

# Private Chinese Investment in Africa

## Myths and Realities

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## Abstract

Private Chinese outbound investment, not as well-known as government-led investment, offers special opportunities and challenges for Africa today. The significance of Chinese private-sector investment is already visible in the burgeoning manufacturing sector in some parts of Africa, and the trend will continue to grow in the near future. The underlying force behind this

trend is the increased pressure of industrial restructuring in coastal China, a force that drives some labor-intensive firms to relocate to other parts of the developing world, including Africa. African host country governments can respond to this phenomenon with proactive development policies and strategies to maximize private Chinese investment for the benefit of their own economies.

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# Private Chinese Investment in Africa: Myths and Realities

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## Private Chinese Investment in Africa: Myths and Realities

By Xiaofang Shen

The recently increased Chinese investment in Africa has grabbed the world's attention. Press views and opinions triggered by this new development are starkly polarized. At one end of the spectrum, one hears praise for China's role in filling financial and technological gaps for Africa, a role which western companies have been reluctant to play especially since the 2008 financial crises. At the other end, one hears considerable skepticism regarding the motivation behind Chinese investment and its consequential impact on Africa, including charges that China is re-colonializing the continent.<sup>2</sup>

At first glance, available statistics do not justify the degree of attention China's investment in Africa is receiving. Official data from the Ministry of Commerce (MOF) on Chinese overseas investment shows total Chinese outbound foreign direct investment (OFDI) in 2011 reached a record high of about US \$74.65 billion, but only \$1.7 billion, or a mere 2.2%, went to Africa.<sup>3</sup> Compared against the global foreign direct investment (FDI) flowing to the continent that year, around \$42.65 billion according to the United Nations Conference of Trade and Development (UNCTAD, 2012), China's contribution was a mere 4%. When measured in terms of FDI stocks, Chinese OFDI in Africa appears even more trivial – reportedly standing at \$14.7 billion by the end of 2011, or 2.6 percent of the total \$570 billion FDI stock for the whole African continent.<sup>4</sup>

So why is China's investment attracting so much attention?

One reason is the pace at which Chinese OFDI has risen in Africa, which, truly, has been breathtaking. Until about 15 years ago, China's capital flow to Africa was almost all government-aid related. According to the MOC, China saw only a negligible amount of \$56 million direct investment in the continent by 1996; this number jumped to \$1.5 billion by 2005, and again multiplied 10 times to nearly \$15 billion by 2011. Most noticeably, just as the world FDI outflow nosedived following the 2008 financial crisis, China's overseas investment more than doubled in 2008, with the part going to Africa actually more than tripled that year and increasing steadily thereafter. Given the pessimistic prospects for the western economy, many

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<sup>2</sup> Among the numerous media reports on the recently hiked Chinese investment in Africa, one representative piece on the controversy is "Beijing, A Boon for Africa," by Dambisa Moyo, *The New York Times* June 27, 2012.

<sup>3</sup> MOC in April estimated the 2011 ODI to the world at \$60 billion, and 2011 ODI to Africa at 1.7 billion. In August, MOC adjusted the 2011 ODI to the world to \$74.65 billion, without breakdown adjusted figure of ODI to Africa.

<sup>4</sup> All figures are calculated using basic data from China's Ministry of Commerce, China, *2010 Statistical Bulletin of China's Outward Foreign Direct Investment* and UNCTAD, *World Investment Report 2012*.

predict that China's place in the FDI arena, for Africa and the world, is likely to further accelerate in the near future.<sup>5</sup>

The second reason for the attention is somewhat complicated, related to the way in which the Chinese are perceived to invest. Western critics generally believe China's investment in Africa is predominantly "state investment," i.e., investment made by government-owned enterprises (SOEs). Critics also emphasize the concentration of investment in oil, gas, and mining to meet the ever growing demand for resources to fuel the startling expansion of China's domestic economy. (Kaplinsky and Morris, 2009) Further, China's growing involvement in Africa has been routinely cast as dependent on deals made at high political levels, profiting the African elites while satisfying China's ambition for enlarged geopolitical influence. Finally, Chinese investment is frequently criticized for its lack of transparency and, disputably, for bringing their own workforce from home, thus depriving the host economies of the benefits of job creation.<sup>6</sup>

Recently, a number African and western scholars have challenged this stereotypical view of China's investment in Africa. (Klaver and Trebilcock 2011, Brautigam 2009, Keenan 2008) Some have pointed out that the country's focused interest in Africa's energy and mineral resources, even if true, is not that different from the FDI traditionally attracted to the continent. (Moyo 2012, Yao 2012) Others have argued that the net impact of China's involvement in Africa, especially in the infrastructural development, has been tremendously positive, as investment in transportation and power is exactly what Africa urgently needs. (Foster and others 2007) Most interestingly, more studies have shown the evidence of growing Chinese firms in Africa's labor-intensive manufacturing sector, which creates jobs and assists in the early industrialization process in many host countries. (Ali and Jafrani, 2012)

There have been few studies on the role of the Chinese *private* sector in its OFDI to Africa, although several Chinese scholars have noticed its important impact on the increasingly diverse and dynamic nature of China's investment in the world and in Africa. (Gu, 2009; Xiao and Chen, 2008; He, 2004) The latest Chinese official announcements have provided some clues: by 2011 a significant 45% of China's total OFDI was attributable to its private sector players.<sup>7</sup> More importantly, in many parts of Africa, the wide range of up-and-coming Chinese businesses – manufacturers of textiles, shoes, ternaries, food products, along with restaurants, wholesale and retail centers and other service providers – have become an everyday sight one can hardly miss. These businesses are seldom run by large Chinese SOEs, but mostly by small and medium sized private Chinese investors, who are often producing outside China for the first time, and who hardly speak any language other than their mother tongue. Exactly who are they, and where are

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<sup>5</sup> See *East Asia Forum Quarterly* Volume 4 No.2 April-June, 2012, which is devoted to "China's Investment Abroad," featuring a collection of articles by nineteen international and Chinese scholars and policy experts contributing to a wide range of views and opinions on the topic.

<sup>6</sup> *Ibid.*

<sup>7</sup> See Wei and Ding, "Private investors play bigger role overseas," *China Daily (USA)*, Aug 31-Sept 2, 2012, p.13.

they from? What draws them to Africa? What impact do they bring to the countries where they invest?

Answers to these questions are difficult as long as data on *private* Chinese investment overseas, both quantitative and qualitative, are lacking. As it stands, consistent OFDI statistics tracking the role of the private sector, from either China's official sources or international organizations, have not been available, while information from African host countries are typically anecdotal and scattered.

As a first attempt to fill this information gap, a pilot research project sponsored by the World Bank's research department was conducted in the spring of 2012, with a view toward exploring the extent and impact of Chinese private investment in Africa. The study took three steps to accomplish its goal: a) gathering and synthesizing the data available from China, the home country; b) gathering official data from selected African host countries; and c) conducting company interviews at selected sites in both home and host countries to gain insight into their respective perceptions and experience. The data unearthed through these efforts were cross-checked and analyzed, leading to a number of findings that shed light on this important but still largely unknown phenomenon.

#### I. Findings based on data from China, the home country

The research started with China's Ministry of Commerce (MOC), the authentic official source of data on China's foreign trade and investment. Other sources, including China's Council for Promoting International Trade (CCPIT), some coastal provincial departments of foreign trade and investment and business associations, were also consulted with for additional information.

The most useful data come from a comprehensive database containing 1,586 Chinese investment projects active in Sub-Saharan Africa by the end of 2011, made available by MOC based upon its approvals for Chinese outbound investment projects.<sup>8</sup> The database contains the following information: name of the investing company, origin province of the company, destination countries, activities to be invested in, and time of MOC approval. Ownership information is not readily available in the database. However, by following the companies' names, their websites and in some cases phone calls, one is able to identify the company's controlling shareholders, thus determining its ownership.

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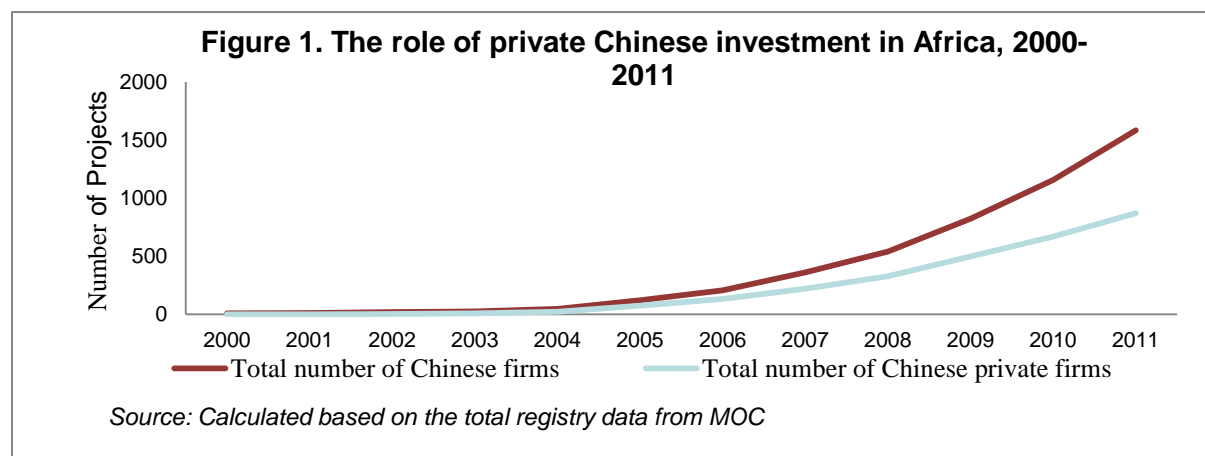
<sup>8</sup> Under the existing regulations, Chinese firms need to obtain government approvals when making outbound investment. Investment projects that exceed 100 million US dollars are required to have central government approval; projects under US\$100 but above US\$10 million need to obtain approvals of Provincial Department of Commerce. Other investment projects, under \$10 million and individuals are not subject to approvals, but are required to receive a "formality review" by MOC, by providing information through the ministry's website, <[www.mofcom.gov.cn](http://www.mofcom.gov.cn)>.

To make it simple, the research created two categories: “private firms” that were privately owned/controlled; and “government firms” that were government owned/controlled, based on who were the majority owners. Further, “collectively owned enterprises”<sup>9</sup> and “Chinese-foreign joint ventures”<sup>10</sup> were lumped into “private firms;” and all SOEs at both central and provincial levels, as well as projects sponsored by all “public institutions,”<sup>11</sup> were grouped together as “government firms.”

The following findings emerged from the data thus compiled:

- ***Private OFDI in Africa has hiked in the last decade, both proportionally and in absolute number. By the end of 2011, the private sector registered 923 projects in Africa, representing 55% of all Chinese OFDI projects in the continent.***

No private OFDI project in Africa was recorded in the MOC system prior to 2000. In 2002, only 2 of the 18 MOC registered OFDI projects in Africa were “private.” Private investors became aggressive in Africa in 2005, in which the number of projects jumped to 52, increasing their total share of China’s OFDI in Africa to a notable 35%. Since then, the number has continued to climb, reaching a total of 923 by the end of 2011. This represents a hefty 55 percent of the total Chinese investment projects in Africa versus 45% owned or controlled by state-owned Chinese firms.



<sup>9</sup> In China, the ownership structure of “collectively owned enterprises” can be complex, and include those owned by rural villages, urban communities, and sometimes special civic groups. Although sometimes involving grassroots government interference, most of the “collectively owned businesses” function like private shareholding companies, responsible for their own risk-taking and profit-making, with the ultimate property rights stayed with the members of collectives. “Collectively owned firms” involve only a very small number in the database.

<sup>10</sup> Chinese-foreign joint ventures” also involve insignificant numbers.

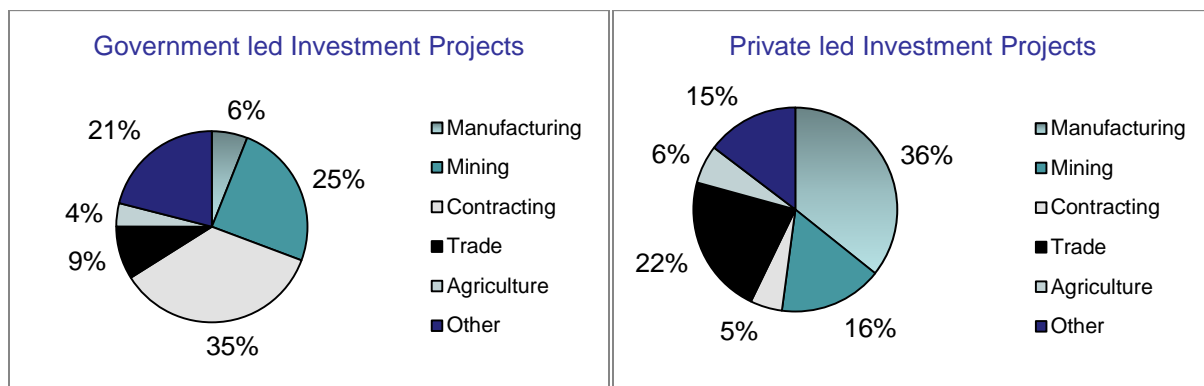
<sup>11</sup> “Public institutions” (“事业单位” shi-ye-dan-wei) functions similarly with SOEs. They are of a small number too.



- *There is a significant difference in sector distributions between the private and government led investments, with the former overwhelmingly concentrated in manufacturing and service industries and the latter in construction and mining.*

Figure 2 below shows the respective sector distribution of private and government led projects. As seen, 36% of private projects are in manufacturing and 22% in the service sector. In contrast, government projects are 35% in construction and 25% in mining. It is notable how little SOEs are engaged in manufacturing, i.e., a mere 6%; and how small the private involvement is in the construction sector, a mere 5%. In the mining sector, however, private participation seems to catch up with their SOE peers, reaching 16% of the total by end-2011.

**Figure 2: Sector spread of Chinese OFDI in Africa, comparing government and private led projects**

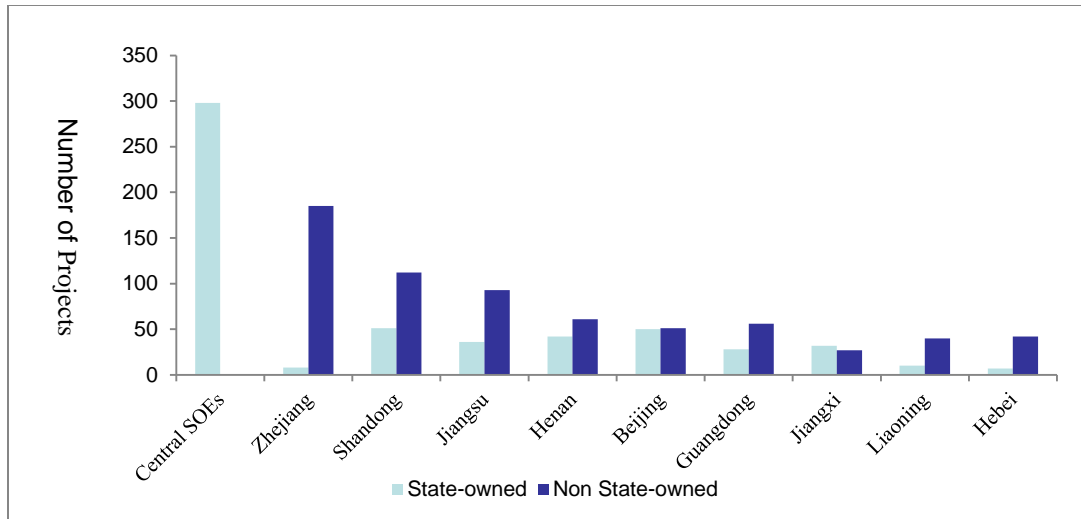


Source: Shen and Wang.

- *The biggest share of OFDI to Africa comes from firms based in coastal China, where the private sector leads the domestic manufacturing and export industries.*

Figure 3 shows the top ten provinces from which Chinese OFDI to Africa originates, along with investment by the central SOEs grouped as a whole. Central SOEs excluded, in all provinces (except Beijing, a city with provincial status), investment from private firms exceeded that of SOEs. Zhejiang, a coastal province, leads China's OFDI in Africa with 191 projects, followed by two other coastal provinces, Shandong and Jiangsu, with 113 and 103 projects respectively. This mirrors well the role of the private sector in the domestic economy in those provinces, especially regarding the manufacturing and export-oriented industries. For instance, Zhejiang province, with 97% of its industrial and commercial output being contributed by the private sector, witnessed 88% of its OFDI to Africa being privately initiated. Shandong and Jiangsu, also known for their vibrant private sector economies, found nearly 70% and 74% of all their OFDI to Africa from private firms, respectively.

**Figure 3: Top 10 Chinese provinces where OFDI to Africa is originated: government verse private led projects**

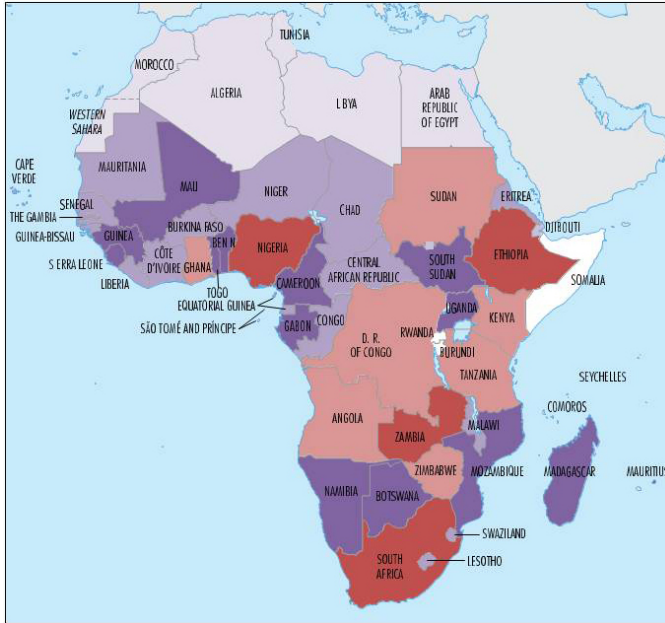


Source: Shen and Wang

Available data from the Zhejiang Provincial Commerce Department confirm that its private sector plays a vanguard role in investing in Africa. According to the provincial records, which capture the provincial OFDI flows more comprehensively than that of MOC, out of approximately 2,000 Zhejiang investment projects overseas as of March 2012, there were 570 African projects, nearly 30% of the total. The registered amount of capital invested in Africa was \$640 million according to the Department, suggesting a relatively small average project size slightly exceeding \$1 million.

- ***Chinese OFDI is widely spread across Sub-Sahara Africa. However, some countries are more attractive than others to Chinese companies.***

MOC data show that Chinese OFDI projects, including both state-owned and private enterprises, are widely spread in 44 countries in the Sub-Sahara Africa. The top five recipient countries are Nigeria, South Africa, Zambia, Ethiopia and Ghana, which all together make up 40% of the total projects in the region. If including the second top five countries, i.e., Tanzania, Congo (Kinshasa), Angola, Sudan and Kenya, the top ten countries represent almost two-thirds of the total. The rest is unevenly distributed across the continent, as illustrated by the map below.



- Countries with more than 100 Chinese investment projects
- Countries with 51-100 Chinese investment projects
- Countries with 21-50 Chinese investment projects
- Countries with less than 21 Chinese investment projects

➤ ***Chinese experts, including MOC officials, believe that the MOC data significantly underestimate the scale of the country’s OFDI in Africa by overlooking many private sector projects.***

Chinese official data on OFDI to Africa, though impressive, is generally believed to underestimate the scale of China’s private sector investment overseas. This is primarily because the MOC’s data are based on OFDI certification required for projects above \$10 million – a threshold which the majority of private overseas projects do not reach, at least in their initial stages. Moreover, investment made by individuals is not subject to the certification system and therefore is not included in the database.<sup>12</sup>

Moreover, many private companies which are by law subject to MOC registration are believed to stay away from the procedures when they can. Even though MOC approvals sometimes come with possible incentives, such as capital subsidies or tax incentives, the procedures are so cumbersome that they do not seem to lure private investors. As one interviewee explained, the firm would have to hire a full- time officer just to handle the applications for government

<sup>12</sup> Outbound investment by Chinese individuals remains legally unregulated unless it is so-called “round trip investment”. A “round trip investment” is an off-shore special purpose vehicle established for financing or listing purposes which subsequently acquires the related Chinese domestic business to be financed or floated. Such “round-trip investment” is subject to strict control by SAFE procedure (<http://www.taylorwessing.com>).

incentives, and the process might delay the project for several months. “This does not encourage me to apply,” he explained, “for me, time is money.”

Officials at local Departments of Commerce seem to be well aware of the circumvention of approvals by private firms. As one official said, “they (the private firms) don’t come to us because, frankly, they want nothing from us,” adding “Nor is there much we can do about it.” Foreign exchange control, which is supposed to be an effective gatekeeper, fails to work in many cases because firms can draw money from their established overseas accounts or swap currencies with other firms with overseas accounts. Unsurprisingly, off-the-record estimates by MOC officials of private overseas projects ran from two to three times that captured by the MOC database.

## II. Findings based on data from host governments

To obtain a more realistic picture of what is happening on the ground, the study made an effort to collect data from host country governments. Host governments tend to capture the data more comprehensively and accurately than the home government, simply because most host countries subject all FDI projects, large or small, to government approvals or registries at the point of business entry.

Collecting data from African host countries has not been easy. Although all countries gather general FDI data, data specifying firms' origins, overtime changes, sector distributions and economic impact are not always readily available. Moreover, the quality of data is very uneven and generally poor. Many agencies in a country may be involved in FDI statistics; each has only a limited view of the whole picture. For instance, investment agencies may be charged giving initial project approvals, company registries responsible for legal establishment of the businesses, and central banks track the actual capital flows. In addition, other line ministries may have a responsibility to track the FDI impact on economic sectors, job creation, exports and tax revenues generation. Ideally, data from all sources are needed to reflect FDI from its intentional initiation, through actualization, and to economic impact generation, but this would require sophisticated FDI data systems which few African countries have at present.

To gain at least a preliminary understanding, the research started with a mini-survey among the national investment promotion agencies (IPAs). Targeting IPAs as the starting point makes sense where they are mandated as the "One Stop Shop" for FDI promotion and facilitation. These IPAs often do their best to gather FDI statistics through coordination with other relevant government agencies even if not directly being in charge of all FDI aspects.

Six national IPAs participated actively in the survey and provided extremely useful data as requested. These included four of the top five African recipients of Chinese investment according to MOC statistics: Nigeria, Zambia, Ethiopia and Ghana.<sup>13</sup> The two additional countries were Liberia and Rwanda. Together, the six countries count for about one-third of all Chinese investment projects in Africa as certified by the MOC.

Most participating IPAs provided specific data on the Chinese investment, both "committed" and "actual," by project number and capital amount, by year of entry and by sector. Most provided data comparing Chinese investment with overall FDI inflows to their countries. Regarding economic impact, most IPAs were able to include numbers of jobs created but unable to provide data on export earnings and tax revenues generated. Finally, participating IPAs generously shared perceptions of Chinese investment, regarding both positive impact and major concerns.

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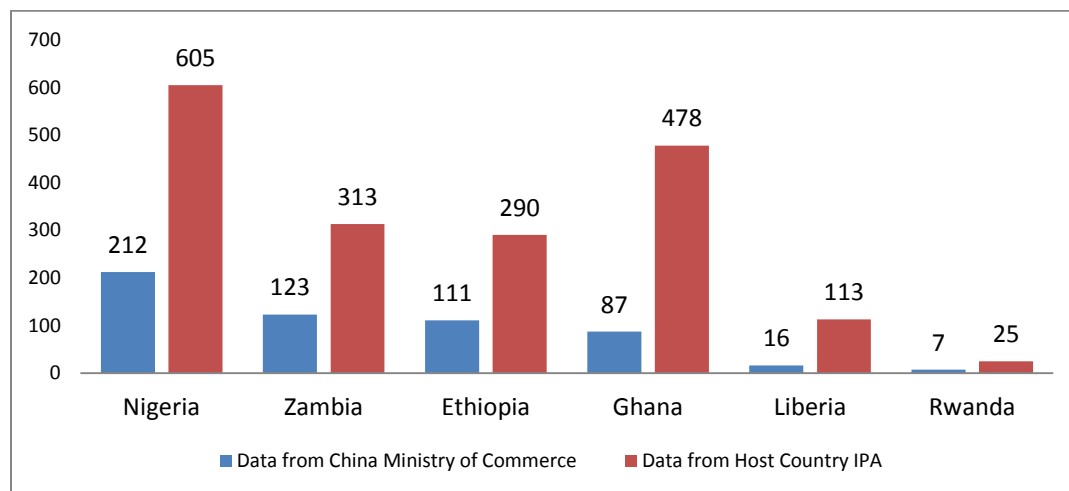
<sup>13</sup> South Africa, ranked as number 2 recipient, was omitted by this research for the reason that it is a mid-income country.

A number of findings stand out based on the host government data.

- *In all six host countries, the numbers of Chinese investment projects proved to be several times higher than those recorded by the MOC system, confirming the suspicions of many in China.*

Figure 4 below shows the number of Chinese investment projects that are “in operation” in each of the six host countries, contrasted to the number of projects reported by the MOC database. To be conservative, in all countries except Rwanda, the research uses numbers of projects “in operation,” rather than “committed.”<sup>14</sup> It is quite astonishing to see how closely the Chinese estimated, i.e., what is happening on the ground is significantly higher, by 2-7 times, than what is captured by MOC data in all six countries.

**Figure 4: Chinese Investment in Six African Countries, as of end-2011**  
(by project number)



*Source: Shen and Zhai.*

More specifically, there are 2.9 times as much Chinese investment projects in Nigeria, 2.5 times in Zambia, 2.6 times in Ethiopia, 3.6 times in Rwanda, 5.5 times in Ghana, and 7 times in Liberia.

Host country data do not distinguish private and government ownership. However, the differences are ostensibly caused by private projects assuming SOEs generally comply with MOC certification requirements. Also, the size and sector distribution of the projects reported by host governments, to be discussed below, support such a supposition. Further, field investigations in two countries, Ethiopia and Nigeria, also to be discussed shortly, confirm this.

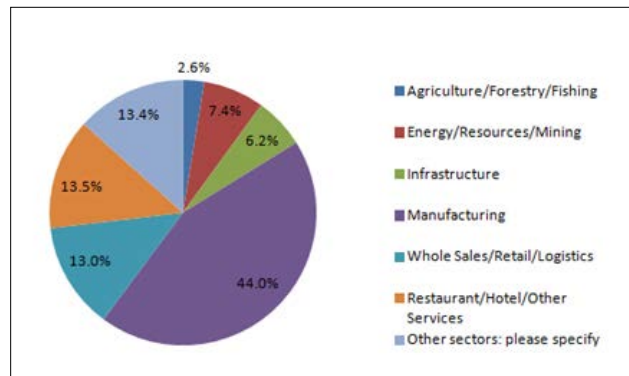
<sup>14</sup> Rwanda only has “committed” figures.

- *Data from host countries reveal a heavy concentration of Chinese projects in labor-intensive manufacturing activities, followed by service industries. Mining and other resource extraction make up only 10% of the total number, and infrastructure projects are even smaller, 6%.*

Figures 5-6 show the sector spread of Chinese investment based on host government data. As seen, manufacturing leads all sectors, representing 44% of all investment projects in the six countries. Respectively, manufacturing represents 60% of all Chinese projects in Ethiopia, 50% in Nigeria, 50% in Zambia, 34% in Ghana, and 32% in Rwanda. Liberia is the only exception, with only 3% of Chinese investment projects in manufacturing.

Following manufacturing, “wholesale and retail” and “restaurants and hotels,” together make up 40% of the total projects in the six countries. Respectively, they attracted 62% of Chinese investors in Liberia, 60% in Rwanda, 59% in Ghana, 39% in Nigeria, 28% in Ethiopia, and 12% in Zambia.

**Figure 5: Sector Distribution of Chinese Investment in Ethiopia, Ghana, Liberia, Nigeria, Rwanda and Zambia (By Aggregated Project Number, by 2011)**



Source: Shen and Zhai.

- *Moreover, data provided by host countries show that the relevant importance of Chinese investment is uneven among the countries. In Ethiopia, Nigeria and Zambia, Chinese investors are taking the leading role of FDI. In other countries, its role remains limited despite some increases.*

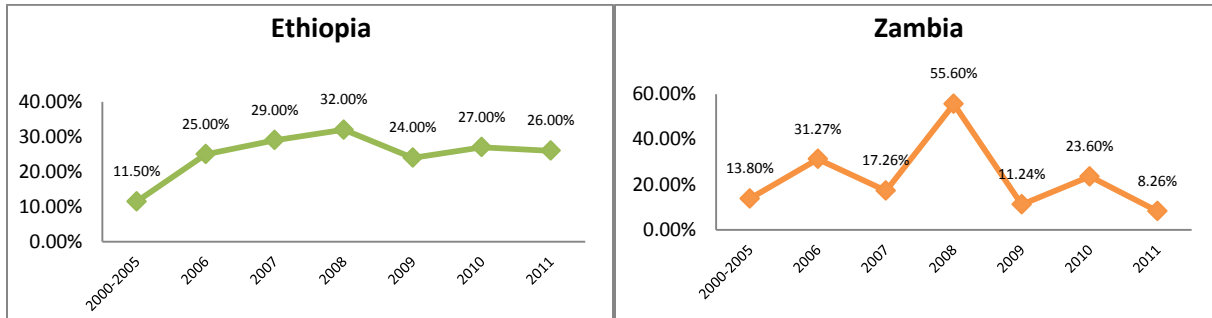
Host governments provided useful data that show the relative importance of Chinese investment in overall FDI inflows for the last decade.

In Nigeria, there is a clear trend showing that Chinese investment has been growing so fast that it is taking over the leading role in new FDI attracted to the country in the last few years.

Measured by number of projects, China contributed only 2.1% of the total FDI attracted to Nigeria during the period of 2000-2008; its contribution increased to 5% in 2009-2010, and jumped to 24% in 2011.

The same trend is seen in Ethiopia, where Chinese investment made up 11.5% of the countries' total FDI inflows in 2000-2005, and rose to top place in 2006-2011 contributing 25% of total FDI in the country. In Zambia, too, Chinese investment held a more fluctuating but generally significant place in total FDI during the same period.

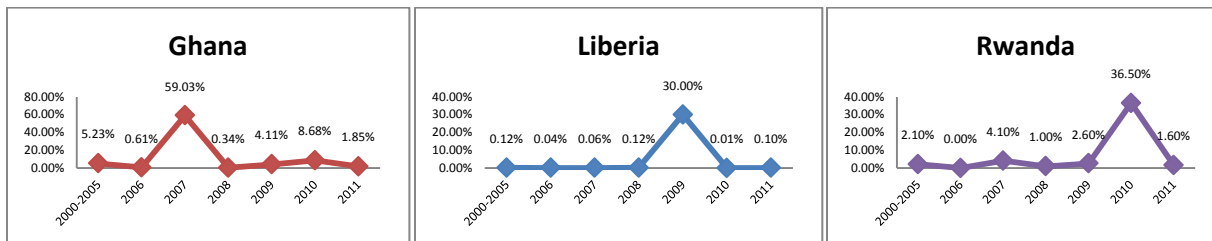
**Figure 6: The Percentage of Chinese Investment of Total FDI in Ethiopia and Zambia, 2000-2011**



Source: Shen and Zhai

In Ghana, Liberia and Rwanda, Chinese investment is proportionally much less significant – except occasional spike years seen in each country, the average Chinese/Total FDI ratios linger at low levels, less than 1% in Liberia, 1.8% in Rwanda, and 3.5% in Ghana.

**Figure 7: The Percentage of Chinese Investment of Total FDI in Ghana, Liberia and Rwanda, 2000-2011**

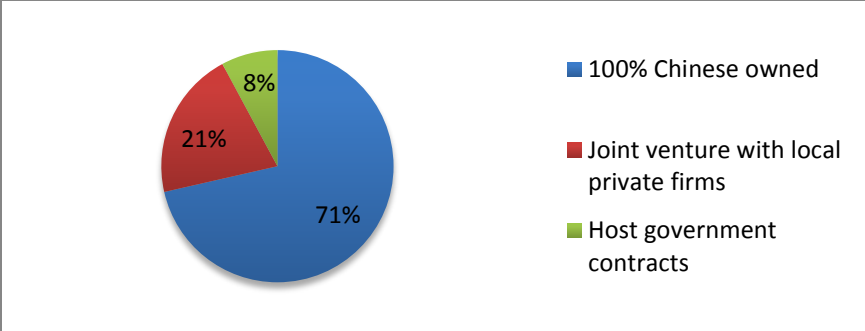


- *Chinese firms tend to be wholly Chinese owned. They are relatively small in size. They mainly complete with firms from other emerging economies of similar size and sector interest.*

Figure 8 based on the six countries' data show that Chinese investments are mostly wholly Chinese owned, with only a small percentage forming joint ventures with local or other foreign business partners.

**Figure 8: Ownership Structure of Chinese Investment Projects**



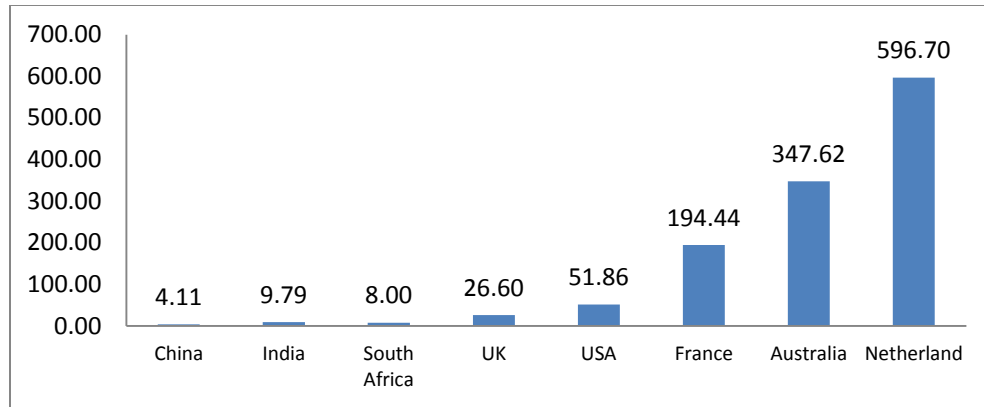


Source: Shen and Zhai.

The average project size of Chinese investment is about US \$4 million, based on available data from six host countries. There is some notable diversity in project size among the participating host countries, which correlates largely with the different sectoral spreads in those countries. For instance, Nigeria, with a number of large capital-intensive projects in energy and infrastructural sectors, has the largest project size among the participating host countries, with an average \$10 million per project. Following Nigeria, Rwanda shows an average project size of \$5 million, Ethiopia \$2.3 million, Liberia \$1.2 million, and Zambia \$0.9 million. Ghana, with nearly 60% of the projects concentrated in the service sector, has the smallest project size, averaged at \$163,000.

Most responding country investment authorities provided data that allow comparing Chinese investment with the overall FDI they attracted and with FDI from other major source countries. These data show that, in terms of size and sector, Chinese investment is similar to that from other emerging economies, notably India and South Africa, the two other top source countries mentioned by host countries IPAs. The data also show that investment originating from western countries is of relatively large size and more engaged in resource-extracting sectors. Figure 9 compares the project sizes of all major FDI source countries, with China being the smallest of all.

**Figure 9: Average Size of Chinese Investment Projects Compared with that of Projects from Other Origins (in million USD)**



Source: Shen and Zhai.

These data imply that, by and large, SOE led Chinese investment, with relatively large size and more focus on oil and gas, mining and other natural resource based sectors, is more likely to compete with traditional European and American investment in Africa. In contrast, private Chinese investors belong more to the group of investors from other emerging markets, such as India and South Africa, featuring numerous small and medium projects concentrated in labor-intensive manufacturing, trade and other service activities.

- *Chinese investment is generally perceived as “positive” in terms of economic impact by most host countries. This is largely thanks to its effect on job creation, a pressing need as perceived by host governments. The overall impact of Chinese investment on local industrialization is mixed, with both praise and concern.*

Four of the five host countries responding to the questions about the economic impact of Chinese investments found the overall impact positive. As seen in Table 1, all five highlighted employment generation to be the top benefit from Chinese investment. To the question about the impact of Chinese investment on local industrialization, the answer is mixed, with three saying “positive” and two saying “negative.” Regarding technology transfer, all responded with “negative.”

**Table 1: African Governments’ Perceptions of the Economic Impact of Chinese Investment**

<b>Contribution</b> \ <b>Country</b>	<b>Liberia</b>	<b>Ethiopia</b>	<b>Rwanda</b>	<b>Nigeria</b>	<b>Zambia</b>
Local job creation?	√	√	√	√	√
Local industrialization?	X	√	√	√	X
Technology transfer?	X	X	X	X	X
Overall	n/a	√	√	√	√

*Source: Shen and Zai.*

Several host countries provided specific data on jobs generated by Chinese investment projects. In Nigeria, 600 or so Chinese businesses generated approximately 69,000 jobs by 2011; in Ethiopia, 290 Chinese firms provided 35,000 regular jobs and nearly 40,000 seasonal jobs by the same time. In Liberia and Rwanda, where employment data are also available, over 3,000 jobs were reported in each case.

Responding host governments also gave their specific concerns regarding Chinese investment. As seen in Table 2, there are a number of concerns shared by host countries, with “increased competition hurting local industries” at the top. “Poor labor standards” are also commonly mentioned. Further, three out of the five countries found it difficult to communicate with Chinese firms due to “language and cultural barriers.” Finally, two countries expressed concerns about “poor environment standards” and one expressed concerns about “immigration.”

**Table 2: Concerns of African Governments about Chinese Investment**

<b>Concern</b> \ <b>Country</b>	<b>Liberia</b>	<b>Ethiopia</b>	<b>Rwanda</b>	<b>Nigeria</b>	<b>Zambia</b>
<b>Competition hurting local industries</b>	√		√	√	√
<b>Low labor standards</b>	√		√	√	√
<b>Low environment standards</b>		√		√	
<b>Language and cultural barriers</b>	√			√	√
<b>Immigration issue</b>		√			

*Source: Shen and Zhai.*

### III. Findings based on feedback from companies

Feedback from companies is primarily based on firm interviews and site visits in selected home and host country locations. Altogether, the research included 35 firm interviews,<sup>15</sup> of which 14 were conducted at the companies' home bases in five Chinese coastal cities, and 21 in two host countries involving factory site visits (11 in Ethiopia and 10 in Nigeria). For the purpose of this research, the interviews prioritized the private sector, with all but four interviewees being privately owned firms. There was also a focus on the manufacturing sector, with 17 producing consumer producers, i.e., textiles (3), footwear (5), wood and furniture (3), leather (2), food (2) auto (2), and six making intermediary products such as construction materials (5), and plastic recycling (1). The remaining twelve included industrial park/estate construction and management (4), mining (1), forestry (1), IT service (1), infrastructure (1), and wholesale/retail/restaurant (4). The majority of the interviewed were small and medium sized enterprises (SMEs), defined as having fewer than 200 workers.

Having limited time and resources, the research prioritized two host countries for field investigation: Ethiopia and Nigeria. Both have a strong record of attracting Chinese investment, especially the privately owned manufacturing firms. Both also have relatively strong Chinese business associations which helped to coordinate site visits with their members.

Given the vast number and diversity of Chinese firms in Africa, this sample is inevitably insufficient and its selection highly opportunistic. Nevertheless, these interviews and site visits provided invaluable opportunities to look deep into the companies' experiences, gain insights into their business motives and operational styles first-hand, and understand better some of the key issues with policy implications for both home and host countries.

A number of findings stand out:

- ***“Market access,” primarily the local market but potentially also the export market, plays a predominant role in attracting private Chinese manufacturing firms to Africa.***

Over half of the firms interviewed, mostly manufacturers, cited “market access” as the main motivation driving them to Africa. Nigeria, with a population of 170 million people, and Ethiopia, with 83 million people, clearly attract Chinese firms with their sizable domestic markets. As one investor making plastic footwear illustrated, all Nigerians, wealthy or poor, wear plastic flippers; and “imaging one pair for each, this country would offer a market of 170 million pairs.” A blanket weaving factory which faced saturated domestic market has been aggressively expanding production in recent years in Ethiopia, a newly discovered market where it “can sell almost as much as [it] can produce.”

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<sup>15</sup> All firms interviewed are referred to anonymously in this report, for the sake of candidness and confidentiality.

Further, firms operating in Ethiopia and Nigeria see the market extending to the neighboring countries. One investor based in Lagos explained the importance of geography and trade traditions that led him to the location he chose: “If you are selling from Lagos, you are selling to the rest of central and western Africa.” Similarly, more than one firm in Ethiopia had eyes on the potential markets of the neighboring African and Arabic countries, even though they were not yet exporting. Several investors said that they were attracted to Ethiopia for its proximity to Europe, their traditional export market. To the textile and footwear producers, Africa offers quota advantages and other preference trade treatments vis-à-vis the American and European markets.

This finding seems to be consistent with the findings of other studies. A firm survey conducted in 2009 by CCPIT in collaboration with European Commission and United Nations Conference on Trade and Development (UNCTAD) found “[the Chinese] domestic market saturation” an important reason for the responding firms’ decision to go abroad, second only to “government policies and incentives” and ahead of “capital availability,” “labor cost” and “transportation costs.” (CCPIT 2009)

- ***Low production cost, especially “cheap labor,” is a critical factor attracting Chinese manufacturing firms to Africa. There is no evidence that private firms depend on imported labor from China.***

A majority of the interviewed firms cited “cheap labor” a critical factor contributing to their decision to invest in Africa. This was expected as most of the firms interviewed were labor intensive manufacturers. For them, cheap labor at home in the 1980s and 1990s helped them grow into competitive producers for the world market. In the recent decade, however, these firms started to lose this competitive edge as labor cost more than doubled or tripled along the Chinese coast. For some companies, production relocation, either to inland China or to other developing countries, became a must if their businesses were to survive. Africa, a remote and unfamiliar destination for most Chinese firms until recently, became increasingly noticeable as a place offering relatively abundant and cheap labor as well as low-cost land.

Other studies support this finding. In the CCPIT survey, almost half of the surveyed firms said “increased domestic labor costs” were an important reason for them to seek relocation overseas. In addition, an internal study by Zhejiang Department of Commerce found that intensified labor shortages (due to reduced supply of migrant workers) and increased factory wages were pressing firms from that coastal province to venture out to other developing world including Africa.<sup>16</sup>

Wages in Ethiopia were particularly attractive, even by African standards. Companies interviewed reported monthly wages from \$30-50 for a factory worker, to \$50-80 for a

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<sup>16</sup> “Study on Zhejiang Outbound Direct Investment” by Zhejiang Provincial Department of Commerce, 2012

technician, to \$80 or more for a mid-level manager, all of which were considerably higher than the minimum wage the government set for its civil servants.<sup>17</sup> This was barely one fifth to one quarter of what they would pay in coastal China. Labor productivity may be low due to the lack of industrial experience and technical skills, but even so overall labor costs were exceptionally competitive.

Firms in Ethiopia were also generally happy with the trainability of local workers. Despite the fact that most new recruits were from nearby villages and some never saw a machine before, they were “eager and quick” to learn. Factory managers were particularly impressed by female workers. “They are hardworking and quick at learning,” one manager commented, “and they don’t drink [a common problem with male workers] so they are more likely to show up to work on time.”

Consequently, Chinese firms in Ethiopia tried to maximize the use of local labor and minimize the staff from home. In the initial stages of production, firms did commonly bring a crew from their home factory as trainers for the local recruits. In those cases they had to at least double the home wages plus providing “hardship” compensation for those who were brought over – a reason for firms to cut down the number of Chinese staff as soon as the locals are sufficiently trained.

Nominal wages in Nigeria also appear relatively low, but have been increasing fast in recent years. In early 2011, the government more than doubled the minimum wage to about \$270 per month, which was moving close to the wage level in coastal China. Moreover, firms found absentee and tardiness a common concern. Although firing was allowed by law, it was costly to employers considering all the required compensations. Employers especially lose if the one they had to fire was already trained. Substituting local workers with those to be brought from China was not a practical option. Cost of doing the latter was high, especially due to the increased security concerns in Nigeria. One company reported a daily hardship/safety compensation of up to US \$100, to retain a medium level Chinese technician in Nigeria.

Among the factories visited, there was one case in which an unusually high Chinese/local workforce ratio was observed: 200 Chinese working side by side with 350 Ethiopians on the factory floor. The manager explained that this was because the operation was still in its initial months of operation and the products (high quality shoes exported to European markets) were extremely quality sensitive. Shoe making was still largely a craft, and the Chinese workers were brought over to teach the local workers one by one. Their number was expected to reduce once the locals became more experienced. For the same reasons, the manager further pointed out, the factory had also brought 80 Ethiopian workers to China for training prior to the commencement of the operation.

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<sup>17</sup> The country does not have a statutory minimum wage, but governments set a minimum wage of 350 Birr for its civil servants.

Most CEOs interviewed agreed that good labor relations are essential to a company's success, and some admitted that there was room for improvement due to cultural gaps. More and more factories were hiring locals as labor managers. In most factories visited, the working conditions were rudimentary, but similar to what is generally seen in local factories. Some Chinese firms provided additional practical assistance to workers, as they often do in China. For instance, recognizing the difficulties in local transportation, some firms provided buses for pick-up and drop-off for workers. Others even provide lunches to workers. Some managers interviewed also emphasized the importance of respecting the local culture and religions. "Africans are proud people," one interviewee said, "the best way to build a good relationship is to show them respect." In another factory visited, one prominent banner hanging over the workshop serves as a reminder to everyone: Where the boss is kind and the workers committed, there will be harmony and money for all (老板厚道, 职工地道, 和谐企业, 生财有道)!"

➤ ***"Availability of raw materials" was another factor attracting Chinese firms, especially agriculture-based "light industry."***

Many firms from the Chinese coastal cities were defined as "light industry," meaning manufacturing dependent on agricultural inputs. Over the past few decades, many of these manufacturers developed specialized clusters back home, where suppliers of raw materials, intermediary input producers and final consumer goods producers formed seamless value chains and their businesses went up and down with each other.

In recent years, however, many felt the pressure of rising prices and shortages of needed raw materials as domestic supplies could not keep up with demand. Many companies already stepped up global sourcing efforts, and found it not easy to find overseas suppliers of quality products with competitive prices and reliable deliveries. Rising transportation costs due to increased oil prices did not help either. These led some intermediary and final goods producers to turn to Africa, where agricultural and other natural resources were abundant and prices competitive.

Firms interviewed in Ethiopia agreed that this was the case for them. Rich in high quality agricultural, forestry and animal products, the country attracted Chinese investors in industries such as textiles, tannery, and wood processing. The owner of a wood products firm with markets in both China and Europe said he was delighted to "find" Ethiopia after a year-long global search for new sources of supply that included Australia, Brazil and Indonesia. He made his decision to invest in Ethiopia on the spot during his first visit to the country, and in less than a year his factory near Addis Ababa was already up and running using local raw materials that used to be burned as fire woods. Another firm, a tannery factory using modern technology to produce high quality hides used for leather goods catering to the European market reported a similar experience. The investor was initially drawn to Ethiopia by its high quality raw animal skins.

After two years of successful tannery operations on the ground, the investor decided to further bring the leather goods sewing production lines over to Ethiopia. “This makes good sense as the raw materials and labor force here are good, and it will save transportation and logistics costs while moving us closer to our ultimate market,” he said.

Sometimes it is the end-product manufacturers who take the first step. A textile weaving factory had been operating in Ethiopia since 2004, and the operation initially depended on importing all yarn from China. As the weaving operation has grown steadily, so has the need for imported yarn. In 2011, the investor asked his long-term supplier, a spinning company back home, to join him in Ethiopia. Learning that cotton grown in Ethiopia was of high quality and low price, and with the trust of his buyer who had already established in the country, the spinning factor owner was convinced almost immediately despite having never operated outside of China. Within a few months, the buyer and supplier jointly purchased a parcel of industrial land big enough to build new factories for both weaving and spinning. Bulldozers were running 24/7 in early spring, and the two factories were envisioned to start operation in early summer. “It’s a win-win situation,” said the two happy owners.

➤ ***Overall operating costs are high in Africa, especially where infrastructure is poor and security concerns significant.***

Doing business was costly in Africa in general despite cheap labor and raw materials, according to the interviewed companies. Common complaints included poor roads, scarce electricity, and other infrastructural obstacles. In some countries, security was an increasing concern and added to operational costs.

These concerns were acute among investors in Nigeria. Public power supply was so dismal that every factory had to install three generators of their own – two to rotate operations and a spare one for back-up in case of breakdown – which added significant investment costs upfront. Keeping the generators running presented another problem, as, ironically, diesel in this oil rich country was chronically in short supply. Road conditions were as bad. The country probably had the most extensive highway network in West Africa, but roads were so poorly maintained that moving cargo around the country was slow and expensive. Finally, there was widespread and increasing concern about safety and security. It was common practice for firms to hire private security crews to fend off crime from the factory premises. Some firms reported difficulty in maintaining Chinese staff and other expats for managerial and technical needs due to safety issues; often this required paying the staff significant “hardship compensation.”

Issues related to infrastructure existed in Ethiopia, too, but to a much lesser extent. In fact, electricity supply was reported to be improving fast thanks to the new dams built by the government. Road conditions were still poor but also improving. Currently, transportation between Addis and Djibouti, the only port outlet for Ethiopia, was clearly a bottleneck. However,



many interviewed made note of highway construction underway as well as upcoming rail project. Water supply, which depended on individually drilled deep boreholes in this highland country, used to be a bottleneck, but it was improved a lot thanks to a growing well-drilling business. In this area, Chinese official aid and SOE involvement seemed to have made a huge impact. Many private firms, with no business overlap with the government programs, acknowledged that they benefited from the infrastructural development aided by Chinese government.

In contrast to Nigeria, safety and security was not seen a concern for Chinese firms in Ethiopia. In fact, many interviewed praised the social order in Ethiopia. Some found living in the country “safer even compared to China.” One senior staff member explained how she was impressed by the peacefulness and kindness of the people. “I was very nervous when I first arrived,” she said. One day, on a rare outing, she had a bad fall in the street, and was immediately helped by many strangers around. “That made me feel at home right away!” she said.

- *Some host governments have applied import substitution policies that have worked to some extent; some Chinese manufacturers move to Africa in an attempt to penetrate trade barriers.*

Some of the Chinese manufacturers moved to Africa in an attempt to penetrate trade barriers. In Nigeria, a number of interviewed firms said that their investment decisions were made in direct response to the host government policies restricting imports. These firms used to export finished products to the country. In January 2004, the host government stepped up import restrictions, with a view to protecting domestic industry. Apart from raised tariffs, the government also introduced a list of prohibited imports comprising 31 products that include many finished textiles and footwear products. Later revisions of the list expanded protection to some intermediary goods. This forced some firms to move production lines to Nigeria lest they lose that market entirely.

In Ethiopia, firms were influenced by government’s protective trade policies as well. Trade protection took the form of high tariffs on imports of finished goods and low tariffs on intermediary inputs. The government also restricted export of certain primary agriculture products such as cotton and animal skins, but encouraged the export of processed raw materials such as cotton yarn and animal hides. These policies served to encourage Chinese firms to invest in agro-processing activities in the country. Some of the investment, as mentioned before, showed potential to lead to more advanced processing industries along the value chain.

However, investment lured in through protectionist trade policies may also come with a cost. In Nigeria, for instance, firms attracted to the country agreed that they did not necessarily perform at the internationally competitive level, due to the relatively high production cost resulted from highly priced power, transportation, and even labor. In such cases, firms managed to be profitable by transferring the cost to the domestic consumers. Thus, one saw a pair of plastic

shoes or a simple piece of garment to be sold in Nigeria at several times higher prices than they were sold in China. One could thus question about the net impact of the protection on the domestic economy.

In addition, if the primary purpose of the protectionist policy was to bolster domestic industry, not just to attract FDI, the impact was even less obvious. In several places visited in Nigeria, including Lagos and Kano where traditionally there were manufacturing industries in textiles, footwear, food processing, and other consumer products, such industries sadly “died” over the last few decades from the so-called “Dutch disease.” Industrial zones built in the 1960s and 1970s deteriorated into vacant skeletons, while domestic markets were swamped by imported goods, many of which from China. The recent step-up of import prohibition, while attracting some Chinese manufacturers over to the country, appeared to have done little to encourage domestic investors. The market continued to be dominated by Chinese goods, now “made in Nigeria.” Clearly, other conditions were needed to get domestic entrepreneurs to invest and succeed. In the longer run, unless the domestics started investing, the goal of industrialization may remain unachieved.

➤ *The investment climate in host countries has made a difference in the final selections of investment locations by Chinese firms.*

Most interviewed firms agreed that the quality of the investment climate is an important factor they looked at when deciding on where to invest their money. Large firms, when short-listing candidate host countries, tended to include an investment climate assessment. A major shoe manufacturer from Guangdong decided to invest heavily in Ethiopia after comparing it favorably against two Asian countries plus one African country, in which “policy stability” and “government support for industries” played a no lesser role than cheap labor and access to raw materials. Small firms also do their due diligence on host government policies, laws and regulations, but their efforts may be less systematic and rely more on the intelligence from their fellow businessmen who had experience doing business in the countries they were targeting.

For the small and medium sized firms interviewed, bureaucratic investment procedures stood out as a main concern. This was because that, being small, they had less capacity and proportionately higher costs in dealing with complex procedures. Also, small firms may receive less attention from high-level host government officials and fewer privileges than their larger compatriots. Many of the interviewed, especially the manufacturers, clearly preferred a transparent policy environment to dealing with local officials informally. “If there is a cost of some kind, we just need to know upfront so that it can be incorporated into our business plan,” said one CEO. “The last thing we want is unpredictable cost and surprises that disrupt the production.”

Many firms interviewed in Nigeria expressed concern about the deterioration of government support after the investment is made. “The government did everything to persuade me to come here, but now that I am on the ground they seem to have forgotten me,” said one CEO. Among the complaints at the operational stage were customs delays, multiple and ad hoc local taxes and fees, unfriendly immigration officers, and, above all, corruption that permeated the operational level. “It is sometimes easier to talk with a Governor than a low ranking officer,” a CEO remarked. Some Chinese firms felt that they were unfairly targeted by the local officers. Others, regrettably, blamed themselves – “I paid them unofficially the previous times to fend off trouble,” one manager said, “Now they keep coming back to me like a bottomless hole.”

More than one of the interviewed became introspective. A CEO who had been operating in Nigeria since 2005 observed that Chinese firms coming to Africa for the first time often had not carefully studied local laws and regulations. As Nigerian procedures were very complicated, they were not easy to understand and innocent mistakes were frequent. Further, because the general monitoring systems were weak and petty corruption at the implementation level common, some firms thought they could successfully circumvent the system. Some got away once or twice, but eventually they got caught. They were the “the rotten apple that spoils the barrel,” as the CEO put it. He believed that efforts were needed from both sides: the government should give priority to making information open and available; while all investors should do their homework about local laws and regulations and NOT try to “outsmart” the system with irregular practices.

In Ethiopia, interviewed firms seemed to be largely content with policy “stability” and “consistency.” “Ethiopian laws and regulations are more complex than those in China, and getting things done takes time,” commented by the Chairman of the Chinese Business Association, established in Addis in 2008, “but the government is making efforts to accommodate investors’ needs.” The association’s 150 voluntary members, mostly manufacturers, met once a month, to discuss common issues, such as taxation, labor management, customs procedures, etc. The Association communicated regularly with relevant ministries and government agencies on behalf of its members. Ministers of Finance, Industry and Transportation had come to meet with the members to hear their complaints and discuss their suggestions. “The government has shown that it is serious about us,” said the Chairman.

When the host countries are part of a customs union, an enabling investment environment seems to be more important to investors who are selecting a specific place to invest while targeting the regional market. A manufacturer of auto parts for the South African market chose to locate the factory in Botswana, mainly because he found it would be easier to do business there due to “more stable and transparent investment environment.” The CEO noted that Botswana and South Africa both belonged to the Southern African Development Community (SADC), which was a customs union allowing free trade among all its members. “Choosing Botswana as the factory base enables me to operate the production side more smoothly, while I can sell my products to South Africa, or any other member countries, duty free,” he explained.

- ***While government investment promotion efforts help, “word of mouth” from the “first comers” is most critical.***

Chinese and African host governments have both been busy promoting Chinese investment in Africa. Senior officials and diplomats on both sides have visited each other, often inviting business leaders on promotional tours and conferences they organize in Chinese and African cities. These efforts help raise awareness and sometimes create useful investment leads that could be followed up by firms. Nevertheless, their immediate impact on private investment decision making seems limited. Interviewed Chinese and African officials alike acknowledged that actual private investment projects rarely resulted from large official events. Interviewed CEOs said they support such events because good government-to-government relations always help. However, some felt obligated to attend the officially organized trips and events which lacked substance, and, sometimes, waste money and time.

Many of the firms interviewed chose to invest in the countries with which they had traded and therefore already had some country knowledge and business connections before they started to invest. For the countries that they were not familiar with, most had relied on information from other businessmen they knew and trusted. Interviews in coastal China showed that Africa, although starting to be known to potential investors, still carried a strong image of a remote, poor and risky land. Those who took the first step to go to Africa and came back with success stories were extremely important for those who were still hesitating. As it happened during one interview in Wenzhou, a coastal city in China, the cell phone of the CEO kept ringing. “I just got off the plane from Africa, and they (fellow businessmen at home) are already chasing me,” he apologized, and then laughed, “I think I’m the best investment promoter for my host country.”

The “first comers” not only pass on information and give advice to fellow businessmen, but also sometimes serve as facilitators for those who decide to join them abroad. Some assisted the new arrivals in going through the initial investment procedures. Others helped with locating available industrial sites, and some even develop serviced land themselves in order to accommodate the development of small clusters, a phenomenon that will be further examined below. The tradition of mutual aid is particularly strong in certain parts of China, such as Wenzhou. Businessmen from Wenzhou are known for their tendency to “form closely knit groups when going overseas (抱团出海).” One Wenzhou CEO mentioned how he was called upon to troubleshoot for his hometown fellows on tax, customs and immigration matters, sometimes in the middle of the night, so that he could call himself the actual “one-stop shop” service provider.

- ***Privately developed industrial estates are emerging platforms for reducing business costs and attracting industrial clusters.***

In some African countries where Chinese manufacturing investors are increasing in number, fast, private industrial estates (PIEs) are an emerging trend. PIEs are different from the better known special economic zones (SEZs) developed by African and Chinese governments – they are usually much smaller, built by industrialists based on more specific industries’ needs, and growing “organically” rather than planned far ahead. No one knows exactly how many PIEs already exist in Africa, and there has been no special study done of them. Nevertheless, in the few places visited, their growing presence and importance to investors could hardly be missed. The following observations are useful to further understanding the phenomenon.

In and around Lagos, Nigeria, the acute need to deal with infrastructural impediments seemed to push firms to turn to the PIE option. As mentioned earlier, power shortages were chronic and firms had to generate their own power to maintain uninterrupted operations. However, installing generators was costly, especially when done factory by factory; building the facilities on a shared basis helped bring down the average cost. The same was true of other infrastructural needs, such as roads, boreholes, water-treatment systems, etc. In Ethiopia, where power supply was much less of a problem, general infrastructure remained weak; firms clustered on a shared site found it more economical to secure the utility supplies they needed.

PIEs also helped firms speed up the process required to get established in the country. In both Nigeria and Ethiopia, PIE founders were often “first comer” investors who had, over the years, gained the knowledge and experience of local laws, regulations, and operational procedures. They often facilitated initial bureaucratic procedures for their new tenants, a significant service saving the latter time and money. Some PIEs had established good track records leading to arrangements with local authorities for blanket permits regarding some regulatory requirements. In such cases, the authorities held the PIE runners responsible for the tenants’ compliance with the needed requirements, which made it easier for both the tenants and the relevant government authorities.

Some PIEs attracted sector-specific clusters, by becoming a textiles park or a shoe manufacturing park, for example. This appeared to have a lot to do with the way in which many of the PIE founders had developed back home. In the last 2-3 decades, China became the world’s manufacturing powerhouse with the help of industrial zones and specialized industrial clusters. Many firms of different sizes and complementary activities became used to operate side by side and support each other’s needs on a just-in-time basis. A large shoe manufacturer, for instance, could be surrounded by dozens of vendors of soles, leather materials, zips and buckles, shoe ornaments, and other products and services needed to support his final shoe assembly operation. When the shoe assembler moves to Africa, he was likely to initially import the inputs from his established suppliers at home. Over time, as his assembly business grew in the new location, some of his suppliers were attracted to move over as well.

One good example was the Yuemei Fabric Industrial Zone (YFIZ), a successful textiles industrial park built by a Zhejiang company in Nigeria. The company started business in Nigeria

in 2000 by exporting its final products. In 2004, it invested US \$1million in its first small factory in the country. Over the next few years, by reinvesting the profits made, Yuemei grew into a relatively sizeable textiles operation with a total investment of over \$10 million. In 2008, it decided to construct a value chain-based industrial park, the YFIZ, to support further expansion. The first phase of the zone was completed by 2009 and immediately put into operation with five textile enterprises moving in. The rents collected were reinvested in building the next phase, to generate more rents, which was again reinvested to the next phase. Today, the whole 130 acres of serviced land is occupied, the space being filled as it was built. Altogether, YFIZ has attracted more than 20 factories of complementary activities such as spinning, dyeing, weaving, sewing, knitting, and embroidery, a value chain cluster that achieves most of what Yuemei had intended from the beginning.

The Hazan shoe industrial park, still under construction in Ogun State near Lagos, shared the same vision. Its goal, as its CEO emphasized, was not to simply manage space and collect rent, but to build a dynamic cluster of small and medium sized plants collaborating on producing high quality shoes for both Nigerian and international market. Hazan from Zhejiang has been a successful shoe manufacturer for markets around the world since the 1990s. It started manufacturing shoes in Nigeria in 2004, mainly using imported inputs from China. Moving some of his Chinese supplies to Africa would save transportation and logistics costs, and make overall production more efficient. “Shoe businesses, like that of fashion, must respond to the constantly changing market demands,” the CEO explained, “As buyers and suppliers are close to each other, they can respond to the market changes together.” However, it had not been all that easy to convince the supplies to move to Nigeria, and part of the difficulty was in finding an appropriate space. Hazan recently acquired a piece of industrial land which would allow it to develop a small PIE to accommodate a dozen factories. Its CEO said that with construction still ongoing, he already had 7-8 potential tenants from home lined up.

PIEs also face special challenges, with financial constraints the most frequently mentioned problem. Developing industrial infrastructure requires significant capital upfront with returns delayed for a relatively long time. Private investors typically face difficulties obtaining bank loans either at home or in their host countries, and they often have to invest their own money, tying up cash flow. This forced many interviewed PIE investors to start small and move in small steps. This approach, albeit practical, limited the investors’ ability to plan and design the zones holistically and optimally. Meanwhile, the industrial specialization and traditionally knitted buyer-supplier relations sometimes prevented the PIEs from networking more broadly with other potential firms and business partners.

The question remains why PIEs multiplied where there were already officially developed SEZs, often offering the same, if not more, industrial infrastructure built with large government investment and, being owned and run by government agencies, promising “one-stop shop” regulatory advantages. Some official SEZs gave firms additional incentives, such as tax holidays and duty exemptions, which were usually not available to PIEs.

This question was raised during the interviews in Lagos, where the Nigerian and Chinese governments had been jointly developing the well-known Lekki Free Trade Zone (LFTZ). The project covered 1.5 square kilometers (nearly 400 acres) in its pilot stage and would eventually expand to a 30 square kilometer, comprehensive modern city combining industrial, financial, transportation and logistics, as well as residential and commercial centers. The total investment for the infrastructural development would be around US \$1.1 billion, one of the largest SEZ projects built outside China. Firms interviewed pointed out that, for its sheer size and complexity, LTFZ took many years to develop. Its massive infrastructural work had been underway since 2006, and was yet to be completed. The involvement of many government agencies made the project planning and execution too complicated to coordinate, which had caused several construction delays. Several firms built in and around Lagos had, in fact, originally considered locating in the Lekki Zone, but decided that developing their own factory sites or renting spaces from smaller PIEs would be faster, cheaper and more effectively serve their specific industrial needs.

The question was also asked around Addis Ababa, where a sizable private industrial zone, the Oriental Industrial Zone (OIZ), had been developed, unusually, with substantial financial assistance from the Chinese government.<sup>18</sup> By the end of 2011, three years after the project's initiation, a total of \$39 million had been invested in OIZ, resulting in 2 sq. km. of fully serviced industrial land with roads, power, water and all other necessary infrastructural facilities. In addition, a total of 50,000 sq. m. of standard factory space was put in place ready for rent. Moreover, the Ethiopian government granted OIZ preferential tax and customs status normally available only to official SEZs. At the time of the site visit for this study, a few factories had moved in OIZ. A large shoe factory hiring 800 workers was able to be up and running within three months after its decision to invest in Ethiopia, which could not have been possible if not for the ready space provided by OIZ. However, the senior manager of OIZ was hardly relaxed, noting that "We are still at the first step of a long march." Government financial support was helpful, but the key to the project's success lied in its own ability to generate income by filling the built space quickly. Many Chinese, Ethiopian and other foreign companies made inquiries but balked at the high rental price resulting from high construction costs. Failure to attract sufficient tenants could cause a serious cash flow problem for the zone and eventually threaten its business sustainability.

- ***Many private Chinese investors consider their African experience "a second opportunity to build a business (二次创业)" and approach it in the same determined, hardworking and frugal style with which they built their first businesses in China twenty years earlier.***

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<sup>18</sup> With the guarantees provided by two coastal municipalities, Suzhou and Zhangjiagang, the investor obtained a long-term loan of \$36 million from China Eximbank. In 2011, OIZ was approved by MOC as one of China's flagship SEZ projects overseas, which, subject to an official site inspection at the completion of the project, could entitle it to a significant amount of financial subsidy up to 40% of its total investment.

Many manufacturing investors interviewed characterized themselves as “grass-root entrepreneurs (草根企业家)” who rose from scratch in China twenty some years ago, out of rural villages and urban small alleys. They showed their dark and rough hands as evidence of how hard they had worked over the years. “We’ve never had the luxury of relaxation. To survive, we have to struggle continuously against all odds,” said a Zhejiang business association representative. Obstacles included particularly difficulties in accessing finance. Many borrowed the savings of friends and relatives to start their businesses, causing them to spend extremely frugally.

Even though some of the enterprises had grown big over the years, they kept their frugality. Most of them were for the first time to set up and manage factories overseas. They were conscious of the risks and costs involved, and many were ready to make personal sacrifices. They went to places of harsh conditions that had turned away many western businessmen. They lived in temporary sheds or containers-converted “houses” next to the construction or production sites. Most of the CEOs interviewed never flew business class or stayed in luxurious hotels, even though their products were sold all around the world, in large stores in Europe and North America.

Many interviewed entrepreneurs had to travel constantly between home and host countries, looking after businesses on both ends. Many were separated from their families for most of the year, as their spouses and children stayed behind in their hometowns in China. One female CEO who decided to be in Africa to run the business with her husband showed a picture of her seven-year old daughter who was left to the care of the grandmother back in China. “This business is like my baby, you know. But it is so hard that I cannot be with my girl,” said she, her eyes tearing up. Another investor who had just lost his business partner to malaria worried about the prospect of his business in Congo, as he could not find someone else willing to continue the venture with him. “I am in my sixties and will need help. But most people, including my own son, think I am a fool to choose to stay in that country, even though the business grows very well,” he said sadly.

➤ ***Private Chinese investors in Africa are generally satisfied with their business performance, measured by profits.***

Although the CEOs generally shun the disclosure of their financial results, most agreed that they were doing “well” or “very well” in terms of profitability.

In Ethiopia, more than half of those interviewed said they became profitable in 2-3 years, and a few in fact made profits the first year of operation. Many had expanded their production, or planned to do so, and several had recommended other investors from home to invest in Ethiopia. All were signs of satisfaction with business performance. One investor said candidly, “Given the risks and hardship involved, I don’t believe that I, or any of my country fellows, would be here if



it were not for a profit at least 3-4 times that at home (which was allegedly reduced to a meager margin of 5-7% in recent years in his trade).”

Although striving for quick returns, manufacturing investors tended to come to Africa with medium to long-term business commitment. Relocating a factory to a foreign country was a highly risky and laborious pursuit, which would not suit those seeking quick payoffs and leave. The investors interviewed generally looked to build upon their initial success by expanding their businesses to the next level.

Private firm CEOs often distinguished themselves from SOE managers in terms of the profit pressure. “They are different from us, as they do not invest their own money,” noted one private owner. Another private investor, who recently withdrew from a public-private joint venture project in Nigeria, explained that he and his SOE partners had different business attitudes. “When construction suffered from delays, they could afford to wait, whereas I couldn’t sleep at night,” said he. Yet another investor who succeeded in running shopping centers in Cameroon proudly described how he succeeded where several state-run trading centers failed. Of the four SOEs interviewed during this study, two were doing well financially; one failed to perform as expected with production recently suspended although not closed; and one was pretty stuck in a murky situation with significant construction delays and rising financial difficulties, but could not withdraw because it was a project based on high-level government-to-government agreement.

Clearly, there were failures among the private investors in Africa as well. As one interviewed CEO reminded, the ones who were on the ground to be interviewed were those who either had survived and succeeded or just arrived. However, stories of those who did not make it were plentiful. The closure of Robinson Shoe Co., Nigeria, was an often cited one. The factory was once a widely publicized success case, hiring over 1,000 Nigerian workers. It closed the operation in 2007, after less than three years of operation in Nigeria, having struggled against problems ranging from foreign exchange transaction difficulties to high utility costs. “Nigeria offers excellent consumer and labor markets, but other factors matter too,” its owner reportedly said at a press conference on his departure. “The world is big, with many places for me to do business. I paid my tuition in Nigeria and I will be smarter when starting a business elsewhere.”

#### IV. Analysis and policy implications

While focusing on the role of private Chinese investment in Africa, one must keep in mind that China as a whole, and its private sector in particular, is still a relatively new player in the FDI field, in Africa and around the world. Given the limited time and scale of this experience, the overall impact of private Chinese OFDI in Africa is not yet fully clear and should not be overstated either positively or negatively at this stage.

Nevertheless, this study, based on data from China, six major host African countries and 35 firm interviews, provides strong evidence that private Chinese investment in Africa is gathering momentum and starting to make an impact in some places. It reinforces what many have suggested, i.e., China's overall role in global cross-border investment is likely to continue to grow in the near future, and the role played by its private sector especially deserves focused attention.

This phenomenon itself raises many more questions: Will private Chinese investment be a blessing or curse to Africa? Will it contribute to Africa's industrialization or will it kill native "infant" industries? Will Chinese private businessmen provide valuable jobs for locals, or will they simply exploit the cheap labor? What influence will this investment have on the local business environment, fostering healthy law and order and economic competition, or aggravating local corruption? Finally, what impact will this new development have on China?

Answers to these questions have important policy implications for African host governments, as well as for China. Like any FDI, private Chinese OFDI carries not only new opportunities but also special challenges. How the host governments meet those challenges will determine the net impact of the investment for their economies. There are also implications for the home government as well as the involved Chinese firms. The following suggests several "do's and don'ts" in terms of government policies, especially those for the host countries, that can influence the outcome of this investment.

#### 1. Policy implications for host countries' industrialization

First and foremost, the rising role of private Chinese investment appears to offer a great opportunity to African host countries, especially those which aspire to transform their traditionally resourced-based economies into more industrialized societies. Industrialization is a process involving many steps. The labor-intensity and relatively low technology associated with the current wave of Chinese firms relocating to Africa provides a desirable first step in this process. Such industries are easy for less developed host countries to absorb and adopt; it also allows them the chance to realize their comparative advantages when competing internationally.

The significance of this phenomenon, the so-called "flying geese" investment or investment from emerging markets, has been a subject of policy and scholarly attention for the last several decades, as summarized in Box 1 below. The positive impact of investment by the south to the south during the industrialization of Latin America and Asia in the 1960s-1970s is well documented. (Wells 1983) In the 1980s-1990s, in turn, China benefited tremendously during its economic take-off by attracting investors from Hong Kong SAR, China<sup>19</sup>; Taiwan, China; and other Asian Tiger struggling to upgrade their industries at home and sending the "sunset" ones

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<sup>19</sup> Until 1997, Hong Kong was a British colony.

overseas (Shen, 1990). Now, as China is moving up the value chain in strategic industries, many coastal producers of simple and labor intensive products need to move somewhere else. This trend offers a special and time-bound opportunity for less developed countries today, including Africa. (Lin 2012) However, Africa would need to act quickly, if it is not to miss out on its piece of the expanding private Chinese OFDI pie.

### **Box 1: What do scholars say about the “flying-geese” investment?**

There is a rich set of literature on the growing role of south-south trade and investment in international economic development. Kaname Akamatsu in the 1960s called such a phenomenon “flying-geese” paradigm, describing a hierarchical move of the production of commoditized goods from the more advanced countries to the less advanced ones. He and other Japanese scholars believed this as an effective model for Asian economies catching up with industrialized Western economies after World War II (Akamatsu 1962).

Harvard professor Louis Wells in the 1980s proposed the theory of “third world multinationals,” identified a number of factors – including the small scale of production, the simple product and low-price strategy, the meshing of technological levels, and ethnic ties – that give companies of newly industrialized countries a competitive advantage when exploring less developed world markets (Wells, 1983).

Many economists have since hypothesized that manufacturing-oriented FDI from emerging markets may have a uniquely positive impact on less developed countries like those in Africa. Broadman in 2007 pointed out that China and India, the two emerging economic “giants” of Asia, were moving to the center of this new phenomenon in Africa (Broadman 2007). A recent UNCTAD report also envisaged an inevitably bigger economic role of investment from the emerging economies in the developing world, given the shifting world economic order (UNCTAD 2007). A more recent IMF report argued similarly that given China's large share in the world market for labor-intensive manufactures, its upgrading to higher value-added products should leave sufficient room for low income countries and other latecomers (Samaké and Yang, 2011).

Most recently, World Bank Chief Economist Justin Yifu Lin suggested the critical role of collaboration among “comparator countries” based on the framework of “new structural economics.” Lin argued that industrial upgrading and infrastructural improvement targets in developing countries should not necessarily draw from those that exist in high-income countries but from other developing countries with a few points ahead of them along the development continuum. Based on this thinking, Lin argues that the coming graduation of China and other middle-income growth poles from low-skilled manufacturing sectors provides ample opportunity for low income countries, including many in Africa, to engage in labor-intensive sectors and create millions of jobs (Lin 2012a, 2012b).

The potential benefits of the investment will not materialize for host countries unless they succeed not only in attracting it but also using it well. The concern expressed about the “crushing” impact on local firms by incoming investment is not all groundless, as incoming investors have advantages over domestic entrepreneurs in terms of capital, technology and access to markets. Government policies and strategies encouraging local catch-up and fostering foreign-local integration are therefore critical to assuring benefits for host economies. In the case of China’s own experience, as summarized in Box 2 below, the early investment inflows from other Asian emerging markets would not have been so beneficial had the business ideas and technologies they brought in not been quickly picked up by local entrepreneurs growing in parallel under policies supporting them. Likewise, the trade and sector protections initially used by the Chinese government to attract FDI would not have been helpful if not accompanied by continued economic opening, which aimed at gradually eliminating protections in favor of steadily enlarged world market integration to achieve the competitiveness.

## **Box 2: How Did China Benefit from South-south Investment in Its Early Experience?**

The first wave of FDI to China, which lasted throughout the decade of the 1980s after it opened up its economy to the world, was led not by western multinationals but by a host of aggressive and risk-taking investors from Hong Kong SAR, China (the then British colony)Taiwan (China); and other neighboring Asian emerging markets. Many of these early investors were small and medium sized, less charismatic, and less intimidated by the initial lack of legal clarity and transparency in the host country. They were good at navigating through the myriad of administrative barriers to get their businesses up and running under difficult conditions. Some of the firms were also known as masters of “going through the back door,” i.e., manipulating the flawed local systems to their own advantage.

Instead of turning these “second class” investors away, China stepped up its efforts to reform its domestic economic system, gradually improving its investment policy and legal framework to make it conducive to larger and more beneficial FDI inflows while fostering domestic entrepreneurial growth. Based on a pragmatic approach, China used the early FDI as a bridge to outside capital at a time such capital was badly needed but unavailable from other sources, including large multinationals. It tapped into the initially labor-intensive FDI production as an effective vehicle to realize its comparative advantage and help it compete in the export market. Moreover, market competition injected by FDI companies, albeit painful to many domestic industries initially, was welcome as a necessary model and impetus to push firms at home to transform. Eventually, those which adapted and survived the initial contest became competitive themselves.

China was also able to learn lessons from many early mistakes it made. As the country started out without a strong legal and institutional framework to support and regulate the market, the early decade of the transition was marked by chaotic competition, distorting restrictions and incentives, and rule by “guanxi” (personal relations) rather than by law. However, China moved aggressively, albeit gradually, to introduce basic commercial laws and regulations needed to bring it closer to international standards. Over time, it equalized the treatment of foreign and domestic companies and installed tax, labor, environmental and other public policy instruments to support orderly business and enhance ethical standards. None of these steps was easy, and the struggle continues even today. Nevertheless, by persisting in the “open door” policy and domestic reforms, the government has managed to maximize the benefits from the early FDI while moving to attract more and larger multinationals, eventually moving up the ladder of the global industrial chain. It’s experience could be inspiring for many African countries today.

As with any cross-country comparison, one should bear in mind the significant differences between the case of China dealing with FDI in the 1980s and the case of Africa dealing with private Chinese investment today. For instance, the overwhelming majority of the early FDI players in China were overseas Chinese who enjoyed a great advantage in terms of language and culture; whereas language and cultural gaps are among the largest barriers for the Chinese firms presently active in Africa. Likewise, the sheer size of China’s domestic market, which attracted many foreign investors, cannot be matched by any African country, or even the continent put as a whole. There are also fundamental differences in the political and historical background between the two cases. Therefore, not all the policy instruments China applied in the 1980s to attract FDI are necessarily relevant to, or reproducible in, Africa today. Nevertheless, one basic truth holds: smart and effective host government policies and strategies, not FDI itself, determine the impact of FDI.

As observed by this study, many African governments appear to have used import the substitution strategy to force Chinese firms to move manufacturing sites to their countries, and this has succeeded to some extent in both Ethiopia and Nigeria. However, there are also indications that, if protracted and unaccompanied by active measures to promote industrial competition and efficiency, protectionism can become counterproductive. As seen in some

sectors in Nigeria, intensified protection coupled with high domestic production costs simply held the domestic market hostage to whoever was producing within the country, be they Chinese, other foreign firms, or national producers. In the end, it is probably the domestic consumers who bear the cost by paying prices several times higher than they should for goods produced inefficiently at home.

Governments of host countries in Africa, therefore, should carefully evaluate their current industrial policies and development strategies taking into account the new opportunities and challenges offered by the upcoming wave of private Chinese investment. At the core of the strategic thinking should not only be the short-term goal of attracting Chinese investment, but also a sustainable inflow of Chinese investment that is well-integrated into the domestic industrialization process and that brings maximum benefits to local economic growth.

## 2. Policy implications for investment promotion

The Chinese firms who were already in Africa appeared to be mostly happy with the decision they made to invest in Africa. However, it remains a reality that Africa is less known to the majority of potential investors in China interested in either relocating or expanding their businesses overseas. If anything, Africa still carries a relatively negative image as an investment destination resulting from both real problems and misperceptions.

Although almost all African countries have dedicated investment promotion agencies and some even have made special efforts to target Chinese investment, few have developed effective strategies to capture the special opportunities created by the dynamic industrial relocation led by the private Chinese investors. The many official visits and conference exchanges by high-level politicians helped create some public awareness but helped little to provide attractive investment leads to private firms, especially the mass of small and medium manufacturers.

One revealing finding of this study is the strong “word of mouth” effect among private Chinese firms. One happy investor may bring 5-10 future investors; or, conversely, the bad experience of one firm on the ground could prevent many more from coming. This suggests that it is important for government investment promotion agencies to pay greater attention to those who have already come. Making them happy with the results of doing business in the chosen country is probably the most economic and effective way to promote the country to prospective investors. However the study suggests that many government agencies were doing just the opposite: investors were lured with great enthusiasm before they came, but once they are in the country, they became a lower priority, sometimes left to struggle on their own. This can be a serious mistake.

Pleasing the existing investors does not mean providing them with privileges but rather providing consistent and transparent procedures affecting their business operations. When asked how they thought the host government could best help, many interviewed CEOs put “stable

policies,” “clarity of laws and regulations,” and “consistent implementation” above “tax incentives.” Investors with long-term business interests in the country, as those in manufacturing, are seen to be considered “good citizens,” prepared to comply with host country requirements regarding taxation, customs, labor and the environment. What they worry most about is frequent policy changes which make business planning difficult. They also resent ad hoc and arbitrary treatment, sometimes executed by low-level officers but badly damaging the credibility of the entire system. Irregular practices of government officials with regard to wrong awards and penalties in turn encourage more irregular practices among the firms. It easily becomes a vicious circle.

The difficulty in resolving many of the operational problems for investors is that such problems have their roots in flawed regulatory and administrative systems. Fundamental improvements will require comprehensive reforms that may take time. It is therefore worthwhile for host governments to “walk on two legs,” i.e., focus on investment facilitation and servicing, while launching reforms aimed to reduce administrative barriers for investors. This has been proven effective in many FDI host countries around the world, including China itself, which featured over 50 official stamps to get a single investment project up and running when it started to attract FDI in the 1980s. (Shen 1990) Many African countries have made notable efforts as well, for instance through establishing “one-stop shop” investment service centers or creating special economic zones and industrial parks with simplified procedures and uniform treatment. These efforts can have a positive impact on investors, if done effectively.<sup>20</sup>

Finally, government efforts to improve the overall infrastructure and social stability and security can go a long way toward making countries attractive to investors. A large number of the firms interviewed in Nigeria expressed frustration about the pitiful electricity supply, poor roads, and other infrastructural conditions. Firms were also increasingly worried about security, spending ever increasing sums on the safety of their staff, factories, and cargoes. These problems add significantly to the cost of doing business in the country and have reportedly led some firms to consider withdrawing. As mentioned early, some firms are coping with these problems by building their own industrial estates. This might be a partial solution to those who can afford the costs. But the costs are so substantial that average investors may not be able to bear the burden on their own. Government efforts focusing on improvements in these areas would help firms reduce production costs, making them more internationally competitive, and thus help attract more new investors.

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<sup>20</sup> There are a bountiful literature on “one-stop shop” investment servicing and SEZ approach for investment facilitation at the website of the Investment Climate Department of the World Bank Group, <https://www.wbginvestmentclimate.org/>

### 3. Policy implications for labor and immigration issues

Job creation is a critical concern for all host countries, economically, socially and politically. The impact is especially important for contemporary Africa, where approximately 60 percent of the population is under age 24 and where the urban population is growing at 7% per year, the world's highest, due to rampant rural-urban migration. Further, it is not only the number of jobs, but the quality of them that is sensitive for host countries. Job training and technology transfer are, therefore, also among the legitimate expectations of host governments when promoting Chinese or any other FDI activity.

Our study suggests that, in the near term, the single largest benefit from private Chinese investment for many African host countries is job creation. The feedback from all responding host countries shows a clearly positive impact on employment perceived in those countries. The factory visits and CEO interviews confirm a general ratio of at least 1:15 Chinese versus local hiring, in the manufacturing sector at least. Moreover, the ratio progressively changes in favor of more local hiring as the investment matures and as local workers get trained, motivated by the firms' self-interest. This study found no evidence of excessive importation of Chinese workers by industrial firms.

At the same time, though, most participating host governments expressed disappointment with the technological transfer aspect of Chinese firms. During most firm visits, workforce training was common, although mostly limited to the low-skill operational level. Although the significance of this kind of training should not be underestimated as many new recruits do need to start from the very basics in an industrial environment it also appeared true that most critical technical and managerial positions were held by Chinese staff. This could be partly due to the cultural and language unfamiliarity and partly due to the strong tendency of traditionally family-run businesses. Such a tendency would not only deprive the locals of some of the most important benefits, but also impede the business growth in the long run.

Finally, the concern about the labor standards as expressed by host governments needs to be addressed. Although working conditions seemed to vary from factory to factory, they are in general at the very basic level, as the owners themselves tend to rough it and tough it. There is also a need for Chinese companies to better understand and respect local cultures and religions.

Many interviewed Chinese CEOs agreed that there was room for improvement in all these aspects. Some made efforts to train and promote local managers, especially for factory floor and labor management; and many who have done so truly appreciated the results. Some also commented that once the language and cultural barriers were broken, the Chinese and Africans would find it easy to understand each other, because, as one CEO put it, "they (the Africans) are going through what we had gone through recently."

Clearly, there is ample room for improving the training of local workers and for forming closer business linkages with local partners. In this context, it was suggested that host governments



could further help through educational programs, including language and cultural training. In the meantime, the government should strengthen labor standards compliance programs, with perhaps rewards and penalties schemes designed to encourage and deter companies.

Most government (except one) did not express concern about the immigration impact. Face-to-face discussions with government officials in at least two host countries further revealed that this concern was more related to the construction projects that tended to bring sizable number of Chinese workers into the country, although it was also acknowledged that these workers would usually leave the country once the construction projects were complete. There was some concern about individuals who might pretend to be “investors” but were actually small traders, who were unwanted by the countries. The merits or the lack of it regarding “traders” notwithstanding, it was clear that manufacturing firms were usually less of an immigration concern to the governments. On the contrary, it was recognized that factories did tend to employ local workers for their own interest but that, in the early operational stages, they did need to bring in some experienced workers to provide on-the-job training to local workers.

#### 4. Impact and policy implication for China, both the government and firms

The Chinese government initiated its “going global” policy at the beginning of the new millennium to promote its overseas investment activities and has since kept heat on this new strategy. Among the expected benefits from outbound investments, Chinese leaders have emphasized access to more markets, the acquisition of natural resources, and enhancement of technology and management skills – all of which would boost the country's economic growth. Most recently, leading officials cited the importance of OFDI as an effective way to release the pressure of excess foreign currency reserves, investment providing an attractive alternative to buying foreign sovereign bonds and serving as a step toward making the Chinese RMB a convertible currency. In his report to the 18th National Congress of the Communist Party of China in November 2012, President Hu Jintao called on Chinese enterprises to speed up their global activities by enhancing their international capacity and reputations. Following that, official spokesmen vowed publically to further ease and improve the systems involved to ensure that momentum continues.<sup>21</sup>

However, interviews with government agencies suggested that, up to now, government efforts to promote OFDI have put the priority on SOEs and a small number of large private companies. Private outbound investment, especially the small and medium sized firms such as the many coastal manufacturers investigated by this study, has received limited attention. In fact, at the provincial level, government officials interviewed had mixed views on letting coastal

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<sup>21</sup> *China Daily*, “Chinese firms' push into global market,” by Li Jiabao, 2012-12-04; [http://usa.chinadaily.com.cn/business/2012-12/04/content\\_15982777.htm](http://usa.chinadaily.com.cn/business/2012-12/04/content_15982777.htm)

manufacturers relocate overseas; some expressed the concern that this may have a negative impact on the local GDP and job market at a time when these were already constrained by the recent decline of the export market.

There has been increased recognition in China that the trend towards more competitive outbound investment, led by private forces, is inevitable as China further integrates itself into the world market of trade and investment. Ge Shunqi, professor of the Institute of International Economics at Nankai University, pointed out that the increased private involvement in going global indicates “a very important structural improvement in China's ODI.” Compared with the resource-driven outbound investment dominated by large state-owned enterprises, OFDI led by private enterprises reflects the real competitiveness of China, argued Ge.<sup>22</sup> The view was shared by Liang Yutang, deputy head of China Minsheng Bank, who said “Private companies are more dynamic than State-owned ones and have become an emerging force in the overseas investment market.” His bank reportedly plans to create a \$10 billion fund to help private enterprises invest overseas over the next three years.<sup>23</sup> Some government think-tanks have agreed. Zhang Jianping, a researcher with the Academy of Macroeconomic Research under the NDRC, said “encouraging more private and small and medium-sized enterprises to engage in foreign investment is a way to counter the skepticism and restrictions that China's State-owned enterprises often encounter (overseas).”<sup>24</sup>

The findings of this study support these views. As evident in the company interviews, many manufacturing firms have moved overseas in response to changing market conditions both at home and in the world. Many of them are from coastal China, where export-oriented activities have been developed competitively in the past decades. However, such activities are now under pressure from increased production costs, including wages, land/office rents, and international shipping.<sup>25</sup> The appreciation of the renminbi has made export-oriented businesses even more expensive. As a result, many coastal firms face a real danger of losing their competitiveness unless they upgrade or relocate. Government policy-makers would do well to help with the transition rather than trying to prevent something that is irresistible.

One effective way for the Chinese government to support this transition is through an effort to help private firms access capital. As seen in the study, many small and medium sized private firms are highly efficient and financially viable. Supporting their overseas ventures not only

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<sup>22</sup> See *China Daily*, “ODI surges in H1 as companies go global,” 2012-07-18; [http://www.chinadaily.com.cn/business/2012-07/18/content\\_15594183.htm](http://www.chinadaily.com.cn/business/2012-07/18/content_15594183.htm)

<sup>23</sup> See *China Daily*, “Chinese firms' push into global market, 2012-12-04; [http://usa.chinadaily.com.cn/business/2012-12/04/content\\_15982777.htm](http://usa.chinadaily.com.cn/business/2012-12/04/content_15982777.htm)

<sup>24</sup> See *China Daily*, “Govt stresses quality for FDI, ODI”; 2012-07-27; by Zheng Yangpeng (China Daily); [http://usa.chinadaily.com.cn/business/2012-12/04/content\\_15982777.htm](http://usa.chinadaily.com.cn/business/2012-12/04/content_15982777.htm)

<sup>25</sup> Since 2010, minimum wages in nine of twelve coastal provinces (including Beijing) rose by an average of more than 21%. Land price in Zhejiang province tripled since 2007.

would help the firms speed up their globalization steps but also help with the nation's need to find more profitable ways to use accumulated official reserves. The government has claimed success in supporting a large number of merger and acquisition projects in the last couple of years, overwhelmingly by large SOEs, but at the end of the day it is not how much is invested but how large are the returns the investment generates that matters. Minsheng Bank has taken a step in the right direction. The CADF has also showed interest in more private investment projects. Other government-owned banks and financial institutions should follow suit.

The Chinese government can further support private firms by making relevant regulatory procedures simple and efficient. The government is already doing this by, for instance, the recent decision to raise the threshold for OFDI project approval from \$10 million to \$30 million. The government could further improve the procedures by asking: what purpose does each of the existing requirements serve? Is the purpose legitimate in light of the changed environment? Are the required procedures effective? Is there a better way to achieve the goal than bureaucratic procedures? The end result of the effort should be to eliminate all unnecessary requirements and focus on the effectiveness of truly important ones. This would make life easier for both firms and the government executing agencies.

Finally, for private Chinese firms, it is important to continue the effort to explore global emerging markets. The study shows evidence that Africa offers many comparative advantages for their businesses and that the continent's potential is yet to be discovered. Those who take the risks of frontrunners in this market can be handsomely awarded if successful. At the same time, moving business overseas, especially to Africa, is still a new phenomenon and there are as many challenges to the government as to the companies involved. To do well, firms need to learn new rules and adapt to new cultural styles of the countries where they invest, to prevent unnecessary mistakes. They also need to be more active in communicating and collaborating with business and social communities that are beyond their immediate families and home-country folks, to ensure lasting business success based on benefits for all parties. Business associations, especially, should continue to provide information, strengthen education and training, and monitor investment activities, to help members following host countries' legal and regular practice.

## V. Conclusion

In August 2012, U.S. Secretary of the State Hilary Clinton said that African countries should consider partnerships with more responsible countries as against countries that just "come in, take out natural resources, pay off leaders and leave," an unmistakable reference to China. The Chinese official news agency, Xinhua, retorted promptly, through the *Guardian*, that "Whether

Clinton was ignorant of the facts on the ground or chose to disregard them, her implication that China has been extracting Africa's wealth for itself is utterly wide of the truth."<sup>26</sup>

This study uses data gathered from the home and host countries as well as individual companies to suggest that neither the US Secretary of State nor China's Xinhua News Agency were correct in their statements. The fact is that Chinese investment in Africa is far from monolithic and is growing increasingly diverse and dynamic. The study shows an underlying factor behind this evolution: the rising role played by the private sector. Whereas large SOEs continue to be important players in areas of infrastructure and resource-based activities, the private sector has indisputably led the way by contributing to the non-traditional manufacturing sector in many parts of Africa.

This diverse trend has had a wide-ranging impact on Africa's development. The injection of private capital, technology and entrepreneurial ideas offers host countries significant economic opportunities, especially in early industrialization and job creation. For these reasons, they are particularly welcome by African host countries. Nevertheless, private Chinese firms invest in Africa based on pure self-interest, i.e., seeking profits. This is what fundamentally distinguishes them from official aid or many investment projects led by their SOE compatriots. However, profit-driven investment does not bring one-sided benefits only. Well utilized, it can generate significant economic benefits for host countries – the reason one sees countries around the world competing for foreign direct investment.

An interesting finding of this study is that not only the motives but also the basic behavior of private Chinese investors are similar to those of other international investors. They make decisions on where to invest by pretty much the same determinants, i.e., market gain, production cost saving, resource and raw materials access, and risks perceived, including those imbedded in the investment environment. In fact, one may argue that the surge in private Chinese investment overseas reflects less the rising economic power of China than China's integration into the international trade and investment market, whose dynamics press and incentivize all participating producers to move where they can produce at the lowest cost and the highest efficiency. As revealed by firm interviews in this study, to maintain their productivity and stay competitive in the global market, Chinese firms often face little choice but act in response to the changing global economic structures and conditions. Some do so by upgrading their products at home, others by moving the production to places that accommodate it better, including Africa.

There are several notable strengths and weaknesses associated with private Chinese investment, the study shows. On the up side, Chinese firms are relatively small in size, and as such are quick and flexible in responding to the African market they serve. They are incredibly adventurous, hardworking and practical, which help them in dealing with the harsh conditions in many frontier countries. On the down side, private Chinese firms are new, and therefore still inexperienced, in

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<sup>26</sup> Associated Press in Beijing, *Guardian* (guardian.co.uk) Friday 3 August 2012.

establishing and managing production overseas. Many of them have limited knowledge of the legal and political systems in which they now operate, do not understand the languages and cultures of their host countries, and, in some cases, are limiting themselves by sticking to strong family business traditions. To sustain and continue to grow their businesses in an enlarged and competitive international investment environment, they will have to climb fast along a steep learning curve.

Host governments, with their priority goals set at industrialization and job creation, should act progressively to tap into the special opportunities offered by the new development of private Chinese investment. Although Africa is rising on the investors' radar screen, it remains a reality that it presently receives only a fraction of China's total OFDI. If anything, Africa still carries a generally negative image among Chinese firms as a distant, poor and unstable investment destination, resulting from both real problems and misperceptions. To gain a large share of the Chinese OFDI pie, African governments should maintain an open and friendly investment environment, by encouraging competition, and by providing better infrastructural support. Host governments should further develop policy and strategy to encourage more technology transfer and Chinese-local business integration. After all, the ultimate goal is not just to attract more private Chinese investment but render more benefits from it for their national economies.

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