ In some cases (as returned to later), Chinese state-owned and private companies may also work together in joint-ventures. Increasingly, Chinese companies are also working with local or transnational companies and international financiers.

State-owned Enterprises

During the period of 1949-1979, almost all enterprises in China were state-owned and operated. Each SOE had a party secretary whose job was to implement production plans created by central and local governments. Local governments could establish small 'collectively owned enterprises' that were jointly owned by local communities, but private ownership of any enterprise was prohibited. After

Deng Xiaoping came to power in 1978, private enterprises were legalized but SOEs continued to dominate the economy. As recently as 1985, 65 percent of enterprises were state-owned, 32 percent collectively owned, and only 3 percent private.¹¹

Over the years, several waves of reform have altered the way SOEs function. Many SOEs have been privatized, merged or closed, but there remained some 160,000 as of 2012, according to China's National Bureau of Statistics.¹² Of these enterprises, 112 are under the supervision of the central government (as of February 2015).¹³ These major enterprises are referred to as 'central SOEs'. At the end of 2012, the total assets of these companies amounted to RMB 44.8 trillion (US\$7.35 trillion). Central SOEs dwarf other enterprises. In 2013, *China National Petroleum Corporation (CNPC)* - the country's largest central SOE - had assets worth around RMB 2.2 trillion. In comparison, the total assets of China's largest private industrial conglomerate at that time, *Fosun Group*, amounted to RMB 150 billion - less than 1/10 the size of CNPC.¹⁴ A large number of Chinese SOEs are now regularly featured in the *Fortune 500* and *Global 2000* indexes, with several making it into the top 20 (see appendix).

SOEs have monopolies over certain strategic sectors, for example, oil and gas exploration and refinement. Although China has considerable domestic oil and gas deposits, the country is heavily dependent on imports, and is now reported to be the world's biggest oil importer.¹⁵ The oil and gas sector is therefore of vital strategic interest to China, and the state provides strong support to SOEs engaging in both domestic and overseas investment and trade in energy resources.

China's central SOEs are under the supervision of the State Council, and senior company leadership is appointed by the Party. SOEs

enjoy monopolies of strategic industries and receive strong state support, including subsidies, preferential loans and lower rates of taxation.¹⁶ The strong involvement of the state sometimes makes it challenging to distinguish between the commercial and political motivations of SOEs.

In the past, the success of SOEs was often measured in relation to production volumes, employment levels and similar indicators. However, the Chinese Government is increasingly aware of the commercial pressures faced by SOEs. As China's economic reforms have taken hold, pressure has risen for SOEs to raise revenues and become more profitable. For a number of years the Chinese Government has been aware of the need to reform the structure and governance of SOEs. As will be discussed later, the concepts of "modern management" and "mixed ownership economy" are now guiding the gradual restructuring of China's SOEs. Nonetheless, the Chinese Government still maintains a strong influence over SOEs. According to China's Minister of Industry and Information Technology, "a large number of operational matters that should be left to SOEs to decide are still subject to the approval of the government".¹⁷

Governance of SOEs

All central SOEs come under the authority of the State-owned Assets Supervision and Administration Commission (SASAC). In addition to the 112 central SOEs, there are also thousands of sub-national level SOEs, which come under the authority of provincial and local departments of SASAC.¹⁸ Although SASAC is ostensibly responsible for supervising SOEs, its influence is often diluted. At the central level, although SASAC is a ministerial level agency, so are many of the central SOEs under its supervision. At the local level, SASAC is under the authority of

local governments, which may also play an important but conflicting role in promoting the expansion of SOEs.¹⁹ Additionally, while SASAC is responsible for appointing top executives at central Chinese SOEs, this must be reviewed and approved by the Organization Department of the Central Committee of the Communist Party of China.²⁰ In some cases SOE management positions can be a springboard to higher positions in government, and senior appointments come with bureaucratic rank as high as vice-ministerial or even ministerial level.

While the State maintains a significant influence over SOE management, many of the central SOEs now have boards of directors, which can in theory improve governance and scrutinize business decisions more effectively. A pilot program was established in 2005, which aimed to empower SOE boards to play a greater management role.²¹ As of late 2013, 52 central SOEs had established boards of directors and 141 had made senior executive positions open to recruitment of worldwide candidates. However, the positions of chair and president of the board are still appointed by the government.²²

Steps are also being taken to cut the salaries of SOE executives appointed by the government. As reported by *China Central Television* (CCTV): "The salary system for SOE executives has long been criticized for lacking transparency and not reflecting the performance of executives. Some executives have gone away with their pockets full even when the SOEs they are managing have gone bankrupt." New policies on executive pay incorporate performance-based indicators that tie executives' pay and bonuses to results, as well as creating requirements for executives to disclose income and other positions.²³

A significant number of central SOEs have now listed subsidiaries on the Shanghai,

Hong Kong and international stock exchanges. These enterprises have listed subsidiaries in order to attract private capital and increase opportunities to invest overseas. Going public is also seen by the government as a way in which corporate governance can be improved, as it requires SOEs to adopt standardized corporate governance structures.

As China's SOEs become increasingly active overseas, there is pressure to further professionalize governance and management and increase transparency regarding investments. In encouraging SOEs to adopt CSR practices, SASAC published the "Guidelines to the State-owned Enterprises Directly under the Central Government on Fulfilling Corporate Social Responsibilities" in 2011. The policy stresses the importance of developing CSR principles not only in domestic affairs but also overseas; article 4 states that "[f]ulfilling CSR is the need for the CSOs [central state owned enterprises] to participate in international economic cooperation....By fulfilling CSR, it is either helpful in establishing a 'responsible' public image by Chinese enterprises and more internationally influential, or significant for China to spread an image as a responsible nation." Many central SOEs now have websites in both Chinese and English (and sometimes other languages of countries where they have operations). The quality varies greatly, but those SOEs with overseas operations are increasingly developing more detailed and accessible websites. Some companies now also publish annual reports, and, in a few cases, corporate social responsibility (CSR) reports. The appendix to this paper includes an overview of the regulations and guidelines that apply to SOEs when investing overseas.

State-owned enterprises and overseas investment

SOEs have been central to the expansion of China's 'going out' strategy. Both domestically and overseas, China's SOEs dominate key sectors including energy, oil and gas, telecommunications and shipping. There are multiple motivations behind China's 'going out' strategy, including the acquisition of resources, gaining access to international markets, developing technical capacities of Chinese enterprises, building global brands, and finding profitable investments for some of China's vast foreign currency reserves. SASAC has made it a priority to develop central SOEs into top global multinationals. In 2013 it stated that 38 percent of SOE profits came from overseas projects, and expected this figure to increase to more than 50 percent within the next 5 years.²⁴

Within China, many SOEs are operating at overcapacity, including those in the steel, cement, chemical, and papermaking industries. SOE production is not always driven by market forces, and production can remain high even when demand for outputs drops. Local governments may encourage maintaining and even increasing production in order to generate tax revenues and employment. The result is unnecessary pollution and outputs that are not being absorbed by the market. In addition, oversupply drives down prices, and creates an environment in which the private sector cannot compete.

The government has been trying to address overproduction for several years, and in 2013 the Ministry of Industry and Information Technology instructed 1,400 companies to cut production.²⁵ One way that companies are attempting to cut production in China is by developing projects overseas. For example, in 2014, Hebei province, where much of China's steel industry is located, announced plans to encourage local companies to

increase their outbound investment in order to cut down domestic industrial capacity.²⁶ Premier Li Keqiang stated in April 2015 that exporting industrial capacity was necessary to counteract economic downward pressure domestically and upgrade production facilities in other countries.²⁷

Although SOEs continue to play a major role in China's overseas investment, MOFCOM statistics indicate that SOE dominance is reducing and non-state actors are growing increasingly important. Of the 15,300 enterprises that recorded overseas direct investment flows in 2013, only 8 percent were SOEs.²⁸ While SOEs may invest in a relatively low number of overseas projects, they still invest much larger amounts than private enterprises. As mentioned earlier, SOEs hold 55 percent of overseas direct investment stock²⁹ and have been responsible for some of China's biggest overseas investments. For example, a subsidiary of *China National Petroleum Company (CNPC)* is responsible for developing the US\$2.5 billion oil and gas pipelines that connect Myanmar's offshore Shwe gas fields and deep water port with Kunming in China's Yunnan province.³⁰ In 2013 the state-owned *China National Offshore Oil Corporation (CNOOC)* completed a massive US\$15.1 billion takeover of the Canadian oil and gas company *Nexen*.³¹

SOEs have access to various financing options when pursuing overseas investments. Although many of these options are also available to private enterprises, SOEs tend to have preferential access to credit from China's policy and commercial banks. The *China Development Bank* and *Export-Import Bank of China* are major providers of finance for companies 'going out'. Neither bank provides detailed breakdowns of its domestic or overseas loans. However, annual reports from both banks indicate that many major overseas projects they finance are implemented by SOEs. SOEs also have

access to finance from China's state-owned commercial banks, and as mentioned above, many have registered subsidiaries that are listed on stock exchanges in mainland China, Hong Kong and internationally. Through these listings the companies are able to raise funds through public offerings.

China's SOEs also enjoy preferential access to contracting opportunities through China's aid program. This approach has generated numerous engineering and construction contracts for Chinese SOEs. SOEs (and private companies) are also bidding for contracts to implement projects funded by multilateral institutions such as the World Bank and Asian Development Bank. One study found that between 1999 and 2009 Chinese firms won 10-20 percent of African infrastructure contracts awarded by the World Bank.³²

Although many SOEs have enjoyed success overseas and have been instrumental in implementing the 'going out' strategy, some ventures have failed to generate as much profit as expected. Others have encountered political, social and environmental risks that were either not foreseen or not properly mitigated. For example, in Myanmar, local communities and civil society groups have raised concerns about the Shwe oil and gas pipelines. Opposition to the US\$3.6 billion Myitsone dam was so strong that the Myanmar government suspended the project in 2011. This project was to be developed by a joint-venture including the state-owned *China Power Investment Corporation*.³³ In a 2015 case in Mexico, the *China Railway Construction Corporation* won a contract to build a US\$3.7 billion high-speed railway, but the deal was cancelled just three days later after concerns emerged regarding the bidding process and the fact that the local partners had links to Mexico's ruling party and government officials.³⁴

In some cases, SOEs have encountered distrust from foreign governments who fear Chinese state-backed investments in strategic sectors pose a threat to national security. For example, in 2005 *CNOOC* pulled out of an attempted takeover of the US oil firm *Unocal* due to political opposition to the deal, and, more recently, the telecom equipment maker *Huawei* faced opposition to planned acquisitions in the US.³⁵ In other cases, large overseas investments have struggled due to SOEs' lack of knowledge of local context and limited capacity to adapt to market conditions. For example, *CITIC Pacific*, a Hong Kong listed subsidiary of state-owned *CITIC Group*, suffered a huge loss connected to investment in an Australian iron ore mine. *CITIC* was new to the country, and losses were attributed to its lack of experience and awareness of local regulatory conditions. According to the *CITIC Group* chairman, problems occurred "because the company wasn't truly familiar with the local situation".³⁶

There is often a perception that China's SOEs are able to run at a loss overseas provided they invest in areas that are strategically important to the Chinese Government. There are examples of SOE invested projects that appear to be motivated more by broader strategic objectives than commercial interests. For example, the *China Railway Construction Corporation (CRCC)* suffered a US\$600 million loss in constructing the Mecca Light Rail in Saudi Arabia. This project - in a country that China was eager to develop political and economic ties with - was seen by many as political rather than commercial: *China's Economic Observer* magazine even quoted the president of *CRCC* as stating the project was driven by political considerations.³⁷ There may also be cases where SOEs engage in projects that have marginal profitability but serve as a way to gain access to new markets. Developing a presence in a new country can both increase the chance of winning future development or contracting

agreements, and limited profits or even losses incurred in one project may be compensated by revenues from future projects.

As mentioned above, the CCP still appoints top executives at the central SOEs, and even when SOEs have gone public, the final say on major decisions will lie with executives who are political appointees. Additionally, many major SOE-implemented projects receive support from the China Eximbank or the China Development Bank. These wholly state-owned banks have mandates to advance China's national interests, including improving China's access to energy and natural resources. However, it is an oversimplification to assume that SOEs and state banks exist only to further the strategic or political objectives of the Chinese Government. Although there is clear government influence over the activities of SOEs, and they may be called on to develop strategic projects, SOEs also have their own priorities, which include generating profit, gaining access to markets, acquiring new technology, and developing global brands.*

State-owned enterprises and China's foreign aid

Although the amount of aid that China provides is considerably lower than the value of its overseas investments, SOEs are closely connected to China's aid program, which is largely implemented through the China Export-Import Bank. One way that China disperses aid is through concessional loans, which now account for more than half of its foreign aid budget.³⁸ These loans are used mainly to support large and medium-sized infrastructure projects and the majority of these loans have funded transport, power

supply and communication infrastructure.³⁹

Concessional loans require that at least 50 percent of the loan is used for Chinese goods and services, including contracts for construction and design work,⁴⁰ and SOEs are frequently contracted to work on aid projects. For example, since 2010 China has been the top provider of development assistance to Cambodia. The Cambodian Government's Official Development Assistance Database lists 53 Chinese funded projects, at least eight of which were contracted to the *Shanghai Construction Group*, a subsidiary of a major SOE. A further two projects were granted to the *China Road and Bridge Corporation*, another major SOE working on domestic and overseas construction projects.

Private Enterprises

China's private sector has grown significantly since the 1980s. Prior to the 'reform and opening up' initiated by Deng Xiaoping, most urban residents were employed by SOEs or other state institutions, and people in rural areas worked collectively in communes. However, by 2014 only 18 percent of people were employed by SOEs, rural communes have been disbanded, and many town and village enterprises have been privatized. Private enterprises now account for a significant proportion of economic activity. According to one analysis, SOEs accounted for only 11 percent of exports in 2013, compared to 47 percent by private foreign-owned firms and 39 percent by domestic private firms. SOEs accounted for 34 percent of fixed investment compared with 48 percent by the private sector.⁴¹

* For a more detailed discussion of the interaction between state priorities and those of China Development Bank, see Downs, E. (2011), *Inside China, Inc: China Development Bank's Cross-Border Energy Deals*, Washington DC: Brookings Institute.



*Huawei Technologies is a private Chinese enterprise with locations across Africa, Europe, Latin America, and North America. On its website, it has published principles regarding environmental protection and energy conservation. **Photo courtesy of Creative Commons***

Private enterprises are increasingly visible in China's overseas investments. However, only a few non-state owned companies rank within the top 20 in terms of overseas stock, assets or revenues (see appendix). The number of private companies investing overseas is growing, but in terms of the value of individual projects, overseas investments by non-state controlled companies are generally much lower than investments by SOEs. Private enterprises also have access to loans from China's state-owned commercial banks and policy banks, however, they have struggled to compete with SOEs due to the comprehensive backing that they receive from the state, as detailed in the previous section. This is especially true in strategic sectors such as oil and gas, in which SOEs dominate.

China's central SOEs are extremely large, employing thousands of staff, with assets in the billions or even trillions of yuan.

On the other hand, private enterprises come in various shapes and sizes, from large multinational corporations, all the way down to micro enterprises employing a handful of people.** Chinese private enterprises of various sizes are active overseas. This includes large enterprises such as *Huawei Technologies*, which is the world's largest maker of telecommunications equipment, all the way down to individual investors engaging in a single overseas investment, for example, a plantation, mine or factory.

Private enterprises are often viewed as more dynamic and market-orientated than SOEs. As they do not enjoy the same level of state backing as major SOEs, they are more likely to make investment decisions based purely on commercial considerations. When investing overseas, private enterprises tend to rely less on government to government relationships

**There is no universal definition of what makes a company micro, small, medium or large, and different countries use different definitions (and some have no criteria at all for defining companies in these terms). The European Union defines micro enterprises as employing less than 10 people with revenue less than EUR 2 million, small enterprises less than 50 employees and revenues under EUR 10 million, and medium less than 250 employees and revenues under EUR 50 million. China uses its own definitions, and criteria differ across industries.

than SOEs. Instead, they are more likely to nurture relationships with other key actors in host countries, such as local government, local enterprises, influential actors from state institutions and the business community, and local ethnic Chinese business groups.

Governance of private enterprises

Private enterprises utilize various ownership structures, for example:

- **Sole proprietorship:** *a company with a single owner.*
- **Private company:** *owned by a small number of shareholders with shares not publicly traded.*
- **Public company:** *owned by multiple shareholders, with shares bought and sold on stock exchanges.*

Often large private companies will have a board of directors and a management team in place to guide the company's activities. A management team usually includes a Chief Executive Officer, Chief Operating Officer and a Chief Financial Officer, among others. The management team reports to the board of directors. The board is usually appointed by shareholders and is responsible for guiding company management and protecting the interests of the company and shareholders.

Smaller companies, such as those owned by one person or by a small and closely linked group (a family, for example), may have no board of directors or a board that plays only a passive role. In larger companies and companies with a diverse range of shareholders the board is more likely to be active. When a company is publicly listed on a stock exchange it must have a board of directors, and the board must comply with relevant government and exchange

requirements in order for the company to list and trade shares.

While many SOEs now have boards of directors, the board is likely to function in a different manner than in private enterprises. When a company is owned by individual shareholders (either privately or through a public listing), the company's responsibility is to provide a return on investment, i.e. make a profit. In cases where a company is state-owned, profit is still important, but as the state is the sole or majority shareholder, other factors may influence company activities. This may include securing control over important resources, building strategic relationships with other countries, generating employment, providing a public service, and so on.

Private enterprises and overseas investment

It has been reported that private firms face greater obstacles than SOEs in receiving government approval and state subsidies for overseas investments⁴² and encounter difficulties negotiating the complicated approval process required in order to use foreign currency in overseas investments.⁴³ As previously noted, private enterprises also pay higher corporation taxes, and do not have the same opportunities to access credit and state incentives. However, market-orientated private enterprises can respond more quickly to market conditions. This dynamism is important for effective overseas investment, particularly in commodities, which are intrinsically connected to global markets.

Government policy is now changing, and more effort is going into promoting private companies' overseas ventures and to encourage financiers to support private enterprises. Companies now also have improved access to credit and preferential rates of taxation and, in 2014, the approval



The recent controversy involving illegal Chinese gold miners in Ghana has caused the Chinese Embassy in Ghana (pictured above) to educate Chinese citizens regarding Ghanaian mining laws. **Photo courtesy of Creative Commons**

process for overseas investment was relaxed.⁴⁴ An increase in the global use of the RMB will also create opportunities for overseas investment by the private sector.

Private enterprises differ greatly in terms of number of employees, assets, revenues and so on, and companies from across this spectrum are investing abroad. Larger private enterprises are the most visible due to the size and scale of their individual investments. Some private enterprises have connections to the government, for example, companies that were previously state-owned but sold during previous economic reforms. Private enterprises that have developed globally recognized brands and enterprises that play an important role in the economy of the area where they are based may also receive support from the state to 'go out'. For example, Cambodian media frequently reports on official delegations of investors visiting the country to meet with high level officials.⁴⁵ These delegations include central SOEs, provincial SOEs, as well as private

enterprises, and are facilitated by local Chinese chambers of commerce and central or provincial government in China.

Although the most visible Chinese overseas investors are often SOEs and large private enterprises, smaller companies are also very active overseas. While the value of their investments may be much lower than large enterprises, they are prolific, and therefore have potentially significant impacts on the economy and areas where they are active. In order to promote outbound investment by smaller enterprises, China's Council for the Promotion of International Trade has announced a reduction in procedural costs for applying for certificate of origin (a document which is often needed in order to pass customs procedures when importing goods to another country). According to *China Central Television*, in response to the rising number of small and medium sized enterprises seeking to go global, the Council has opened a training centre and launched training sessions "to educate



The Kamchay Dam was the first large scale hydropower in Cambodia. Constructed by Chinese SOE Sinohydro, the dam was financed by China Exim Bank. Photo courtesy of Mark Grimsditch.

domestic companies in the nuances of investing overseas”.⁴⁶

At the bottom end of the hierarchy in terms of size and value are those investments implemented by micro-enterprises or individual investors. This is an area that has not received much attention and is probably the most difficult to assess in terms of scope and impact. Most small-scale overseas investments do not attract a great deal of attention outside the area of the investment, but one notable exception is the issue of small-scale Chinese gold miners operating in Africa. Facilitated by brokers in China with connections in Ghana, thousands of Chinese miners have travelled to Ghana looking to make their fortunes. According to China’s *Xinhua* news agency, many of these miners were from a single impoverished county in Guangxi – over 12,000 people from that area travelled

to Ghana between 2003 and 2013.⁴⁷ According to a Chinese academic studying these groups, miners from Guangxi would pool capital from family savings, bank loans and black market loans and form a small company through which to invest in a small mining area, usually less than 25 acres in size. These companies then partnered with a Ghanaian holding a small-scale mining license who would act as a front for the company, while the Chinese investors provided labour and equipment.⁴⁸ This case hit the headlines in 2012 and 2013 when a large number of miners were arrested in Ghana for working illegally.

Small and family run enterprises have also invested in overseas factories, farms and trading. In some cases, overseas businesses that started small have expanded over the years. For example, the Chinese-owned Collum coal mine

in Zambia was founded by an individual who originally worked as a translator for a Chinese trading company doing business in Zambia. This individual built connections and set up his own construction company, which won a number of contracts before eventually obtaining the mining rights at Collum. According to the Chinese media group *Caixin*, he managed the mine along with four brothers and 70 relatives and family friends. In this case the company was registered in Zambia, with no parent company in China.⁴⁹ This mine was at the centre of controversy for years and attracted a significant amount of media attention. Eventually the license was cancelled due to breaches of safety and environmental regulations and the mine was taken over by the government.⁵⁰

While SOE investments and some investments by larger private enterprises may be agreed through high-level discussions, smaller private investors are more likely to operate 'under the radar'. They may rely more on informal business networks and connections than formal investment channels. For this reason, some such investments may not be recorded leaving China or entering the host country, and can therefore be very difficult to track. It is often very difficult to obtain information on smaller investors as many have no website, are not listed on stock exchanges, do not partner with international companies, and have no communications or public relations department.

While private enterprises have in the past struggled to access financing for overseas investment, opportunities are increasing. In addition to accessing finance from China's state-owned banks, there are also a number of investment funds that provide finance to Chinese companies investing overseas. Additionally, some of

China's biggest private enterprises have listed subsidiary companies on stock exchanges in Shanghai, Shenzhen and Hong Kong. Listing can increase access to finance and opportunities for overseas investment. Major Chinese companies with overseas investment portfolios that have listed subsidiaries in recent years include conglomerates such as *Fosun International*, agribusiness companies like *New Hope Group*, the mining and metals companies *Hailang Group* and *Nanjing Iron and Steel*, real estate companies including *Evergrande* and *Vanke*, and automobile manufacturer *Zhejiang Geely*.

Private enterprises are becoming increasingly active in areas including mining, real estate, telecommunications, electronics, and agriculture. Recent major deals announced or commenced by private investors include the proposed Nicaragua Canal, which is set to be developed by *HKND Group*, a Hong Kong-based company owned by a businessperson from mainland China, as elaborated later in the case studies section. In some cases, private and state-owned companies are now working in partnership, as illustrated by the joint venture between the private company *Cambodia Iron and Steel Mining Industry Group* and the state-owned *China Railway Group*, which planned to jointly develop a major iron and steel project in Cambodia (also discussed in case studies section).

Private enterprises are also required to comply with the regulations and guidelines issued by the Chinese Government and regulatory institutions. An overview of these regulations is included in the appendix.

Comparing Chinese SOEs and Private Enterprises

STATE-OWNED ENTERPRISES	← Larger PRIVATE ENTERPRISES Smaller →
<p>Profit-driven, but strongly influenced by the state.</p> <p>Directly under the oversight of the state.</p> <p>Senior executives appointed by Government.</p> <p>Dominate key sectors including energy, mining, oil and gas, shipping.</p> <p>Many SOEs now have websites in English (and other languages).</p> <p>Website may include annual reports CSR/sustainability statements, especially if the SOE has publicly listed subsidiaries.</p> <p>Increasingly aware of reputational risks, but still investing in high risk projects.</p> <p>Now working in joint-venture with private enterprises, international companies and financiers.</p> <p>In the process of reform. Opening to private investors and foreign investors.</p> <p>Facing greater scrutiny since the start of China's crackdown on corruption. Overseas investments in particular have been highlighted as an area that will face greater scrutiny.</p>	<p>Profit-driven, market-oriented.</p> <p>Market focus means private firms may be more dynamic than SOEs.</p> <p>Accountable to shareholders, board, investors.</p> <p>Large companies sometimes receive support from the state, e.g. through joining state-led investment and trade delegations,</p> <p>Often have website in English, especially if investing overseas.</p> <p>Website may include CSR/ sustainability statements.</p> <p>Sometimes post annual reports and sustainability reports, especially if the company has publicly listed subsidiaries.</p> <p>Larger firms are becoming concerned about image and corporate brand, as well as identifying business risks.</p> <p>In some case may work in joint-venture with SOEs.</p> <p>The state is increasingly encouraging private enterprises to 'go out'.</p>
	<p>Profit-driven, market-oriented.</p> <p>Minimal or no state influence.</p> <p>Smaller enterprises may invest in a single project, e.g. plantation or small-scale mine.</p> <p>Smaller companies unlikely to do due diligence.</p> <p>Very small companies investing in resources, e.g. small-scale mining, are frequently connected to violations of local regulations.</p> <p>Tend to have limited concern about company reputation or corporate image.</p> <p>Activities often informal, overseas investment may not be registered exiting China or entering the country of operation.</p> <p>Unlikely to make any reports public.</p> <p>Often limited transparency and access to information.</p> <p>Usually no website in English, often no Chinese website.</p>



MODERNIZATION OF SOEs AND GROWTH OF THE PRIVATE SECTOR

Since 2013, the Chinese central government has re-prioritized SOE reform in order to stimulate “modern management” and “mixed ownership economy”. **Photo courtesy of Creative Commons**

As China’s economy has developed, the role of SOEs and the private sector has evolved significantly. The private sector is now responsible for a large portion of domestic investment and employment, and its contribution to China’s GDP continues to grow. SOEs still dominate a number of core industries, including oil and gas, energy, and finance. However, China’s SOEs have also developed a reputation for being inefficient, with many operating overcapacity and utilizing dated equipment and techniques. Furthermore, most still lack modern management structures. Although China is promoting the growth of its private sector, private companies still struggle to compete with SOEs and their access to government

support. Since the 1990s the Chinese Government has discussed the need to reform SOEs, but with mixed results. In 2013, the goal of SOE reform was re-prioritized, and discussion now focuses on developing ‘modern management’ and a ‘mixed ownership economy’. This has implications for SOE activities both in China and overseas.

SOE Reform and the Developing Role of the Private Sector

In the mid-1990s, China began to implement the policy of “grasping the big and releasing the small”, which involved closing, consolidating or privatizing SOEs that were running at a loss and focussing state support

on the larger, more profitable and strategic enterprises.⁵¹ This policy created more space for the private sector to grow, but also allowed the state to maintain dominance over key industries. The pace of SOE reform slowed in the 2000s but the urgency of reform was re-emphasized at the Third Plenary Session of the 18th Communist Party of China's Central Committee in late 2013. A document issued during this session stated that "reform should let the market play a decisive role in allocation of resources".⁵²

As part of its reforms, SASAC has been taking measures to restructure SOEs, including encouraging investment in more profitable sectors, supporting SOEs to list on stock exchanges, and promoting private capital investments in SOEs. In addition, SASAC has pursued a number of initiatives to increase efficiency in the sector, instructing SOEs to sell off underperforming assets, promoting improved management, and advocating mergers and acquisitions of major SOEs in order to create enterprise groups that can compete internationally.⁵³ The main aims of SOE reform is to separate government functions from commercial functions, to improve supervision of SOEs and raise competitiveness through innovations in technology, management and brand building.⁵⁴

An important part of ongoing SOE reforms is encouraging 'mixed ownership'. The Chinese Government is promoting private companies and investors to acquire larger shares in SOEs and gain a bigger role in decision making. Non-state investment in SOEs has been going on for some time, but much of this investment has been carried out by state-backed investment groups, SOE subsidiaries or provincial level SOEs.⁵⁵ Under the new wave of reforms, more private investors will be encouraged to invest in SOEs. The structure of ownership shares has still not

been confirmed, however, it is likely that the state will retain a majority share in companies engaged in resource development, social welfare and other key sectors. Sectors that concern national security will remain solely state-owned.⁵⁶

In addition to these top-down reforms, several major SOEs have begun their own reform programs. In 2014, *CITIC Group* transferred most of its assets to *CITIC Limited*, which is listed on the Hong Kong Stock Exchange.⁵⁷ Even in the energy sector, which has always been under close state control, companies are now looking to encourage other types of investment. For example, in 2014 *China Petroleum & Chemical Corporation (SINOPEC)* transferred almost 30 percent of its downstream industry to 25 private investors, including private equity funds, social welfare funds and private enterprises.⁵⁸ Interestingly, as well as working with Chinese banks, *SINOPEC* also turned to Bank of America, Merrill Lynch and Deutsche Bank to find investors. In the main, however, the areas opened to private investment are in retail, and do not impact strategic assets such as those connected to oil exploration and refining.⁵⁹

Foreign investors – both portfolio investors (financial institutions that purchase company shares) and corporate investors -- can also now acquire equity in China's SOEs. For example, in January 2015, a Japanese-Thai joint venture obtained a 20 percent stake in *CITIC Limited* – the largest ever foreign investment in a Chinese SOE.⁶⁰ In a statement to the media regarding this deal, *CITIC's* chairman stated: "Not only have we brought in private investors, but they are attractive global conglomerates who will extend our reach". This illustrates the motivations of SOEs to attract established international investors.⁶¹ Additionally, as of late 2013, the Singaporean Government's investment company, *Temasek*, held stakes of around US\$18 million in

the state-owned *China Construction Bank*, *Industrial and Commercial Bank of China* and *Bank of China*, making it the biggest foreign investor in Chinese banks.⁶²

SOE reforms have had significant impacts on the structure of China's economy. As of late 2013, SASAC statistics showed that 90 percent of state-owned and state holding enterprises have become corporations and shareholding firms. Further, a total of 56 percent of total assets and 62 percent of business revenue of all centrally-administered SOEs belonged to listed companies. At this time, 71 central SOEs had received private investment worth RMB 682 billion (US\$105 billion).⁶³ By mid-2014 over 50 percent of SOEs and their subsidiaries already hosted some type of private investment, but the role of these investors was limited.⁶⁴ The current wave of SOE reforms could potentially change this and increase the influence of these private investors.

Evolving Characteristics of Overseas Investment

The characteristics of Chinese overseas investment have shifted over time. Overseas investments were once dominated by SOEs with close state involvement. Now SOEs are operating with greater levels of independence and the private sector is becoming increasingly important. Private investment in particular has become a major driver of economic growth in China; the increase in overseas deals indicates that private Chinese enterprises will grow as a global economic force.

Following a number of failed and troubled investments, SOEs are exploring new approaches to investing overseas. Mergers and acquisitions (M&A) have become a common approach to obtaining overseas projects over the last ten years, especially since the financial crisis, which saw many

international companies fall on hard times. M&As have helped both Chinese SOEs and private companies to gain control of already established companies and in the process access their technology, expertise, brands and market access. The case study of *MMG Limited*, discussed later, provides a useful example of a large central SOE acquiring the overseas assets of an established company and adopting its standards and management systems.

Other approaches to investment that are becoming increasingly common include nurturing linkages between state-owned actors and private enterprises. SOEs have also begun to work in joint ventures with established multinational companies, for example, the aluminium company *CHINALCO* is involved in a major joint venture with the British-Australian company *Rio Tinto* in Guinea. This project also includes investment from the World Bank's private investment arm, the International Financial Corporation (IFC), which holds a 4.6 percent stake.⁶⁵

While the role of the private sector may be increasing in some areas, SOEs are also consolidating their influence in certain sectors. One way that this is occurring is through mergers of large SOEs. Several of China's SOEs were broken up in the 1990s in order to increase domestic competition, however, this has also led to Chinese SOEs competing with each other overseas. In a number of cases this has resulted in competing firms becoming locked in price wars. In 2014 *Chinese Southern Railways (CSR)* and *Chinese Northern Railways (CNR)* were consolidated in order to address this issue, reducing competition between Chinese companies and instead increasing global competitiveness. There are also suggestions that this could happen in other industries,⁶⁶ including an announcement in 2015 that the Chinese Government

will further consolidate the SOE sector, particularly in strategically important sectors, and reorganize the newly-merged companies to be more profitable.⁶⁷

The ongoing anti-corruption crackdown is also likely to have an impact on overseas investment, especially for SOEs. During the crackdown it became clear that waste and mismanagement of state assets by SOEs was an extremely serious problem, and in 2014 over 70 SOE executives were removed from their positions.⁶⁸ According to the former deputy director of China's National Audit Office, weak auditing systems have resulted in huge losses of SOE's overseas assets.⁶⁹ The ongoing SOE reforms and the anti-corruption campaign are likely to affect the way that SOEs operate overseas. In particular, SOEs may be more cautious in future when engaging in high-profile and high-risk investments.⁷⁰ In light of these problems, and following on from a number of high-profile and unsuccessful overseas ventures, SASAC now requires more detailed feasibility studies and due diligence reports, including third-party appraisals of project values.⁷¹

CASE STUDIES

Several case studies are included below in order to illustrate some specific examples of the new approaches to overseas investment being adopted by SOEs and private enterprises, and how the roles of these actors overlap.

State-backed investment

MMG Limited: A Subsidiary of China Minmetals Corporation

China Minmetals Corporation is a central SOE and one of the biggest metals and mineral traders in the world. Minmetals consistently ranks highly among Chinese enterprises investing overseas, and in 2014, placed 14th in terms of overseas investment stock and overseas assets, and 16th in terms of foreign revenues.⁷² In 2009 Minmetals successfully acquired the Australian mining firm *OZ Minerals*.⁷³ Following this acquisition, Minmetals established the subsidiary *MMG Limited* to manage these assets. MMG is headquartered in Australia and listed on the Hong Kong Stock Exchange.⁷⁴ China Minmetals owns 74 percent of MMG shares, with the remaining stock owned by public shareholders.⁷⁵ The company is governed by a board of nine directors, and also has several committees including an Audit Committee; Safety, Health, Environment and Community Committee; and a Disclosure Committee.⁷⁶

One of the projects acquired in the takeover was the Sepon gold and copper mine in Laos. This mine has developed a reputation for having high environmental and social standards and has in place internal performance standards that are far higher than Laos regulations require. It has

also established programs for training local workers, a community development trust fund, supports local business groups, and has established a grievance mechanism for local people who feel they have been negatively impacted by the mine. High standards were already in place when Minmetals acquired the project from OZ Minerals, but rather than scrap the policies and systems implemented by the previous company, Minmetals kept them in place and subsequently developed them further. Senior management was also kept on, which maintained continuity after the acquisition and also allowed the parent company to benefit from their experience and expertise. The company became a member of the International Council on Mining and Metals (ICMM) and is presently the only Chinese company that supports the Extractive Industries Transparency Initiative (EITI). MMG reports also follow the Global Reporting Initiative's (GRI) mining and metals reporting guide.^{***}



*The Sepon gold and copper mine in Laos has developed a reputation for complying with environmental and social standards that are higher than what Laos regulations require. Photo courtesy of **Creative Commons***

^{***}For an in depth look at the Sepon mine, see Greenovation Hub (2014), *China's Mining Industry at Home and Overseas: Development, Impacts and Regulation*, Beijing: GHUB Climate and Finance Policy Centre.

MMG is active in Australia and DR Congo and continues to expand. In April 2014, a consortium of companies led by MMG acquired *Glencore Xstrata's* Las Bambas copper mine in Peru for over US\$6 billion. This will be China's largest investment to date in an overseas copper project. MMG holds a controlling stake, with the rest held by subsidiaries of state owned *CITIC Group* and *Guoxin Group*. MMG has stated that it will apply its existing social, environmental and management policies to new acquisitions, including the Las Bambas mine; and will uphold the community development commitments formerly made by *Glencore Xstrata* in the Las Bambas project.⁷⁷

The case of MMG provides an interesting example of investment by a Chinese SOE which through an overseas acquisition has adopted international standards and practices, both in its management systems and environmental and social policies. However, it should be noted that while China Minmetals owns the majority of the company, the company's senior management (in charge of the day-to-day operations) are veterans of OZ Minerals and mining majors such as BHP Billiton. While assessments of MMG's practices to date have been positive, the Sepon mine was already established and operational when Minmetals acquired it. The major test will come when MMG continues to develop newer projects like the Las Bambas mine in Peru.

Private Investment

HKND's Nicaragua Canal Project

In 2013, a privately-owned Chinese enterprise announced plans to develop one of the most ambitious construction projects in Latin American history: a shipping canal through Nicaragua, connecting the Pacific and Atlantic oceans. At a cost of US\$50 billion, the project includes free trade areas, two ports, tourism zones, airports and power generation and transmission facilities.⁷⁸ The project developer is *Hong Kong Nicaragua Development Group (HKND)*.

The project aims to provide a shipping route through Latin America that can accommodate ships much larger than those currently able to use the Panama Canal. This could potentially boost regional trade and raise considerable revenues for the country. However, the project has caused serious concern among civil society groups and some members of the public due to the lack of transparency in the way it was approved and its potential environmental and social impacts. No detailed project description was



Should the Nicaragua Canal move forward, Lake Nicaragua (pictured above/below) would be bisected and partially dredged in order to accommodate ship traffic. **Photo courtesy of Creative Commons**

released until preliminary work on the project was already underway, and at the time the government awarded the contract to HKND no environmental assessment had been conducted. The project will run through Lake Nicaragua, the main source of drinking water for the country, and will affect several national parks. The canal will also require resettlement of an unspecified number of villages in its path.⁷⁹ Public protests against the project have already led to dozens of arrests.⁸⁰

The scale and cost of the project has caused much debate, particularly as HKND has no experience in major infrastructure construction. It is also unclear how a private enterprise can raise the capital necessary for such a massive project. The size, cost and complexity of the project has led to speculation that the project must have backing from the Chinese state. This has been denied by the government. In December 2014 a spokesperson from China's Foreign Ministry stated: "the Chinese company's engagement in the Nicaragua project is an act of itself, and has nothing to do with the Chinese Government."⁸¹

Although the Chinese Government has denied any link to the project, a number of central SOEs are involved. This includes the *China Railway Construction Corporation (CRCC)*, which is contracted for design work,⁸² and *China Gezhouba Group*, which has signed an MOU for strategic cooperation and plans to make equity investments in the project.⁸³ The state-owned *Changjiang Institute of Survey, Planning, Design and Research* is also responsible for aspects of the design work. In addition, subsidiaries of the central SOEs *China Communication Construction Group* and *China Airport Construction Group Corporation* are responsible for the port and airport components, respectively.⁸⁴

In the absence of a full and public environmental and social impact assessment, the benefits and risks of the project are still not fully understood, and local concerns remain. Despite several statements from the Chinese Government denying a connection to the project, speculation continues due to the project's reliance on Chinese state-owned enterprises. At present it is unclear how the project will be financed and when construction will commence. HKND's chairman has stated that finance would be raised through "combined measures of cross-shareholding, bank lending and debt issuance."⁸⁵ He has also stated that HKND is preparing an IPO to raise funds for the project.⁸⁶ It remains to be seen how financing will be secured and if the project will go forward as currently planned.

State-Private Joint Venture

China Railway Group and CISMIG in Cambodia

In 2013, the private company *Cambodia Iron and Steel Mining Industry Group (CISMIG)* and a subsidiary of the state-owned *China Railway Engineering Corporation (CREC)* – also known as *China Railway Group* – announced plans to develop a major project comprising an iron ore mine, steel refinery, railway, bridge and commercial port in Cambodia. The proposed project spans from the north of the country all the way down to the southwest coast. At over US\$11 billion, the project would be the most expensive single investment in the country's history.****

Information on the project is hard to come by, but details gathered from media reports and company websites indicates that the project developers are CISMIG and *China Railway Major Bridge Engineering Group (MBEC)*, a subsidiary of *China Railway Group*.⁸⁷ Another subsidiary, *China International Railway Group*, is responsible for the design and survey work.⁸⁸ A deal to design and construct the port component of the project was signed with *China Ocean Engineering Construction General Bureau (COEC)*,⁸⁹ a subsidiary of the major Chinese SOE, *China National Machinery Industry Corporation (SINOMACH)*.

While the project includes involvement from two of China's biggest SOEs, the private partner, CISMIG, has no website, no track record in Cambodia or elsewhere, and is not listed on any stock exchange. The company holds a license for mining exploration over a huge area in Preah Vihear, a province

in northwest Cambodia. Local Chinese language media reports indicate that the company has been building connections in the area, providing supplies to local schools, constructing classrooms and a new district office for the local branch of the ruling party in the district where the mine is to be located.⁹⁰

In this case, major SOEs appear to be working in partnership with a private company in order to capitalize on its connections and networks. CISMIG holds an exploration license covering some of Cambodia's most iron ore-rich areas. By working in joint-venture, the SOE partners do not have to go through the complex process of securing a license elsewhere. Descriptions of CISMIG included in media reports suggest that the company does not have the resources or manpower required to develop such a major project. The partnership, therefore, appears to be a marriage of convenience: the private company provides local knowledge and connections, the SOEs contributes capital and expertise.



Valued at over \$11 billion USD, the proposed CISMIG and CREC project would include an iron ore mine, steel refinery, railway, and commercial port. Mining exploration is expected to take place in Preah Vihear, the northwest province of Cambodia. **Photo courtesy of Creative Commons**

**** For an in depth look at the this project, see Greenovation Hub (2014), *China's Mining Industry at Home and Overseas: Development, Impacts and Regulation*, Beijing: GHUB Climate and Finance Policy Centre; and *Equitable Cambodia & Focus on the Global South* (2013), Briefing Paper: The Chinese North-South Railway Project, Phnom Penh & Bangkok: EC and Focus.

Unfortunately, the companies have not been forthcoming with detailed project information, and all available information has been gleaned from press statements and news reports. To date, the project has been remarkable for both its size, and the lack of transparency around the proposed development. Although the project was originally supposed to commence construction in 2013, it is still dormant, reportedly due to a funding shortage.⁹¹ Information on the railway company's website indicates it is still eager to develop the project,⁹² but the Cambodian people remain in the dark.

CONCLUSION



Photo courtesy of Creative Commons

The economic reforms that China has implemented over the past 20 years have greatly impacted on the role that SOEs play in both domestic and overseas investment. The importance of the private sector is increasing, and at the same time the government has announced plans for further reforms of SOEs. These reforms could potentially steer SOEs in the direction of more modern management systems and market-based approaches, and in the process reduce the role of the state in directing SOE operations. China has attempted to reform its SOEs in the past, and previous rounds of reform have stalled. However, the government has placed a strong emphasis on pushing through the current measures, and although the state is likely to maintain a strong role in SOE operations, reforming governance and decision making structures is seen as one way in which SOEs can become more competitive on the global stage.

China's private sector continues to grow rapidly, and private enterprises of various sizes are now investing in all corners of the globe. This rise will continue, but SOEs will maintain a dominant role in major investments related to strategic sectors including those concerning resources and energy. Each year China's official statistics show an increase in the volume of outbound investment, and this is also likely to continue for years to come. A key challenge that China now faces is increasing the *quality* of this investment as well as the *quantity*. This goal can be realized in part by improving corporate governance both in private and state-owned enterprises, and applying higher standards when implementing investment projects.

APPENDIX

2014 Forbes Global 2000: Top 20 Chinese Companies

The Forbes Global 2000 is an annual ranking of the top 2000 publicly listed companies. The ranking is based on a mix of four criteria: sales, profit, assets and market value, and is published annually by Forbes magazine. Non-state owned entities are highlighted in green. (All values in US\$ billions).

	G-2000 Rank	Company	Revenue	Profit	Assets	Market Value	Industry
1	1	Industrial & Commercial Bank of China	148.7	42.7	3,124.9	215.6	Banking
2	2	China Construction Bank	121.3	34.2	2,449.5	174.4	Banking
3	3	Agricultural Bank of China	136.4	27	2,405.4	141.1	Banking
4	9	Bank of China	105.1	25.5	2,291.8	124.2	Banking
5	10	PetroChina	328.5	21.1	386.9	202	Oil
6	29	Sinopec	445.3	10.9	228.4	94.7	Oil
7	62	Ping An Insurance	59	4.6	552.8	66.1	Insurance
8	65	Bank of Communications	46.6	10.1	942.2	48.7	Banking
9	66	China Life	68.4	4	327.2	79.8	Insurance
10	102	China Merchants Bank	32.2	8.1	634.7	45.2	Banking
11	121	China Minsheng Banking	34.1	6.8	541.2	33.6	Banking
12	124	China Shenhua Energy	42.8	7.2	80.4	57.6	Mining
13	129	Industrial Bank Co.	32.7	6.7	593.5	28.8	Banking
14	130	Shanghai Pudong Development Bank	31.7	6.7	607.9	29.2	Banking
15	134	China CITIC Bank	27.8	5.7	555.6	32.5	Banking
16	150	China Telecom	52.3	2.9	89.7	37.4	Telecomm.
17	175	SAIC Motor	88.3	4	56.4	24.7	Automotive
18	206	China Everbright	21.2	4.2	404.2	18.6	Financial services
19	223	China State Construction Engineering	88.1	2.5	123.4	14	Construction
20	227	China Pacific Insurance	33.2	1.6	118.6	23.2	Insurance

Source: http://www.forbes.com/global2000/list/#page:1_sort:0_direction:asc_search:_filter:All_percent20industries_filter:China_filter:All_percent20states (accessed April 2015).

2014 Fortune Global 500: Top 20 Chinese Companies

The Fortune Global 500 is an annual ranking of the top 500 corporations worldwide according to revenues. The list is compiled and published annually by Fortune magazine. Non-state owned entities are highlighted in green. (All values in US\$ billions).

	G-2000 Rank	Company	Revenue	Net Profit	Industry
1	3	Sinopec	457.201	8.932	Oil
2	4	China National Petroleum	432.007	18.504	Oil
3	7	State Grid Corporation	333.386	7.982	Utilities
4	25	Industrial and Commercial Bank of China	148.802	42.718	Banking
5	38	China Construction Bank	125.397	34.912	Banking
6	47	Agricultural Bank of China	115.392	27.050	Banking
7	52	China State Construction Engineering	110.811	1.853	Construction
8	55	China Mobile	107.647	9.197	Telecomm.
9	59	Bank of China	105.622	25.520	Banking
10	76	Noble Group	97.878	0.234	Conglomerate
11	79	China National Offshore Oil	95.971	7.700	Oil
12	80	China Railway Construction	95.746	0.986	Construction
13	85	SAIC Motor	92.024	4.034	Automotive
14	86	China Railway Group	91.152	1.524	Construction
15	98	China Life Insurance	80.909	0.594	Insurance
16	107	Sinochem Group	75.939	0.755	Oil/Chemicals
17	111	FAW Group	75.005	3.263	Automotive
18	113	Dongfeng Motor Group	74.008	1.48	Automotive
19	115	China Southern Power Grid	72.697	1.325	Utilities
20	122	China Development Bank	71.305	12.949	Banking

Source: http://en.wikipedia.org/wiki/List_of_largest_Chinese_companies#cite_note-Fortune500-1 (accessed April 2015).

Top 20 Chinese Enterprises Operating Overseas, 2013⁹³

This table lists the top 20 Chinese non-financial enterprises operating overseas in 2013. Taken from Ministry of Commerce statistics, the table shows the top 20 enterprises ranked by outward FDI stock, foreign assets, and foreign revenues, as of the end of 2013. (Non-state controlled companies in green).

	According to Outward FDI Stock	According to Foreign Assets	According to Foreign Revenues
1	China Petrochemical Corporation (Sinopec)	China Petrochemical Corporation (Sinopec)	China Petrochemical Corporation (Sinopec)
2	China National Petroleum Corporation (CNPC)	China National Petroleum Corporation (CNPC)	China National Petroleum Corporation (CNPC)
3	China National Offshore Oil Corporation (CNOOC)	China Resources Co. Ltd.	China National Offshore Oil Corporation (CNOOC)
4	China Mobile Communications Corporation	China National Offshore Oil Corporation (CNOOC)	China Resources Co. Ltd.
5	China Resources Co. Ltd.	China Unicom Corporation	Sinochem Corporation
6	China Ocean Shipping Company (COSCO)	China State Construction Engineering Corporation	China Unicom Corporation
7	Sinochem Corporation	China Merchants Group	China Ocean Shipping Company (COSCO)
8	China State Construction Engineering Corporation	Sinochem Corporation	China National Cereals, Oils and Foodstuffs Corp. (COFCO)
9	China Merchants Group	China Ocean Shipping Company (COSCO)	Guangdong Guangxin Holdings Group Ltd.
10	Aluminium Corporation of China (Chalco)	China National Cereals, Oils and Foodstuffs Corp. (COFCO)	China state Construction Engineering Corporation
11	China Unicom Corporation	Aluminium Corporation of China (Chalco)	China Electronics Corporation
12	Huawei Technologies Corporation	China Mobile Communications Corporation	SAIC Motor Corporation, Ltd.
13	China National Chemical Corporation	Beijing Enterprises Group Co. Ltd.	China National Aviation Fuel Group Corporation
14	China Minmetals Corporation	China Minmetals Corporation	CITIC Group Corporation
15	CITIC Group	Guangzhou Yuexia Holdings Limited	Shanghai Baosteel Group Corporation
16	China Communication Construction Company	CITIC Group	China Minmetals Corporation
17	China National Cereals, Oils and Foodstuffs Corp. (COFCO)	China Communication Construction Company	Xi'an Maike Enterprise Group
18	China National Aviation Holding Corporation	China Power Investment Corporation	China National Chemical Corporation
19	China Three Gorges Corporation	BOE Technology Group Co. Ltd.	Shanghai Wanxiang Investment Co. Ltd.
20	State Grid Corporation of China	Huawei Technologies Corporation	Zhuhai Zhenrong Company

Source: http://en.wikipedia.org/wiki/List_of_largest_Chinese_companies#cite_note-Fortune500-1 (accessed April 2015).

An Overview of the Regulations applying to State-owned and Private Enterprises Operating Overseas

Outbound investment by both state and private enterprises is subject to the regulation and oversight of various government and regulatory bodies. This includes, among others:

- **State Council:** *China's most senior administrative body. The State Council is chaired by China's Premier and includes the heads of all ministries and major government agencies.*
- **National Development and Reform Commission (NDRC):** *The main government body responsible for developing and implementing strategies related to national economic and social development.*
- **Ministry of Commerce (MOFCOM):** *Responsible for formulating strategies, guidelines and policies for developing domestic and foreign trade and international economic cooperation.*
- **China Banking Regulatory Commission (CBRC):** *Responsible for developing rules and regulations for the supervision of China's banking institutions.*
- **State-owned Assets Supervision and Administration Commission (SASAC):** *Central SOEs are subject to the oversight of SASAC, which is under the State Council. Sub-national SOEs are under the supervision of local and provincial SASAC departments.*

The existing regulatory framework applies to overseas investment in general, but there

are also additional requirements which apply only to SOEs.

Approval of Overseas Investment Projects

In early 2014 the approval process for outbound investment was relaxed. Previously, approval was required by the NDRC or MOFCOM for all outbound investments. Under the new regulations, most investments require only a filing (or registration). Only investments that are of very high value or are in "sensitive" countries, regions or sectors now require approval. Sensitive countries or regions include those that China does not have diplomatic relations with, and countries subject to international sanctions or affected by conflict. Sensitive sectors include those that require large-scale land and resource development, telecoms, media, and several other industries.⁹⁴

Rules Applying to China's Overseas Investment in General

Over the last decade a number of policy documents have been issued by the Chinese Government which call for improved implementation of overseas investment projects. This includes the State Council's 2006 *Nine Principles on Encouraging and Standardizing Foreign Investment*, which call on Chinese enterprises to comply with local laws and regulations, commit to social responsibility, pay attention to environmental protection, and support local communities and people's livelihoods.⁹⁵ In 2009 MOFCOM issued *Measures for Overseas Investment Management*, which state that enterprises making overseas investment "shall earnestly learn and abide by the relevant domestic and foreign laws, regulations, rules and policies, and follow the principle of 'mutual benefit and win-win'."⁹⁶

These principles and measures are important, but they lack detail on how

exactly Chinese companies can improve the implementation of overseas investment, and they do not clearly define the meaning or implications of terms such as “corporate social responsibility”. However, they do indicate that there is high-level support for improving standards.

Guidelines for Implementation of Overseas Investment and Finance

In recent years more detailed guidelines have been developed for Chinese companies investing overseas. These guidelines include:

- *Guide on Sustainable Overseas Silviculture (2007)*
- *Guide on Sustainable Overseas Forest Management and Utilisation (2009)*
- *Guide on Social Responsibility for Chinese International Contractors (2012)*
- *Guidelines for Environmental Protection in Foreign Investment and Cooperation (2013)*
- *Guidelines for Social Responsibility in Outbound Mining Investments (2014)*

The guidelines discussed above all fall short of providing binding frameworks for overseas investment. However, they specifically address areas of concern such as environmental impacts, public communication and public participation. Although they are a positive step forward, the guidelines lack accountability mechanisms, and there is no process through which people can raise grievances or report poor practices.

Monitoring and Evaluation of Overseas Projects

Under the 2002 *Interim Measures for Joint Annual Inspections of Overseas Investments*, MOFCOM is required to conduct annual inspections of overseas project performance. Companies are given an evaluation score based on the status and appraisal of their project, and companies that score poorly should not be eligible for preferential state support for future overseas investments.⁹⁷ This evaluation process originally focussed on profitability and compliance with Chinese law, but since 2009 the evaluation has incorporated local performance issues. For example, if a company is reprimanded by the recipient country for a violation of local laws, or if problems emerge related to safety, environmental issues, or labour, the company may also lose points during the evaluation.⁹⁸ There is only limited information available on this inspection process, and results are not made public.

Additional Regulations Applying to SOEs

SOEs are subject to the oversight of SASAC, which is responsible for guiding the reform and restructuring of SOEs, and appoints and removes the top executives of central SOEs.⁹⁹ SASAC has also issued guidelines to encourage improved corporate responsibility of centrally-owned SOEs. In 2008, SASAC issued its *Guidelines to the State-owned Enterprises Directly under the Central Government on Fulfilling Corporate Social Responsibilities*. The guidelines state that fulfilling corporate social responsibilities is necessary to ensure the sustainable development of enterprises as well as society and environmental resources, however, the guidelines do not go into detail on what this entails.¹⁰⁰

SASAC performs audits of SOEs, and companies that perform poorly may be disciplined by SASAC, which also has the power to replace directors if a company performs badly.¹⁰¹ SASAC has powers to conduct inspections of the overseas investments of central SOEs, but it is not clear how frequent and how thorough these inspections are, nor is it clear the extent to which social and environmental performance is considered.¹⁰²

Much of the existing regulatory framework applies to overseas investment in general, but there are also some additional requirements for central SOEs. In 2011 SASAC issued its *Interim Measures on the Supervision and Administration of the Overseas Assets of Central State-owned Enterprises*. These measures established filing and approval requirements for central SOE's overseas projects and instruct SOEs to establish sound management systems and strong corporate governance structures for overseas subsidiaries, and to abide by the laws and regulations of the host country.¹⁰³ Further detail was added in 2012 by SASAC's *Interim Measures on the Supervision and Administration of Outbound Investment of Central State-owned Enterprises*. This states that all SOEs must submit overseas investment plans to SASAC, which include investment amounts, sources of funding, and general information on key projects (including business activities, shareholding structures, locations, investment amounts, and risk analyses). Under this circular, SOEs are not permitted to invest in sectors outside their core area of business without explicit permission of SASAC.¹⁰⁴

Regulations Affecting Listed Companies

Chinese companies listed on the Shanghai and Shenzhen stock exchanges are subject to the disclosure regulations and guidelines

issued by the stock exchange and by the China Securities Regulatory Commission. As Chinese companies expand their presence globally, they will also become subject to the regulations of stock exchanges based outside mainland China. For example, the Hong Kong Stock Exchange has disclosure rules for mining companies which require applicants, at the point of listing, to provide information related to tax, royalties and other payments to governments. Companies are also required to disclose information related to project risks arising from environmental, social, and health and safety issues, as well as compliance with local laws and plans for rehabilitation of sites after project closure.¹⁰⁵

Guidelines Affecting the Financial Sector

Chinese financial institutions supporting overseas investments are also subject to the *Green Credit Guidelines*, issued by the China Banking Regulatory Commission. These guidelines address issues including due diligence, compliance review of clients, and assessments of project performance. Article 21 of the Guidelines explicitly addresses overseas investment:

Banking institutions shall strengthen the environmental and social risk management for overseas projects to which credit will be granted and make sure project sponsors abide by applicable laws and regulations on environmental protection, land, health, safety, etc. of the country or jurisdiction where the project is located. The banking institutions shall make commitments in public that appropriate international practices or international norms will be followed as far as such overseas projects are concerned, so as to ensure alignment with good international practices.

The CBRC has put in place Key Performance Indicators for implementing the Green

Credit Guidelines, which require all banks to conduct annual self-assessments of green credit implementation for submission to the CBRC.¹⁰⁶ However, there is currently no enforcement mechanism in place to compel banks to implement the guidelines and no grievance procedures exist for people that feel they have been negatively affected by a project financed by a Chinese bank.****

International Best Practice Guidelines and Standards

Although it has taken some time for Chinese enterprises to embrace international guidelines and standards, this is beginning to change. Both private and state-owned companies are signing or making reference to such initiatives with increasing frequency. For example, *Shougang, Baosteel, China Minmetals, China Nonferrous Metal Mining Group, Datang Corporation, Huaneng Group* and *Sinosteel* have all signed on to the Global Compact, as has the *China Development Bank*. The chairman of the Chinese oil company *Sinopec* is also a Global Compact board member.¹⁰⁷ A number of Chinese companies have adopted Global Reporting Initiative (GRI) reporting standards, including *MMG Limited*, a subsidiary of *China Minmetals*. To date, only one company, again *MMG Limited*, has signed onto the Extractive Industries Transparency Initiative (EITI). EITI is a global coalition of governments, companies and civil society groups working to improve openness and accountable management of revenues from natural resources.

***** For more information on the Green Credit Guidelines, see Friends of the Earth (2014), *Going Out, But Going Green? Assessing the Implementation of China's Green Credit Guidelines Overseas*, Washington DC: FoE. <http://libcloud.s3.amazonaws.com/93/86/d/4972/GCG-web.pdf>.

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