

# CHINESE OUTBOUND DIRECT INVESTMENT IN AUSTRALIA - CHARACTERISTICS AND INTEGRATION<sup>1</sup>

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## ABSTRACT

This paper examines Chinese outbound direct investment (ODI) in Australia as the largest recipient country of Chinese direct investment. We introduce the most complete and recent data set on Chinese ODI in Australia to give an overview of Chinese enterprises investing in Australia, including their focus on specific industries, entry strategies, local distribution, dominant ownership structures and other characteristics of deals specific to Australia.

This database is the only of its kind for Australia that incorporates information on individual deals in Australia made by entities from the People's Republic of China through M&A, joint-ventures and greenfield projects from 2006 to 2012.

Using Mike Peng's (2005) strategic management 'tripod' with its resources, firm and institution-based perspectives as a framework, we highlight characteristics and trends in the Australian experience of Chinese global direct investors. We conclude with an outlook on future Australia China investment cooperation in Australia and globally.

Keywords: China, Australia, ODI (outbound direct investment), institution-based approach, SOE, resources

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## 1. INTRODUCTION

China has emerged as a major global portfolio investor and, more importantly for Chinese enterprises, outward direct investor at a time when capital is scarce globally. Chinese demand for mineral resources, energy, food security, technology and markets is growing. Australia is playing an important role in this process as the largest recipient of China outbound direct investment (ODI) since China's 'go out' policy started in earnest in 2005. At the end of 2012, Australia in terms of investment stock was the major host country for Chinese investors looking globally for suppliers and markets. As Australia China business relations are moving from trade engagement to deeper business integration through investment cooperation with

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<sup>1</sup>Data and analysis of Chinese ODI in Australia draws substantially on Hendrischke and Ferguson (2012 a; 2012b; 2012c; 2013)

Chinese corporate partners, the Australian market experience is an important element in the globalization process of Chinese enterprises. This includes a complex and diverse institutional dimension.

Globalizing Chinese business firms from the state-owned enterprise (SOE) and non-state sector are adapting to new and changing business environments domestically and abroad through constant restructuring. Domestically, they face dynamic change as privatization and marketization take hold. Internationally, they face unfamiliar physical, legal and institutional environments. This paper draws on the most complete and recent data set on Chinese ODI in Australia as the background for a wider research agenda that uses Mike Peng's (2005) strategic management 'tripod' of a resources, firm and institutions-based perspectives to analyze the Australian experience of Chinese global direct investment.

According to UNCTAD, Chinese ODI has maintained an uninterrupted upward trend over the last decade. Even during 2008/09 financial crisis when global ODI fell by 20 per cent, China's ODI continued an upward trend (UNCTAD, 2010). As Table 1 shows, annual ODI flow from China reached US\$84 billion in 2012, nearly 7 times the total outflow of 2005. By the end of 2012, China's ODI stock has reached US\$509 billion, more accounting for 2.16 per cent of the global ODI stock (UNCTAD, 2013). In global comparison, while ODI stock remains relatively small in terms of absolute value, China has undoubtedly become a major new source of capital investment.

**Table 1: China's annual global ODI stock and flow 2000-2010**

Year	Annual ODI flows (US\$ million)	ODI stock (US\$ million)	ODI stock annual growth rate (%)
2000	916	27768	-
2001	6884	n.a.	-
2002	2518	35206	-
2003	1800	37006	5.11%
2004	1805	38825	4.92%
2005	12261	46311	19.28%
2006	21160	73330	58.34%
2007	22469	95799	30.64%
2008	52150	147949	54.44%
2009	56530	229600	55.19%
2010	68811	297600	29.62%
2011	74654	365981	22.98%
2012	84220	509001	39.08%

Source: UNCTAD, World Investment Reports 2001 to 2013.

While there are numerous studies on Chinese global ODI in general, less is known about the distribution and characteristics of China's investment in individual countries. In-depth analysis has been hampered by the lack of reliable Chinese data. This is due to at least two reasons: firstly, statistical bureaus of most recipient countries do not collect or publish detailed breakdowns on direct investment from China; secondly, information provided by the Chinese Ministry of Commerce (MOFCOM) on direct investment in individual country is heavily distorted towards tax haven jurisdictions that serve as first port of call without indicating the final destinations.

This study adopts an alternative, bottom-up approach to construct a comprehensive data set of Chinese ODI in Australia as a major destination country, similar to data sets existing for other countries and regions, in particular Rhodium Group for North America and the Centre for Chinese Studies, Stellenbosch University, for Africa. Our results reveal the trends and patterns of Chinese ODI in Australia. Our resources-based analysis shows Australia as a major supplier of mineral resources and energy with investment targeting off-take. Firm-based analysis shows globalizing Chinese firms from the state-owned enterprises (SOEs) and non-state small and medium enterprises (SMEs) sectors adapting to new and changing business environments. We use case studies to illustrate beginning institution-based cooperation and local integration of Chinese investors.

The paper is organized as follows. Section 2 reviews the general literature of FDI and discusses the extent to which it holds for an emerging economy like China. Section 3 defines the methodology used for our bottom-up data base on Chinese direct investment data in Australia and contrasts our data with other sources, such as the Australian Bureau of Statistics, the Foreign Investment Review Board, the Chinese Ministry of Commerce, The Heritage Foundation and others. Section 4 discusses the overall trend and patterns of Chinese outbound direct investment in Australia over the last 7 years. In Section 5 we focus on the institutional dimensions of local integration. Section 6 concludes with a summary and an outlook on further research questions.

## **2. LITERATURE REVIEW**

Enterprise globalization through ODI has been studied extensively for developed countries, using a market as well as a firm perspective. Mainstream international business research looks at multinational enterprises (MNEs) and their imbedded characteristics to explain their ODI motivations, as well as how external factors affect their intrinsic behavior. Dunning's (1977; 1980) OLI (ownership-location-internalization) framework brought together traditional trade economics (Porter, 1990), ownership advantages and internalization theory (Buckley and Casson, 1976; 1981) to become a widely used theoretical explanation of strategic investment motives, choice of foreign entry mode and performance of MNEs. Two important studies (Hill, Hwang and Kim, 1990; Barkema et al., 1996) combined elements of the strategic behaviour approach, transaction cost economics and internalization theory to provide a conceptual framework for MNEs research. Based on these foundations, a large number of empirical studies use firm-based survey data to look at MNEs ODI decisions. A recent study by Rugman (2010), for example, finds that ODI and firm-level performance depend primarily on firm specific advantages, including R&D and technological know-how, market ability, brand name, consumer goodwill, management skills, firm size and industry size.

Chinese enterprises going global have challenged these approaches and produced new attempts to understand their choice of investment destinations and the characteristics and motivation of their ODI (Alon et al., 2011; Luo, 2005; Tan, and Peng, Tsang, Child and Yan, 2003; White and Liu, 2001; Keister 2004; Peng et al., 2004; Tan and Tan, 2005; Wong et al. 2001; Huff and Kelley, 2003; Farh et al. 2004; Buckley et al. 2003; Wang et al. 2004; Zhao and Luo, 2005). These studies are concerned with the ability to explain Chinese ODI by existing theories, but also point to the lack of conclusive evidence and the difficulties to explain the behaviour of Chinese globalizing enterprises. Buckley et al. (2008), for example, find that among the host country factors attracting Chinese ODI some are covered by existing theory, such as market size, while others are unique to China, such as the consideration of political risk. In particular, Buckley et al. (2008) argue that Chinese enterprises globalize because of their particular ownership advantages and their 'home country embeddedness'. These advantages refer to the

ability to rapidly adapt to change and complex market structures that Chinese firms gain from operating in a highly dynamic domestic market. In contrast, Child and Rodrigues (2005) propose that rather than leveraging their existing competitive advantage to internationalize, Chinese enterprises globalize in order to address their relative disadvantage from having been excluded from global markets for a long time.

Increasing global direct investment by Chinese enterprises has spawned political discussions about how the Chinese state and associated institutional factors shape the characteristics of Chinese ODI and firm behaviour (Ren et al., 2011; Peng, et al., 2009; Child and Rodrigues, 2005). These discussions address the behaviour of Chinese enterprises from two perspectives. The first perspective regards the state and state-related institutions as exogenous factors influencing and facilitating Chinese ODI (Buckley, et al., 2007; Ren et al., 2012) in the form of government intervention or encouragement external to the enterprises. This top down approach is in consonance with North's idea that polity as the enforcer of the rules of the game is "the primary source of economic performance" and institutional change will come from the top (North, 2005:57).

The second perspective is on how managers and firms pursue their commercial interests and make strategic choices within formal and informal constraints of given institutional frameworks (Peng et al., 2009). This perspective regards institutions as formal and informal constraints that not just drive Chinese firms to go global but also determine their strategies and competitiveness in foreign markets. Mike Peng et al. (2009), for example, suggest that formal as well as informal institutions explain firms' strategies and that an institution-based approach is needed to supplement the industry-based and resource-based views to become the third leg of a strategic tripod.

In this study, we take the broader institutional approach to look at Chinese direct investment in Australia. Our in-depth country-level analysis not only enables us to examine some of the conflicting views on Chinese ODI, but also gives us the opportunity to explore latent institutional factors and dynamics which may not be captured by preset control variables in quantitative models based on cross-country statistical data.

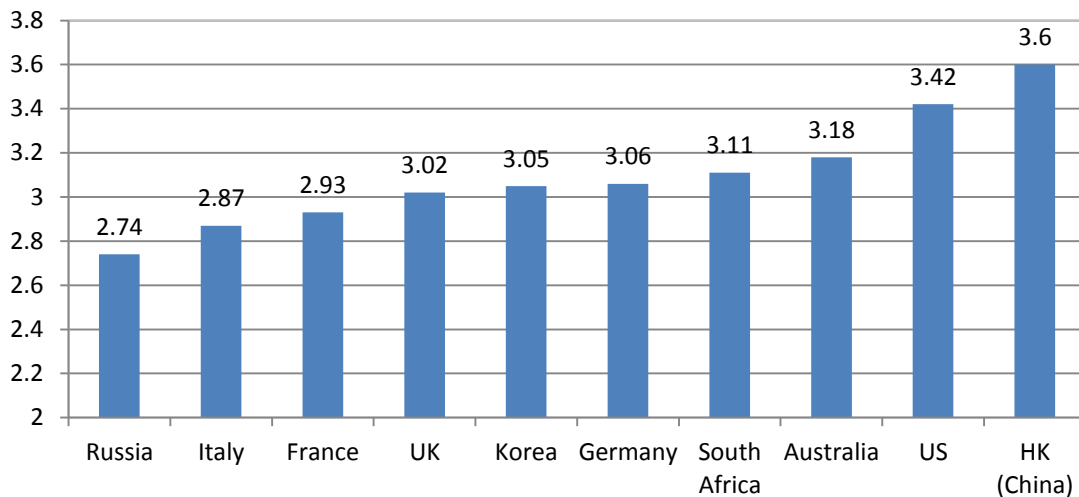
Building on the innovative institution-based view (Mike Peng et al., 2005; 2009), we aim to highlight the importance of decentralized institution building in deciphering the behaviour of Chinese globalizing enterprises. As discussed, studies on Chinese ODI have mainly adopted a state-centered perspective which focuses on the 'helping hand' of central government and government-related incentives in facilitating Chinese ODI. Yet, institutions can emerge spontaneously from the bottom up. Avner Greif's pioneering research (summarized in Greif 2006), for example, suggests that networks of merchants can enforce contracts in the absence of formal institutions. Furthermore, recent path-breaking research contends with the over-reliance on the state-centered perspective to interpret the organization of the Chinese economy (Nee and Oppen, 2012; Nee and Oppen, 2007; Nee, 2003; Keister, 2000; Guthrie, 1999; Cao, 2001; Nee, 1996; Walder, 1995). In short, by using Australia as a case study we hope to show that a combination of the resource, firm, and institution based perspectives will be useful in capturing the complexities and dynamics of Chinese ODI and China's globalizing enterprises.

This database is the only of its kind for Australia that incorporates information on individual deals in Australia made by entities from the People's Republic of China through M&A, joint-ventures and greenfield projects.

### 3. DATA SETS ON CHINESE DIRECT INVESTMENT IN AUSTRALIA

Thanks to its rich natural resource endowment and low sovereign risk, Australia stands out as one of the favourite destinations for Chinese investors. In a 2010 survey of over 1000 Chinese companies by China Council for the Promotion of International Trade (CCPIT), Australia is rated as the third most open country/region to China's ODI, just after Hong Kong and the United States (as shown in Figure 1). According to the Heritage Foundation, from January 2005 to December 2012, China's aggregated outward non-bond transaction investment in Australia surpassed US\$50 billion, making Australia the largest recipient of Chinese investment.

**Figure 1: level of openness perceived by Chinese enterprises, by host countries/regions**



Note: based on five-level Likert scale: 1-completely not open; 2-not open; 3-moderately open; 4-open; 5-very open

Source: China Goes Global 2011, Survey of Outward Direct investment Intentions of Chinese Companies, CCPIT

Despite intense Australian interest in China's direct investment, the nature and distribution of Chinese ODI is poorly documented and understood. This is partly because Chinese ODI which was almost non-existent before 2005 is still a new phenomenon. Historically, Australia's economic relations with China have been built on commodity trade in minerals, energy and agricultural products. The gradual expansion of trade with China was not matched by investment which played no role in economic relations (Dunn and Fung, 1985). In fact, the first ODI from China took place in 1987, when Metallurgical Import and Export Corporation (CMIEC, now Sinosteel) formed a joint venture (JV) with (now Rio Tinto) – the Channar Project. Only in 2005 did the Foreign Investment Review Board (FIRB) start to list China as a separate country in its reporting tables.

More importantly, a clear understanding of the characteristics of Chinese investment in Australia has been impeded by the difficulties in obtaining suitable data. Due to the lack of reliable data, current Australia related research mainly focuses on the impact of Chinese ODI from strategic, regulatory and geopolitical perspectives (Zha, 2013; Drysdale, 2012; Larum, 2011).

#### 3.1. Existing data sets

Currently, there exist four sets of data reporting Chinese ODI in Australia: The Australian

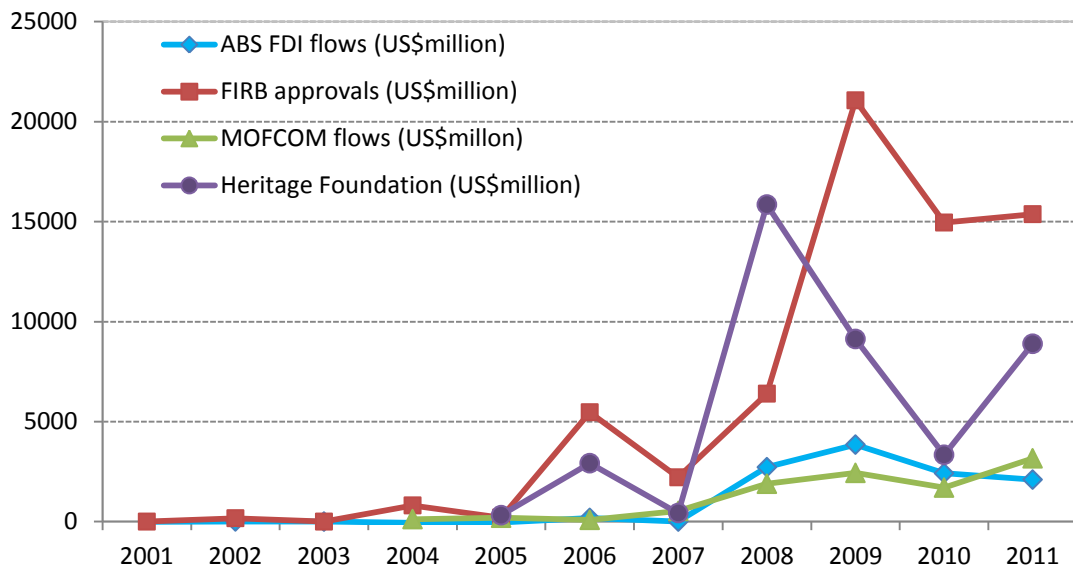
Bureau of Statistics (ABS) International Investment Position account which reports annual direct investment stock and flow data from all foreign countries including China; the Foreign Investment Review Board (FIRB) annual reports which present yearly statistics on proposed investment in Australia by foreign interests that has been approved by the Board; the Ministry of Commerce of the People's Republic of China (MOFCOM) *Statistical Bulletin of China's Outward FDI* which lists annual Chinese outward FDI figures by stock and flow into different countries and regions including Australia; and the China Global Investment Tracker by The Heritage Foundation which collects data of large Chinese investments and contracts (over \$100 million as the minimum threshold) worldwide, excluding Treasury bonds. These datasets, with the exception of The Heritage Foundation's China Global Investment Tracker, mainly aggregate investment data at the national level, without detailed sectoral or geographical breakdown.

Not surprisingly, these data are not compatible with one another, as they differ with regard to compilation methods, underlying definitions, quality and timelines. Still, in each set is helpful for illustrating different aspects of Chinese investment into Australia. The investment accounted for by FIRB comprises planned foreign investment that requires FIRB approval, rather than the actual direct investment. In other words, the FIRB statistics only measure intended and approved investment, some of which may never eventuate, but do not cover the actual investment levels, investment income, or actual transactions and other changes in inward or outward investment. Moreover, FIRB statistics only relate to investment projects that require Commonwealth Government approval. In other words, proposals that are below the thresholds are not included in the FIRB approvals statistics.

The Heritage Foundation data include large Chinese investments (USD100 million is the minimum threshold for inclusion) and thereby omits smaller investments, especially those made by private enterprises. On the other hand, the Heritage Foundation data set potentially overstates the Chinese ODI volume, because it includes transactions that do not meet the threshold for foreign direct investment (FDI) which is a final stake of 10% or more of voting rights in the invested company.

Figure 2 shows the divergence in Chinese ODI flows into Australia between 2001 and 2011, based on figures from ABS, FIRB, MOFCOM and The Heritage Foundation. Since MOFCOM statistics are most widely used, we will focus on them in detail.

**Figure 2: China's ODI flows to Australia: a comparison of different data sources**



During the last 10 years, China's ODI compilation methods and standards have experienced huge changes (for example, MOFCOM ODI Statistics Manual 2002 (NO. 684); MOFCOM ODI Statistics Manual 2008 (NO. 529); MOFCOM ODI Statistics Manual 2010 (NO. 520)). An external reason is that China is gradually becoming an important player in the global ODI scene and that the Chinese central government is urged to improve data transparency and compatibility with international organizations and governments. An internal reason is that different Chinese ministries used to publish ODI statistics which exhibited large discrepancies and were inadequate for specific policy needs and unsuitable for an in-depth, real-time analysis of Chinese investment abroad.

The most recent ODI Statistics Manual was published by MOFCOM in conjunction with the National Bureau of Statistics (NBS) and the State Administration of Foreign Exchange (SAFE) in 2010. The manual specifies the concept of foreign direct investment as well as the administration and collection of statistics. According to the manual, all non-financial enterprises engaging in ODI are required to submit relevant information to local bureaus of commerce through an electronic system on a monthly basis. SAFE takes charge of providing MOFCOM with ODI statistics collected from financial institutions. The national Bureau of Statistics is in charge of summarizing and integrating ODI statistics submitted by MOFCOM.

In theory, MOFCOM reports should track ODI flows and capture all investment deals made by Chinese enterprises abroad. However, there are considerable weaknesses in the MOFCOM system. For example, instead of relying on direct enterprise surveys, MOFCOM collects data based on information submitted by firms to local bureaus of commerce in the mandatory approval process. This can result in significant underreporting by firms wishing to side-step approval procedures for a variety of reasons, thus dragging down the aggregate figures. In addition, many Chinese firms do not report foreign earnings that are reinvested abroad as ODI as required by international standards (Rosen and Hanemann, 2009). This leads to undercounting of actual ODI flows.

More importantly, firms tend to report the first, not the final, destination of their investments, weighting the numbers toward stop-over locations such as Hong Kong and tax havens. According to MOFCOM data, around 80 per cent of Chinese OFDI stock lies in Hong Kong or tax havens. The same problem exists in industry categories data, as ODI is obscured by passing through stop-over industries.

While there is undercounting in the reporting process, there are reasons to suspect that China's overall official statistics overestimate ODI volumes. Limited capital account convertibility has long been understood as a motive to disguise hot money flows by overstating or understating direct investment values (Rosen and Hanemann, 2009). Another factor potentially contributing to overstatement of ODI is "round-tripping", referring to capital leaving China first and then coming back to China (Cai, 1999). Firms have incentives for round tripping capital because inbound foreign direct investment enjoys formal and informal preferential treatment in many circumstances, including favourable land use rights, convenient administrative supports, and even favourable financial services from domestic and foreign financial institutions. There are no official estimates for round-tripping money flows, but some analysts think it could be more than one third of all inward FDI (Xiao (2004).

The above distorting factors are known, but it is hard to weight them and to determine whether the aggregate figures are understated or overstated. Figure 2 shows a noticeable gap between Chinese ODI flows into Australia reported by the Australian Bureau of Statistics and those reported by MOFCOM with MOFCOM statistics showing less variation in investment volume than the ABS data. In 2009, for example, ABS recorded close to USD5 billion ODI flows from Chinese enterprises, but MOFCOM figures showed less than USD2.5 billion. Besides the differences in compilation methods, Chinese firms going through stop-over locations before arriving in Australia could be one strong reason for these discrepancies.

In sum, current available data sources on Chinese ODI in Australia either do not tell the base-level story well (ABS, FIRB, MOFCOM), or only track mega size investment deals (The Heritage Foundation) including those not classified as direct investment according to international standards.

### **3.2. A bottom-up view of Chinese ODI in Australia**

In 2011, after an initial investigation of available data sources, we concluded that a new assessment method and dataset were needed for a better understanding of the nature of Chinese direct investment in Australia, such as the characteristics of Chinese investors, their corporate governance structures and deals. The joint University of Sydney/KPMG team started to compile an original and bottom-up dataset in 2011. The dataset covers direct investment into Australia made by entities from the People's Republic of China, through M&A, joint-ventures, and greenfield projects.

For the period from September 2006 to December 2012, in total 128 completed deals were recorded in the dataset. Raw data are drawn and verified from three main sources: data on investment activities provided by KPMG China Business Group; independent commercial databases: mergermarket and Financial Times database; news articles from the Australian, the Age, Mining News, Reuters, Bloomberg, Wall Street Journal, etc. The database also tracks Chinese investment facilitated by subsidiaries or special purpose vehicles based in Hong Kong, Singapore or any other third countries. But it excludes portfolio investment, such as the purchase of stocks and bonds, which does not result in foreign management, ownership, or legal control. Deals with completed valued under US\$5 million are not included because they were found to consistently detailed information on the actual investment arrangements, and the acquirer and target companies are usually hard to identify.

Besides basic information on names of the acquirer and target company and the value of transaction, five additional metrics have been set up for each of the individual deal: registered office of the target company, industry sector, whether the acquiring company and the target company have been listed in a stock market, whether the acquiring company is a central state-



owned enterprise, local state-owned enterprise, or a private enterprises. So far, the database has established a good reputation and is considered as a reliable and comprehensive source of information for Chinese investment in Australia by academics, government bodies and the media.

The bottom-up data set enables us to conduct analysis at the aggregate level on industry and internationalization strategies and to explore individual characteristics of firms, such as entry mode, ownership and attitudes towards risk and commercial motivation.

#### 4. CHINESE ODI IN AUSTRALIA: CHARACTERISTICS AND STRATEGIES

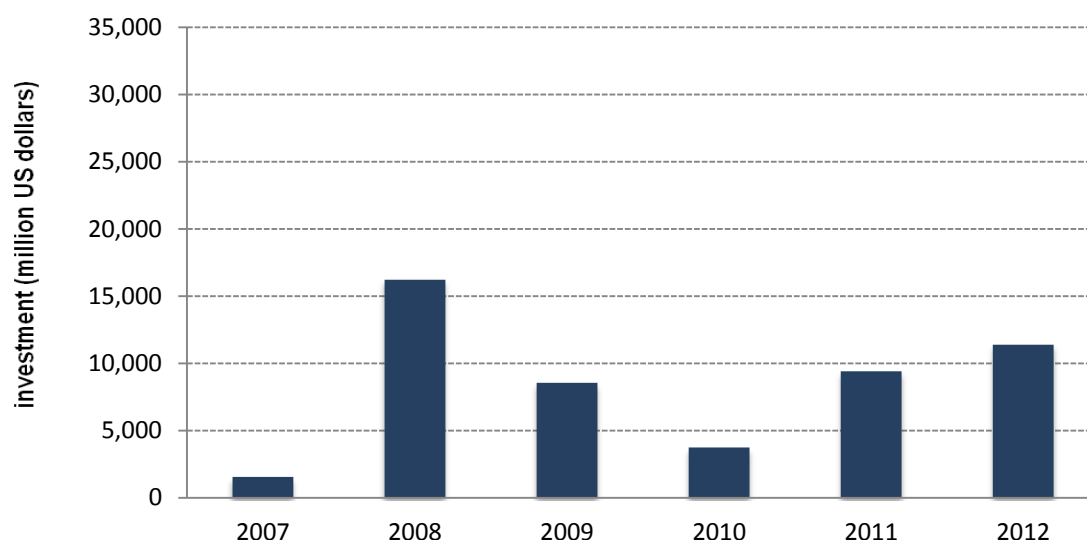
Based on the bottom-up data set, we are able to disaggregate Chinese ODI investment in Australia according to economic sector, geographical distribution, size of deals, and firm ownership and to present a fuller picture of Chinese ODI in Australia than previously possible. Besides conventional wisdom that Chinese ODI is mainly resource focused and conducted by SOEs, we find some unique characteristics of the operation of Chinese business enterprises and their strategies, which differ particularly from other MNCs from emerging economies.

##### a. Overall trend

For the period from September 2006 to December 2012, a total of 128 completed deals were recorded. During this period, an accumulated USD 50.8 billion was invested by Chinese enterprises in Australia.

As shown in Figure 3, Chinese investment flows into Australia have maintained an incremental growth trend since 2010. Contrary to claims that flow and size of Chinese investments in Australia are falling away, total investment continued to grow over the last two years, from USD3.7 billion in 2010 to over USD11 billion in 2012. While inflows in 2012 are still short of the historic peak of USD 16.2 billion in 2008, the two years of consecutive growth in 2011 and 2012 show a remarkable recovery after the slowdown in 2009-2010.

**Figure 3: Chinese ODI into Australia by volume**



Source: The University of Sydney/KPMG database

**b. Chinese investment in Australia by state**

As shown in Western Australian (WA) registered firms attracted the highest level of Chinese investment, by transaction value, during the September 2006 to December 2012 period. More than 31 per cent of the total Chinese investment in Australia during that period – or around US\$16 billion – was absorbed by WA, followed by Queensland (QLD) with US\$ 15.5 billion and New South Wales (NSW) with US\$10.8 billion. Companies registered in these three states accounted for over 80 per cent of China’s investment.

**Table 2: Total completed deals by state**

State	Value (million US\$)	%
NSW	10,778.87	21.22%
VIC	7,123.51	14.02%
QLD	15,501.04	30.52%
WA	16,030.82	31.56%
SA	1,124.38	2.21%
TAS	233.26	0.46%

Note: deals are categorised by registered office location of target companies

Source: *The University of Sydney / KPMG database*

**c. Characteristics and strategies of Chinese ODI in Australia**

According to our analysis of activity from September 2006 to December 2012, there are at least six characteristics that distinguish Chinese ODI in Australia from those of other countries:

First, a focus on mining and energy: Chinese ODI has, to date, been heavily concentrated in the mining and energy industries. Other industries barely feature. Over 72 per cent of investment during the period we examined was directed into mining industries, and a further 17.5 per cent went into gas.

**Table 3: Chinese ODI by industry 2006-2012**

Industry	Value (million US\$)	%
Mining	36,874.95	72.6%
Gas	8,867.01	17.5%
Renewable energy	2,212.60	4.4%
Others	2,837.32	5.6%
<b>Total</b>	<b>50,791.88</b>	<b>100%</b>

Source: *The University of Sydney / KPMG database*

Despite the high concentration of Chinese ODI in mining and energy, in 2012 we witnessed a gradual shift of investment from resources to energy, particularly to the LNG sector (as shown in Table 4). The shift in Chinese investment away from mining indicates a lagged response to changes in domestic conditions in China and global markets. The Chinese steel and iron industry experienced a slowdown in 2012 as property sector and new infrastructure spending was deliberately slowed down to address inflation. According to National Bureau of Statistics of China, crude steel output halved in March 2012 and remained low for the rest of 2012. On the other hand, global demand for LNG has increased significantly in the last two years primarily due to the sharp increase in demand from Japan and the emergence of new LNG importing markets. Currently, global LNG trade is constrained by supply shortfall due to lower overall gas output. This gap in global supply and demand, together with China’s plans to diversify its energy consumption structure and reduce reliance on coal for power generation

explains the growing interest of Chinese companies to bid for Australian LNG projects.

**Table 4: Chinese ODI by Industry in 2012**

Industry	Value (million US\$)	%
Mining	5,471.46	48.06%
Gas	4,785.20	42.04%
Renewable energy	182.60	1.60%
Others	944.20	8.29%
Total	11,383.46	100.00%

*Source: The University of Sydney/KPMG database*

Second, large deal sizes: the average size of the completed deals is larger in Australia than in other host countries. Twenty-four of the 128 deals, for example, have a transaction value of more than US\$ 500 million. These “mega-sized” deals account for more than 80 per cent of total Chinese investment in Australia. Furthermore, almost half of the completed deals have a transaction value of over \$100 million. The benefit of such deal sizes is that larger individual investment can provide Australian businesses and projects with more certainty and a longer-term perspective in terms of operational decisions and investment in research and development. A high level of investment is essential for infrastructure and transport projects, which are critical to the long-term development of the Australian economy.

**Table 3: Size of deals from 2006-2012**

Size of Deal	number of deals	%
USD 25m-5m	37	28.91%
USD 100m-25m	34	26.56%
USD 200m-100m	12	9.38%
USD 500m-200m	21	16.41%
Above USD 500m	24	18.75%
Total	128	100.00%

*Source: The University of Sydney/KPMG database*

A high proportion of large deals means that individual deals may have a strong impact on overall ODI data. This explains some of the volatility of Chinese ODI figures for Australia. Chinese investment decisions are also exposed to mineral and energy price changes, which may add to the volatility of data.

Third, dominance of state-owned enterprises: Chinese State-Owned Enterprises (SOEs) dominate investment in Australia, a characteristic that can give rise to the perceptions that investment is government-directed rather than commercially motivated. The dominance of state-owned enterprises has attracted attention of the Foreign Investment Review Board and reportedly led to a change of regulations (Larum, 2011:21). Of the 128 completed deals, 102 were made by SOEs. Based on transaction value, nearly 95 per cent of the investment during our data timeframe involved SOEs. This is notably higher than the 70 per cent global average (Ministry of Commerce 2010 statistics on China’s global ODI stock) and the 65 per cent for the United States, and 72 per cent for Europe respectively (Rhodium Group 2011, 2012).

**Table 4: deals by ownership from 2006 -2012**

Ownership	Investment Value	%	no. deals	%
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	(US million)			
<b>SOE</b>	47.88	94.23%	102	79.69%
<b>Private</b>	2.93	5.77%	26	20.31%
<b>Total</b>	50.80	100.00%	128	100.00%

*Source: The University of Sydney/KPMG database*

SOE ownership is, however, consistent with the fact that Chinese investment in Australia is concentrated in the energy and resource sectors. As these sectors require high levels of initial capital outlays and their projects often involve longer investment cycles and higher investment risk, SOEs – with their easier access to finance - are still the main players. In addition, SOEs have the advantage of networks and experience accumulated through years of minerals trading with Australian businesses, which inevitably facilitate their investment in Australia.

Fourth, a preference for listed companies: The targeted or partner companies of Chinese investors are mostly listed on the Australian Stock Exchange (ASX). Based on our data, excluding a few deals involving projects with Australian mining figures such as Clive Palmer and Gina Rinehart, all other completed deals were made with ASX-listed companies, either directly or indirectly. There are a number of possible reasons. Acquiring ASX-listed companies provides some SOEs with the facilities to raise additional financial capital for expansion. More importantly, like other companies, SOEs aim to identify projects which are more likely to generate profits. However, SOEs that invest in Australia face an unfamiliar regulatory environment with vastly different accounting rules, legal frameworks, environmental regulations and standards of corporate governance. Hence, SOEs find it a challenge to identify attractive projects - to do so requires the deployment of a variety of screening devices. An ASX listing may act as one such screening device. By investing in ASX-listed companies, Chinese SOEs are better able to perform due diligence and understand the performance of the company due to continuous disclosure requirements and Joint Ore Reserves Committee Code (JORC) standards for listed companies. Companies already listed on the ASX may, on average, involve less risk and a higher probability of generating profits.

Fifth, the majority of Chinese investors use mergers and acquisitions (M&A) as the preferred mode of entry. Based on results from our data set, these represent the most important form of Chinese ODI in Australia, far outstripping greenfield investment and joint ventures in terms of the number of completed deals and their value. In terms of deal number, for example, about 95 per cent of the transactions are M&As. The M&A boom is in direct contrast to global greenfield investment which still represents two thirds of all FDI flows in 2012 (UNCTAD, 2013). This can be partly explained by SOEs' sensitivity to investment risks, because M&As require less involvement with different local governmental departments and communities that potentially delay greenfield investments. Above all, the preference for M&As reveals the strategic intent of Chinese ODI: rather than just acquiring natural resources, Chinese SOEs also seek to exploit complementarities of capabilities from the acquired companies and gain access to strategic assets, such as technology, intellectual property and brand names, which in return helps them to increase competitiveness in both domestic and international market.

Last but not least, Chinese firms seem to prefer taking majority stake when acquiring a company. Yanzhou Coal Mining's acquisitions in Australia, for example, including 2009's 100% acquisition of Felix Resources, 2011's 100% of Syntech Resources, and the merger with Gloucester in 2012, all involve acquiring majority interest of target companies. This focus on high-level controlling stakes seems in conflict with the adversity to risk discussed above. However, a possible explanation could lie in the experience of Chinese investors with Chinese

domestic institutions where the actual position of minority shareholders is much weaker than either government rhetoric or legal rules would suggest (Tomasic and Andrews, 2007). Thus, the perceived sense of powerlessness of minority shareholders would push Chinese enterprises, both SOEs and privately owned enterprises, to seek high majority stakes even it means taking more risks and lower profit.

## 5. LOCAL INSTITUTIONAL INTEGRATION OF CHINESE ODI

In view of the characteristics of Chinese ODI in Australia, institutional integration and contributions to the Australian local economy are not as easily measured as in more diversified investment environments such as the USA (Rosen and Hanemann 2011). We will rely on two case studies to illustrate the localization strategies and local institutional integrations by large Chinese investors in industries which are sensitive to environmental concerns such as coal mining, or community concerns such a wind farms. In each case, the Chinese investors faced considerable compliance costs and have responded with a variety of localization measures, ranging from project funding to HR policies.

### Case 1: Yancoal Australia

Since its incorporation in Australia on 18th November 2004, Yancoal Australia Limited has grown rapidly in terms of market presence, employees, and revenue. In 2004, Yancoal, a Shandong-based provincial-level SOE, purchased its first Australian mine in Hunter Valley, New South Wales (NSW). This was followed by a series of mine acquisitions and significant expansion from 2006. By early 2012, after eight years of operation, Yancoal had a portfolio of six operating coal mines and major development projects across NSW, Queensland (QLD) and Western Australia (WA) with total assets valued at more than A\$8 billion. On 28th June 2012, Yancoal Australia was listed on the Australian Stock Exchange following its merger with Gloucester Coal Limited. The merger created a significant and growing coal company with a diversified products, which is expected to be Australia's largest listed pure-play coal producer and the world's ninth largest pure-play coal company.

Yancoal Australia has brought considerable benefits to the Australian economy. According to Yancoal Australia, approximately A\$4.6 billion have been invested in its operations since 2004 (including the acquisition of Felix Resources in December 2009). Yancoal Australia in 2012 employed over 3000 people. In addition, along with its capital investment, Yancoal also contributed to technology spillovers into Australian coal mining by introducing Longwall Top Coal Caving (LTCC) technology. Yancoal Australia's parent company Yanzhou Coal owns the patent rights to this system and has contributed the operational experience to make this technology feasible in Australia.

Before investing in Australia, Yancoal Australia's Chinese parent company, Yanzhou Coal Mining Company Limited set up an Investment Committee to compare investment destinations in Africa, Europe, Russia, Indonesia and Australia and rank them in terms of resources, geography and culture. According to a senior Chinese executive, Australia was chosen as a destination on the following institutional grounds.

- 1) Strong formal institutions: Highly developed legal system that provides legal security and all eventualities are covered by law.
- 2) Strong informal institution: Strong respect for formal institutions. People can be trusted to work according to law and rules and in line with market principles.
- 3) High government accountability: Australian governments take a practical approach as

they are accountable to their electorate.

- 4) Supportive environment: Australia as an immigration society welcomes immigrants and does not discriminate against foreign investors.

Confidence in the institutional environment is reflected in Yancoal Australia Ltd working closely with all levels of government to ensure compliance with local laws and regulations. At federal government level, Yancoal Australia Ltd prides itself of having established on-going cooperation with the Foreign Investment Review Board (FIRB) and pro-actively fulfilling its annual reporting obligations by regularly informing FIRB of all major developments. Likewise, Yancoal claims to maintain an active information exchange with the Department of Resources, Energy and Tourism. At local level in New South Wales, Yancoal Australia Ltd works with state and local governments with attention to improving localization and local social integration.

For example, Yancoal Australia employs a small team of less than twenty expat managers from China working with over one hundred local staff. The Chinese expat managers communicate with shareholders in China, decide about investment directions and spot local market opportunities in NSW and beyond. At the mine level, all management teams are made up of local staff. Localisation was a learning process for Yancoal Australia, as there are geological and technical differences in operating mines in Australia and China and local management helped to develop local solutions, including payment and incentive structures. Local management teams also maintain relations with the unions. Yancoal Australia has not had any strike activities.

Community engagement and corporate social responsibility is visible in support for local social activities and aid in emergency situations. Yancoal Australia works on the principle that engaging with local communities and looking after the welfare of workers is as important in NSW and Australia as it is in China, even though procedures may be different.

### **Case 2: Goldwind Australia Pty**

Xinjiang Goldwind Science & Technology Co. Ltd (Xinjiang Goldwind) is the parent company of Goldwind Australia. Established in Urumqi City in 1998, Xinjiang Goldwind became a joint-stock limited liability company in 2001, and is currently listed on both the Shenzhen Stock Exchange and Hong Kong Stock Exchange. In an ongoing effort to globalise the business, Xinjiang Goldwind expanded to Australia in 2009. Since then, Goldwind Australia, a wholly subsidiary of Xinjiang Goldwind, has been involved in a number of local projects, such as Gullen Range wind farm near Goulburn with 73 state-of-the-art wind turbines which will supply electricity for 63,000 households and help achieve the NSW State Plan's 20 per cent renewable energy target.

Goldwind has acquired institutional expertise and local partners to successfully navigate the approval process. Goldwind operates across the whole value chain of wind energy solutions from installing wind turbines to selling and operating wind farms with business partners including local wind project developers, international buyers of completed projects and Australian and Chinese banks to provide long-term finance. For wind farm development Goldwind relies on local wind farm developers, such as Epuron, to guide projects through initial feasibility studies and assessment and approval processes.

Operation of a wind farm relies strongly on local communities and suppliers and creates local work places. Local governments are closely involved in planning, construction and operating process of the wind farms as they provide the necessary physical infrastructure, suppliers of

towers, grid connections and cables as well as integration in local communities.

These examples point to the awareness of Chinese investors of the local effects of their investments on local employment, tax bases and competitiveness. The concentration of Chinese investment in capital-intensive and little labour-intensive areas means that these examples can only be taken as a sign of potential developments in a much diversified investment environment. More generally, institutional engagement by Chinese investors is an important indicator of their willingness to pursue long-term and sustainable commercial cooperation.

## **6. CONCLUSION**

Our data set on Chinese direct investment in Australia shows the need for bottom-up data capture and for a re-examination of the standard reliance on official Chinese top-down data for more detailed analysis of Chinese ODI.

Our data point to a shift away from resources towards energy and greater diversification. Diversification, however, is slow in coming and depends on institutional integration. Our data and our two case studies indicate that Chinese investors, including large state-owned investors are seeking long-term and sustainable integration into the Australian host economy.

A shift towards greater integration in the local host economy will have to overcome self-imposed commercial and institutional constraints affecting Chinese investors who are reluctant to engage in joint ventures and other forms of cooperation in favour of M&A and with listed companies largely based on domestic experience.

Chinese investors are gaining experience in operating in unfamiliar physical, commercial and institutional environments. The institutional environment can make a break investment projects by imposing unforeseen costs and constraints on projects.

Our study illustrates that Chinese investors, including state-owned enterprises, are aware of the need to contribute to and integrate in local host economies. This dimension is important in reassessing the assumed predominant focus of state-owned investors on strategic aims.

In terms of future research, local integration and contribution to local economies are topics which merit greater scrutiny and could add to a better understanding of commercial mechanism and policy incentives.

**Table 14: Top 10 historic Chinese investment in Australia**

Company name	State ownership	Managing owners	Listed	Australian company	Year	Equity	Comment
Chinalco (Shinning Prospect Pte. Ltd)	100%	Chinalco (100% SASAC)	n.a.	Rio Tinto	2008 2009	9.3% 9.8%	
Yanzhou Coal Mining Company (Yancoal Australia)	52.86%	Yankuang Group (Shandong SASAC 100%)	HK, NY, Shanghai	Felix Resources	2009	100%	
Yanzhou Coal Mining Company	52.86%	Yankuang Group (Shandong SASAC 100%)	HK, NY, Shanghai	Gloucester Coal	2011	merger	Yancoal 78% stake, Gloucester 22% stake
Taurus	100%	Guangdong Nuclear Power Group (100% SASAC)	n.a.	Extract Resources Ltd. (EXT)	2012 2012	91.34% 100%	
China National Offshore Oil Corporation Ltd	64.43%	China National Offshore Oil Corporation Group (100% SASAC)	HK, NY, Shanghai	BG Group - Queensland Curtis Island at Gladstone	2012	equity in QCLNG Train 1, + resources	
PetroChina Company Ltd	86.5%	China National Petroleum Corp. (100% SASAC)	HK, NY, Shanghai	Arrow Energy	2010	100%	50% Shell joint venture
PetroChina Company Ltd	86.5%	China National Petroleum Corp. (100% SASAC)	HK, NY, Shanghai	Woodside (WPL) Petroleum Ltd.'s proposed Browse LNG project in WA	2012	8.33 % in East Browse JV, 20% West Browse	
Sinopec Corp.	75.84%	Sinopec Group (100% SASAC)	HK, NY, London, Shanghai	Australia Pacific LNG	2011 2012	15% 25%	
Minmetals Resource Ltd	71.56%	China Minmetals Corp. (100% SASAC)	HK	OZMinerals Ltd	2009 2010		





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