

Get Ready for Chinese Overseas Investment in Agriculture

Elizabeth Gooch and Fred Gale

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In November 2014, a corn shipment from Bulgaria arrived at the Port of Shenzhen, China. The corn was grown on leased land in Bulgaria by a Chinese company that had invested close to \$80 million in Bulgaria, to grow and process grains, and oils for export to China. The company set up a Bulgarian subsidiary in 2011, leased 28,700 hectare (ha) of land, and purchased processing plants and storage facilities in the country. The Chinese embassy in Bulgaria identified the country as a favorable target for Chinese agricultural investment in Europe, and the project was endorsed by Chinese dignitaries (Luo, 2014).

As China becomes a large importer, its food security strategy calls for gaining control over imports from their source. To achieve this, a growing number of Chinese companies are making investments abroad that resemble the Bulgarian project. U.S. leaders in agriculture, business, and government should be aware of this new development in agricultural markets.

Whole Supply Chain Control

China has a long history of investing in agriculture overseas with a mix of foreign aid and commercial objectives (Chen, Zhang, and Wang, 2009). As China's imports rise, investment is growing rapidly as Chinese companies pursue profit-making opportunities with encouragement from the Chinese government (*The Paulson Institute*, 2013; Han, Jin, and Wu, 2014). Chinese President Xi Jinping has advocated agricultural investment as a national food security and diplomatic strategy, and officials say outward foreign direct investment in agriculture (OFDI-A) is in

its early stages (*Xinhua News Service*, 2014; *Global Entrepreneur*, 2014; Smaller, Wei, and Liu, 2012).

China's OFDI-A is diverse, ranging from small farms cultivating rice across the Russian border, to massive oil palm plantations and processing facilities in Indonesia. In August 2014, China's Ministry of Commerce announced that over 300 Chinese companies were investing in agricultural, forestry, and fishing projects in 46 countries (*Farmer's Daily*, 2014). The Ministry of Agriculture reported that Chinese businesses and state-owned enterprises had cultivated over 230,000 ha of foreign land by the end of 2013.

Chinese OFDI-A is aimed at gaining greater control in the global marketplace. The strategy encompasses mergers and acquisitions of firms from developed economies, while also laying out a clustered investment strategy to access under-utilized agricultural resources with an emphasis on Africa (*Ministry of Commerce*, 2015; *GRAIN*, 2012). The strategy has evolved from the traditional focus on land acquisitions to encompass investments in the entire supply chain, including processing, logistics, ports, and trading. The strategy is influenced by the widespread belief among Chinese government and industry leaders that multinational trading companies will gain large profits and influence prices by controlling the supply chain for Chinese imports of soybeans and other commodities (Dan, 2014; Irwin and Gallagher, 2014; Niu and Wong, 2014; Schneider and Sharma, 2014).

The OFDI-A strategy is a distinctly Chinese approach that aims to meld commercial opportunities with the achievement of national food security objectives. Recent

statements of the strategy emphasize that companies will be the main investors. OFDI-A decisions are made primarily on the basis of profit opportunities, but consultation with authorities and various support seeks to steer investment to achieve national objectives (Liang, Renneboog, and Sun, 2013). Government support includes subsidized and earmarked loans, information services and training, as well as less visible coordination by officials and diplomats (Chen, Zhang, and Wang, 2009).

Mergers and Acquisitions

China wants to take a more assertive role in the global agricultural marketplace, acquiring assets at all stages of the supply chain from cultivation to processing to distribution (Dan, 2014; Irwin and Gallagher, 2014; Schneider and Sharma, 2014). An increasingly important part of China's strategy is to gain control over supply chains plus access to production technology, management techniques and resources in major agricultural-producing countries through mergers and acquisitions.

An example is the recent purchase by China's State-owned agriculture and foodstuff giant, COFCO, for a majority share of Dutch grain trader Nidera for an estimated \$1.6 million. The acquisition gives COFCO access to Nidera's Brazilian assets and helps COFCO compete with multinational grain traders. State-backed enterprises like COFCO, Chongqing Grain Group Co., Ltd, and Beidahuang have been the central actors in China's procurement of a large portion of the agricultural marketplace (Hu, 2013), but private companies like WH Group and New Hope Group Co., Ltd. also play a major role.

When acquiring established firms, Chinese companies generally lack the advantage in technology or management, so their main advantage is large capital investment (Spigarelli, Mucelli, and Alon, 2013; Quer, Claver,

and Rienda, 2010; Milelli and Sindzinger, 2013). Access to the Chinese market is also attractive to firms that want to increase their distribution (Zheng et al., 2015; Edamura et al., 2014). With the lack of Chinese experience in management, many Chinese firms practice a light-touch approach with acquired companies, retaining the purchased firm's management structure, now loyal to the Chinese parent company (Zheng et al., 2015). For example, after acquiring Smithfield Foods, Inc., WH Group retained the company's management and posted only one staff member at Smithfield's headquarters.

The Smithfield acquisition is China's largest OFDI-A thus far and established China as a major player in the global agricultural market. There have been few details about the motivation for the investment, for which there was no explicit government support. However, the size of the deal and WH Group's takeover of a much larger U.S. based company suggests to some observers that Smithfield was a test case for other large scale investments. Smithfield's vertically-integrated business model that includes control of farming, processing, and marketing of branded products fits China's interest in controlling the entire supply chain. Smithfield's model is also consistent with WH Group's strategy of vertical integration to build consumer confidence in the safety and quality of pork products—a sector that has been troubled by food safety concerns in China. WH Group began test-marketing branded Smithfield products in Chinese supermarkets in 2014. It is noteworthy that China's biggest acquisition to date is a pork company. Meat, dairy, and feed investments reflect a new emphasis on securing animal protein supplies (Schneider, 2014).

New Zealand's dairy industry is another prominent target of Chinese OFDI-A, offering Chinese firms access to already-established dairy farms and

processing facilities, knowledgeable employees, and a well-developed dairy market. New Zealand is the leading dairy exporter, so it has attracted interest from Chinese companies facing constraints and high costs in acquiring domestic milk supplies to meet China's rapidly-growing demand.

Developing Untapped Resources

Another prong of China's OFDI-A strategy is to develop new sources of supplies by accessing land and resources in less-developed countries (Anderson and Strutt, 2014). Since the regions containing the world's future agricultural resources have poor infrastructure and low levels of agricultural productivity, China is taking on the role of introducing improvements to the most important and underdeveloped food-producing regions (Freeman, Holslag, and Weil, 2008). For example, China is establishing small cooperative demonstration field project to bring improved technology in agriculture to communities in Southeast Asia and Africa (*People's Daily Online*, 2004; Smaller, Wei, and Liu, 2012).

China's success in cultivating new import sources has been mixed. Chen, Zhang, and Wang (2009) observed that most Chinese ventures had failed because companies were too small, lacked financing, or had unrealistic expectations. Chinese investments in Southeast Asia have played a role in its imports of tropical crops like palm oil, rubber, and cassava, but it is unclear how large. The Bulgarian project described earlier and the commitment to import from Ukraine appears to be part of a strategy to develop new sources for corn imports. Ukraine and Bulgaria became significant corn-exporters to China for the first time during 2014, although the volumes exported were less than promised when the projects were initiated. In 2012, there were protests in Kazakhstan against a plan to lease land to Chinese investors,

but Kazakhstan, nevertheless, became a sunflower seed exporter to China in 2014.

China's investments appear to have an overstated role in the country's imports. Han, Jin, and Wu (2014) reported that the Heilongjiang Province State Farm system produced 800,000 metric tons of grain in Russia during 2011, but the China Customs Statistics reported soybean imports from Russia of 60,000-90,000 metric tons annually during 2012-2014 (China considers soybeans a "grain") and no imports of cereal grains. China has a long history of setting up rice projects in Africa and is now the world's leading rice importer, yet it does not import any rice or other grains from Africa. China Customs Statistics show that the imports of African sesame seeds doubled during 2012-2014 to over \$1 billion USD. However, it is not clear that Chinese companies had a role in production (Levitt, 2013).

Several prominent ventures involving land acquisitions in Argentina, Brazil, and Indonesia collapsed or were put on hold after encountering opposition from local governments and legal action by environmental groups (*Global Entrepreneur*, 2014; Myers, 2013; Rosen and Hanemann, 2009). In Brazil, land-ownership laws were changed to forestall a Chinese investment, prompting some Chinese commentators to urge a shift away from land-acquisition in the OFDI-A strategy (*Economic Observer*, 2011).

Implications for the U.S.

U.S. agricultural producers, industry, and government leaders need to be aware of the rising trend of Chinese agricultural investment. Much of the investment—including the Bulgarian case—is intended to create competition for U.S. suppliers. An increasing share of U.S. exports to China may be made by companies under Chinese control.

Chinese agricultural trade opportunities may tilt towards specific

countries or regions that are most receptive to Chinese investment. In recent trips abroad, both President Xi Jinping and Premier Li Keqiang have emphasized agricultural investment as well as arranged investment-trade deals. A number of state government agencies in the United States court Chinese agricultural investors, but the U.S. Federal Government has no source of information on U.S. laws, regulations, or assistance for Chinese companies exploring investment opportunities. In addition, there is no mechanism to track Chinese investments in the United States.

A question arises of whether Chinese control will be an important factor determining access to the China market for U.S. products. According to Chinese news media, the Bulgarian corn was expedited through inspection and quarantine at the Chinese port while most other grain shipments have to wait for days or weeks while inspection and quarantine procedures are completed. In the pork sector, U.S. suppliers that use ractopamine are being banned from the Chinese market while those that certify their pork as free of ractopamine have smoother access. With differing requirements for the U.S. and Chinese markets and increasingly strict Chinese enforcement, this raises the possibility that exporters to China may need dedicated production and supply channels geared to produce to Chinese standards.

While Chinese investment will grow and become more important, it is unlikely to play a dominant role in agricultural markets. China's agricultural imports exceed \$100 billion USD annually and are growing. China's Development Research Center estimates that the country's imports of edible oils and oilseeds use 50 million hectares of land overseas—the 350,000 hectares currently cultivated overseas by Chinese companies is less than 1% of that total.

Chinese discussions of OFDI-A strategy seem to presume that pure size is the key to creating a profitable trading company, when in fact the multinational companies they aspire to compete with began as family-owned firms and became large because they were well-managed. Shambaugh (2013) suggests that Chinese companies have a lot to learn about doing business overseas, many invest without a well-thought-out business plan, and he reports that as many as 90% of Chinese overseas investment ventures have failed.

While China will try to diversify its imports by investing in seemingly neglected countries, they are likely to find that the costs are higher than they imagined. China's progress in developing overseas supply bases has been slow, and many projects have faltered.

The United States will remain the dominant supplier of China's agricultural imports because it is such a large and efficient supplier. However, U.S. farmers and leaders in industries and governments should be aware of the potential opportunities and competition that may arise from Chinese investment.

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- Elizabeth Gooch (elizabeth.gooch@ers.usda.gov) and Fred Gale (fgale@ers.usda.gov) are Economists with the United States Department of Agriculture, Economic Research Service, Washington, DC. The views expressed here are those of the authors and do not represent those of the U.S. Department of Agriculture or the Economic Research Service.*