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THE CHALLENGE OF GLOBALIZATION FOR LARGE CHINESE FIRMS

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DISCUSSION PAPERS

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THE CHALLENGE OF GLOBALIZATION FOR LARGE CHINESE FIRMS[1]

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Abstract

As China joins the World Trade Organization, the author questions whether China's large firms will be able to compete on the global level playing field. Over the past two decades, Chinese large enterprises have undertaken extensive evolutionary change but, at the same time, the world's leading firms have undergone a revolutionary transformation. Based on analysis of firms with the aerospace, oil and petrochemical industry, the authors conclude that China's leading firms face critical challenges, even in sectors in which China's policy makers have scored significant successes.

I. CHINA AND THE GLOBAL BUSINESS REVOLUTION

China's entry to the World Trade Organization (WTO) is a historic milestone in the process of China's integration with the world economy and business system. Among the many important possible effects is the impact on its large firms. In the course of two decades of struggle, China's large enterprises have undertaken large-scale *evolutionary* change. During the same period, the world's leading firms have undergone a *revolutionary* transformation. This poses a deep challenge for China's large firms at the point of entry to the WTO. During the global business revolution, in order to survive and prosper, the nature of the large firm based in high-income countries altered greatly. The inter-twining of China's internal business system change with the revolution in large global firms has been a protracted and complicated process.[2] It is far from over.

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[1] This paper was originally prepared for the Third United Kingdom-China Forum in October 2001. Professor Peter Nolan facilitated the discussions for the Industry Committee, Finance and Economy Committee of the Forum. Leaders of major firms from the United Kingdom and China participated in the discussion. Participants include BP, BAe System, Rolls-Royce, BOC, British Airways, Barclays, HSBC, Standard Chartered Bank, Prudential, Royal & Sun Alliance Insurance, Standard Life Assurance, Citigroup Europe, CGNU plc., Pricewaterhouse Coopers, Dresdner Kleinwort Wasserstein, Bank of England, China Petroleum & Chemical Corporation (Sinopec), China Ocean Shipping Corporation (COSCO), China Aviation Industry Corporation Group 1 (AVIC 1), China Aviation Industry Corporation Group 2 (AVIC 2), China International Trust and Investment Corporation (CITIC), China State Development Bank, and Ministry of Finance.

[2] Peter Nolan is Director of the China Big Business Programme, based in the Judge Institute of Management Studies in the University of Cambridge. Since 1994, he and Dr. Wang Xiaoqiang have been engaged in research on the transformation of the 'commanding heights' of China's industry, using in-depth case studies to attempt to analyze China's policy of building a powerful 'national team' of big businesses that can challenge the global giant corporations. They have combined their research in China with case study-based research inside the United Kingdom and US-based global corporations. This has attempted to provide a careful benchmarking of the progress and problems encountered in the course of China's industrial policy since the early 1980s. Their research has resulted in numerous books and articles written individually (Wang, 1999, Nolan, 1996, 1999, 2000, 2001a, 2001b, 2002a, 2002b), jointly by them (Nolan and Wang, 1997, 1998a, 1998b, 1999a, and 1999b), and jointly with other members of the research team (Nolan and Yeung, 2001a, 2001b). This paper is a part of that continuing research effort, and the general conclusions reached here draw heavily on these publications.

A. China's reforms

1. Lessons from other countries

A succession of 'late comer countries' developed powerful indigenous firms through different measures of industrial policy, including Britain during the Industrial Revolution, the United States and Continental Europe in the nineteenth century, the Republic of Korea, Taiwan Province of China and Singapore in the second half of the twentieth century. From the 1950s to the 1970s, Japan's industrial planners supported the growth of a series of oligopolistic companies that developed into globally powerful firms. After two decades of industrial policy in Japan, the country possessed a whole corps of globally competitive companies. Today, it still has over one hundred *Fortune 500* companies and 83 of the world's top 300 companies by R&D expenditure (DTI, 2000). In the light of these experiences, it seemed reasonable for China to follow similar policies to support the growth of its own indigenous large firms. The history of other fast-growing, late-industrializing countries suggested that it was realistic to hope that Chinese large enterprises would be able to 'catch-up' rapidly with the world's leading firms.

2. China's ambitions

China began liberalizing the post-Mao economy in the late 1970s. A consistently stated goal of China's industrial policy has been to construct globally powerful companies that can compete on the global level playing field:

> In our world today economic competition between nations is in fact between each nation's large enterprises and enterprise groups. A nation's economic might is concentrated and manifested in the economic power and international competitiveness of its large enterprises and groups… *Our nation's position in the international economic order will be to a large extent determined by the position of our nation's large enterprises and groups.* (Wu Banguo, Chinese State Council, August 1998.)

China's 'national team' of large industrial firms included: Aviation Industries of China (AVIC) in the aerospace industry; Sinopec and CNPC in oil and petrochemicals; Sanjiu, Dongbei, and Shandong Xinhua in pharmaceuticals; Harbin, Shanghai, and Dongfang in power equipment; Yiqi, Erqi, and Shanghai in automobiles; Shougang, Angang, and Baogang in steel; and Datong, Yanzhou and Shenhua in coal mining.

China's chosen global giant corporations were supported through industrial policies, which included: tariffs, which still were significant in many sectors at the end of the 1990s; non-tariff barriers, including limitations on access to domestic marketing channels, requirements for technology transfer and to sub-contract to selected domestic firms as the price for market access; government procurement policy; government selection of the partners for major international joint ventures; preferential loans from state banks; and privileged access to listings on international stock markets.

As the reform process progressed, the Chinese government made it increasingly clear that the country intended also to be able to establish a group of globally competitive large firms in financial services and telecommunications. China Mobile and China Unicom, with massive international flotations, were at the forefront of this process. The Bank of China is scheduled to be the first major international flotation from the Chinese financial services sector. As China prepares to enter the WTO, the country's commitment to building globally competitive large firms remains undiminished:

> The state will encourage big state-owned businesses to become internationally competitive corporations by listing on domestic and overseas stock market, increasing research and development expenditure, and acquiring other businesses. *The country will develop thirty to fifty large state-owned enterprises in the next five years through public offerings, mergers and acquisitions, restructuring and co-operation.* (Bai Rongchun, Director General, Industrial Planning Department, State Economic and Trade Commission, July 2001.)

3. China's progress

China's industrial policies to support large firms were successful in the following senses. Large state-owned enterprises avoided the collapse that took place in the former USSR. Industrial output grew at around 13 per cent per annum from the early 1980s to the late 1990s, with sustained rapid growth for large firms. Major changes took place in the operational mechanism of large, state-owned enterprises. They absorbed a great deal of modern technology; learned how to compete in the marketplace; substantially upgraded the technical level of their employees; learned wide-ranging new managerial skills; and gained substantial understanding of international financial markets. China's large firms became sought-after partners for multinational companies. China attracted huge amounts of foreign direct investment. Increasingly, global corporations viewed China as a central element in