PETER NOLAN & JIN ZHANG

GLOBAL COMPETITION AFTER THE FINANCIAL CRISIS

While the economies of the US, Europe and Japan are still struggling to emerge from their post-2008 recessions, to date China has continued on its path of upward growth, apparently undaunted by the global financial crisis. In 2009 the PRC overtook Germany to become the world's largest exporter of goods, with 34 firms in the Fortune 500. The market capitalization of Chinese firms in the FT 500 was second only to that of American firms, while in the banking sector, the top three positions were occupied by Chinese institutions. Indeed, it has been suggested that the PRC has used the financial crisis to embark on a buying spree of western companies. In the autumn of 2009, *Fortune* ran a cover story under the banner, 'China Buys the World', with the sub-heading: 'The Chinese have $2 trillion and are going shopping. Is your company—and your country—on their list?'[1]

In fact, Chinese companies face enormous competitive challenges in operating on the international stage. Contrary to the belief of mainstream economists that opening up developing economies would provide opportunities for indigenous firms to catch up with those of high-income countries—a perspective epitomized by Thomas Friedman's 2005 *The World is Flat*—the three decades of globalization in the run-up to the 2008 financial crisis witnessed an unprecedented degree of international consolidation and industrial concentration.[2] This process took place in almost every sector, including high-tech products, branded consumer goods and financial services. Alongside a huge increase in global output, the number of leading firms in most industrial sectors shrank.

This is not inconsistent, of course, with the existence of numerous firms that employ a large number of people, yet produce a relatively small share of global output, for sale mainly to poor and lower-middle income consumers. In the mining industry, for example, a handful of firms employing highly skilled labour and large-scale complex equipment accounts for the lion's share of internationally traded coal, iron ore and other mining products. These companies have a total of a few hundred thousand employees and sell mainly to multinational customers in the advanced-industrial sector. In addition, there are tens of thousands of small-scale mines around the world that employ many millions of workers, typically in dangerous conditions, using simple extraction methods; they sell mainly to small-scale local customers in the informal sector, who, in turn, sell their low-quality products to poor people. But the 'commanding heights' of the world economy are almost entirely occupied by firms from high-income countries, whose principal customers are the global middle class. In many sectors, two or three firms account for more than half of total sales revenue (see Table 1).

In this context, well-known firms with superior technologies and powerful brands have emerged as 'systems integrators', at the apex of extended value chains. In the process of consolidating their lead, these giant companies exert intense pressure upon their suppliers, further increasing concentration as components' firms struggle to meet their requirements. This 'cascade effect' has profound implications for the nature of competition and technical progress. It also means that the challenge facing firms from developing countries is far greater than at first sight appears. Not only do they face immense difficulties in catching up with the leading systems integrators, the visible part of the 'iceberg' of industrial structure. They also have to compete with the powerful firms that now dominate almost every segment of global supply chains, the invisible part of the 'iceberg' that lies beneath the water (see Table 2). Thus, just two firms produce 75 per cent of the world supply of braking systems for large commercial aircraft; three firms produce 75 per cent of constant-velocity joints for automobiles. Companies from developing

[1] *Fortune*, 2 November 2009.

[2] The process was more accurately captured by non-mainstream economists: see Joseph Schumpeter, *Capitalism, Socialism and Democracy*, London 1943; Alfred Chandler, *Scale and Scope: The Dynamics of Industrial Capitalism*, Cambridge, MA 1990; and Edith Penrose, *The Theory of the Growth of the Firm*, Oxford 1995.

TABLE 1. *Industrial concentration among system-integrator firms, 2006–09*

	Number of firms	*Global market share*
Large commercial aircraft	2	100
Automobiles	10	77
Fixed-line telecoms infrastructure	5	83
Mobile telecoms infrastructure	3	77
PCs	4	55
Mobile handsets	3	65
Pharmaceuticals	10	69
Construction equipment	4	44
Agricultural equipment	3	69
Cigarettes	4	75*

Source: *Financial Times* and company annual reports; estimates of market share. * Excluding China.

TABLE 2. *Industrial consolidation within global value chains, 2006–08*

	Number of firms	*Global market share*
Large commercial aircraft		
Engines	3*	100
Braking systems	2	75
Tires	3	100
Automobiles		
Auto glass	3	75
Constant velocity joints	3	75
Tires	3	55
Information Technology		
Micro-processors for PCs	2	100
PC operating systems	1	90
Glass for LCD screens	2	78

Source: *Financial Times* and company annual reports. * Including GE's joint venture with Snecma.

countries are trying to enter the 'global level playing field' at a time when the consolidation of business power has never been greater.[3]

The high degree of concentration in terms of market share that emerged in the era of globalization has been accompanied by an equally high degree of concentration in technical progress. Three sectors dominate overall investment in R&D, accounting for almost two-thirds of the total investment by the G1400, the world's top 1,400 firms. These sectors are technology hardware and equipment, together with software and computer services, which account for 26 per cent of G1400 R&D investment; pharmaceuticals, healthcare equipment and services, which get 21 per cent; and autos 17 per cent.[4] As a further illustration of core consolidation, companies from the US, Japan, Germany, France and the UK account for 80 per cent of the G1400, while within this group, the top hundred firms account for 60 per cent of total R&D investment.

Consolidation and the crisis

How has the financial crisis affected the ongoing process of global concentration? Although the value of mergers and acquisitions fell steeply alongside the collapse in stock markets from September 2008, in real terms there was a large amount of M&A activity over the three-year period of 2007–09, and plenty of opportunities to acquire assets relatively cheaply as the crisis intensified. There were 169 cross-border mergers and acquisitions valued at over $3 billion in 2007–08, of which just eight involved companies with headquarters in low and middle-income countries.[5] The pharmaceutical sector saw around twenty mergers and acquisitions valued at over $1 billion between 2007 and 2010, and there was a spate of mega-deals in IT.[6] None of these involved firms from developing countries acquiring firms in the advanced-capitalist core;

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[3] For a detailed analysis of globalization, industrial consolidation and the 'cascade effect' see Nolan, *China and the Global Economy*, Basingstoke 2001; and Nolan, Zhang and Chunhang Liu, *The Global Business Revolution and the Cascade Effect*, Basingstoke 2007.

[4] Other important sectors are electronics and electrical equipment (7 per cent), aerospace and military (4 per cent) and chemicals (4 per cent).

[5] UNCTAD, *World Investment Report 2008*, Geneva 2008, pp. 204–5; and UNCTAD, *World Investment Report 2009*, Geneva 2009, pp. 216–7.

[6] In pharmaceuticals these included Pfizer's acquisition of Wyeth, Novartis's of Alcon, Roche's of Genentech and Merck's of Schering-Plough; in IT, Nokia bought Navteq, HP bought EDS, SAP acquired Business Objects, and Oracle snapped up both BEA and Sun.

indeed the foremost developing-country pharmaceutical firm, Ranbaxy, was acquired by Japan's Daiichi Sankyo.

It was in the financial sector, of course, that the most dramatic series of mergers and acquisitions took place. In the heat of the crisis, governments in the high-income countries 'circled the wagons' around their own financial institutions and encouraged a round of high-speed buy-outs that would have been unthinkable only a few months before. JPMorgan acquired both Bear Stearns and Washington Mutual; Bank of America acquired Merrill Lynch; Wells Fargo acquired Wachovia; BNP Paribas acquired the main part of Fortis; Lloyds TSB acquired HBOS; Nomura and Barclays Capital divided Lehman Brothers between them; Santander acquired ABN Amro's Latin American operations, as well as Abbey National and Bradford & Bingley; and Commerzbank acquired Dresdner Bank. The principal acquisitions were made at bargain-basement prices: in 2007, the combined market capitalization of the main target banks stood at around $500 billion; their competitors acquired them for less than a fifth of this amount.[7] The upshot was the further consolidation of the sector's oligopoly. In 1997, the top twenty-five banks held 28 per cent of total assets of the thousand largest banks; by 2006, their share had risen to 41 per cent; by 2009, it had expanded further, to 45 per cent.[8] Once again, banks from developing countries played no role whatsoever in this process.

Between 1980 and 2008, the globalization decades, companies from the advanced capitalist core increased their outward stock of FDI from $503 billion to $13,623 billion. Developing-country firms also increased their outward stock of FDI, but by 2008 their total amounted to less than a fifth of the core's. Indeed the combined outward FDI of the so-called BRIC countries—Brazil, Russia, India and China—was less than that of the Netherlands alone. During this period, business structures within the developed world became increasingly intertwined, with a significant expansion of foreign share-ownership: by 2008, foreign investors owned 37 per cent of the equity of European firms.[9] Companies headquartered in one core country 'went out' to other core economies, while their home

[7] For example, JPMorgan acquired Washington Mutual for just $1.9 billion, Wells Fargo acquired Wachovia for just $15 billion and Lloyds TSB acquired HBOS for around $8 billion.

[8] *The Banker*, July 2006 and 2009.

[9] *Financial Times*, 1 March 2010.

country also saw other rich-world firms 'coming in'. The inward stock of FDI in the advanced economies rose from $394 billion in 1980 to $10,213 billion in 2008, mostly from other advanced economies. Between 1987 and 2008 there were 2,219 cross-border 'mega-mergers' of over $1 billion, with a total value of $7,232 billion, most of which involved firms from developed countries.[10] It could be said of the business systems of the high-income countries: 'you have me within you, and I have you within me'.

The growth of international investment by multinational companies increased dramatically over the three decades of globalization. World trade grew at over 8 per cent per annum between the early 1980s and 2008, significantly faster than the growth of world output; but overseas investment by international firms grew even faster, rising from 5 per cent of global GDP in 1982 to 27 per cent in 2008. For the hundred largest multinational companies, international assets, sales and labour forces outstripped their domestic equivalents: by 2008, foreign assets made up 57 per cent of these companies' total assets, foreign sales amounted to 61 per cent of their total sales, and foreign employment was 58 per cent of total employment. Yet on the eve of the crisis, the international assets and foreign revenues of the 'top hundred TNCs from developing countries'—including firms from South Korea, Kuwait and Qatar—amounted to barely 14 per cent of those of the world's hundred largest TNCs (see Table 3).[11] In 2008, only three of the top 100 non-financial firms had their headquarters in low and middle-income countries.

China in perspective

To what extent does the PRC show signs of breaking this mould? China's foreign-exchange reserves famously reached over $2.3 trillion in 2009, the largest of any state. Yet to put this in perspective, the market capitalization of the top ten US firms alone amounted to $2.4 trillion, while the top 500 asset managers had a total of $63.7 trillion at their command—of which 96 per cent was managed by firms from Europe, North America and Japan. We should also recall that China's foreign-exchange reserves amount to only $1,800 per person, compared with $5,600 per person for Korea, or $8,400 for Japan.

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[10] UNCTAD, *World Investment Report 2009*, p. 11.

[11] UNCTAD includes Taiwan, Singapore, Hong Kong, Kuwait, Qatar and Republic of Korea as 'developing economies', classified by the World Bank as 'high-income'. These contain 59 of UNCTAD's '100 largest TNCs from developing economies'.

TABLE 3. *Comparing world's largest TNCS with developing-economy TNCS*

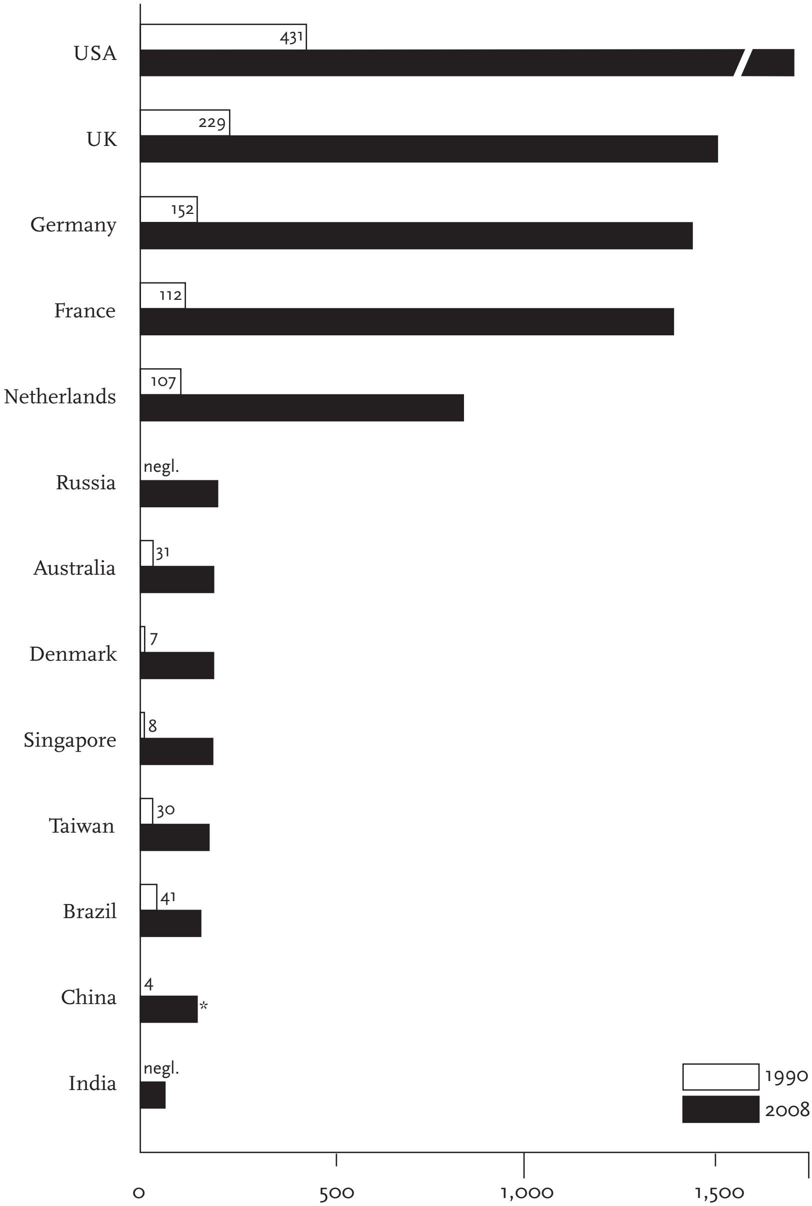
	A 100 largest TNCS	B 100 largest developing-economy TNCS	B/A (%)
Assets ($ billion)			
Foreign	6,094	767	12.6
Total	10,687	2,186	20.5
Foreign as % of total	57	35	
Sales ($ billion)			
Foreign	5,208	737	14.1
Total	8,518	1,617	19.0
Foreign as % of total	61	46	
Employment ('000s)			
Foreign	8,898	2,638	29.6
Total	15,302	6,082	39.7
Foreign as % of total	58	43	

Source: UNCTAD, *World Investment Report 2009*, Geneva.

In recent years, the PRC's largest firms have rapidly increased their acquisition of overseas assets: outward stock of FDI rose from $28 billion in 2000 to $148 billion in 2008.[12] However, China's companies are still at the earliest stage of constructing global businesses. Their level of FDI is small compared with the immense production systems that have been built up across the world by the leading international corporations. Among developing countries, China's total stock of outward FDI is less than that of Russia, Singapore or Brazil (Figure 1, overleaf). It is less than a tenth of the UK's, and less than a twentieth of the US's. Significantly, nearly two-thirds of China's outward FDI goes to Hong Kong and Macao and less than a tenth to the high-income countries, in which Chinese companies have virtually no presence (Table 4, overleaf).

[12] UNCTAD, *World Investment Report 2009*, p. 253.

Figure 1. *Outward stock of* FDI *in $ billions, 1990 and 2008*



Source: UNCTAD, *World Investment Report*, Geneva, 2009. * Includes flows to Hong Kong and Macao.

TABLE 4. *Distribution of China's outward FDI*

Region	*$ billion*	*Per cent of total*
Hong Kong/Macao	119.2	64.8
Latin America	32.2	17.5
Cayman Islands	20.3	11.1
Virgin Islands	10.5	5.7
Africa	7.8	4.3
Europe	5.1	2.8
Oceania	3.8	2.1
North America	3.7	2.0
Singapore	3.3	1.8
Korea	0.9	0.5
Japan	0.5	0.3

Source: State Statistical Bureau, 2009, p. 752.

China's total outward stock of FDI amounts to only a small fraction of the total value of foreign assets accumulated by any one of the world's leading multinationals—GE, Vodaphone, Royal Dutch Shell or Toyota (see Table 5, overleaf). The total stock of China's FDI in the advanced economies amounts to only $17 billion, less than 5 per cent of its inward stock of FDI, most of which is from companies headquartered in Europe, North America and East Asia. Large firms from these regions are deeply embedded in the Chinese economy, while China's firms are almost invisible within the advanced core: 'I have you within me, but you do not have me within you'.

China's giant state-owned banks have undertaken significant reforms in recent years. Some of the world's biggest financial institutions have become strategic investors and have been involved in restructuring their operational mechanisms. Chinese banks have invested heavily in information technology, which has helped transform their internal control systems. They have floated a share of their equity on the stock market, which has led to close scrutiny of their performance by shareholders and the mass media, both in China and internationally. They have appointed independent directors, as well as directors representing their main

TABLE 5. *China's FDI stock in comparative perspective, 2008*

	$ billion
China's outward FDI stock (excl. Hong Kong/Macao)	65
Mining	23
Manufacturing	10
Outward FDI stock of high-income countries	13,624
EU	8,087
US	3,162
Japan	680
Foreign assets of world's top 100 TNCs	6,094
GE	400
Vodafone	205
Royal Dutch Shell	222
BP	188
Exxon Mobil	161
Toyota	183
Total	141
EDF	129
Ford	103
E.On	141

Source: State Statistical Bureau, 2009; UNCTAD, 2009.

shareholders, which has helped shake up management practices. The international operations of China's largest banks have advanced significantly in recent years, including ICBC's $5.6 billion minority investment in Standard Bank of South Africa. By 2009, as noted above, the world's top three banks in terms of market capitalization were Chinese.

However, the international operations of China's leading banks remain far behind those of the Atlantic core. China does not have a single bank among the world's top fifty, ranked by geographical spread. The 2008 financial crisis appeared to offer a once-in-a-lifetime opportunity to acquire banking assets in the high-income countries—yet, despite their huge market capitalization, China's banks were conspicuously absent from the wave of mergers and acquisitions in this sector. It requires a huge leap to progress from being a powerful domestic bank, operating in a heavily protected home market, to one that is globally competitive and able to finalize large-scale international mergers and acquisitions. In addition, the few attempts that have been made by Chinese companies to make a substantial acquisition or a large equity investment in the US have attracted intense media and political scrutiny. This clearly complicates the possibility of China's firms expanding their international operations.

Intensification

The global financial crisis marks a critical point in the evolution of the modern world. One cannot simply project trends from the 'Golden Age' of globalization into the future. The era of free-market fundamentalism is over, but there is deep uncertainty about the future structure of the global political economy and hence about inter-state relations. In this context, a sober understanding of the evolution of global business systems in the past three decades is vital. As we have seen, companies headquartered in the high-income countries were in prime position to benefit from the liberalization of international economic relations that was at the heart of the Washington Consensus. The age of globalization witnessed the rapid consolidation of systems-integrator firms and their supply chains. Large companies from the advanced economies vastly expanded their international investment, building production networks across the globe. Technical progress during these decades was driven by intense oligopolistic competition among leading global firms.

China is still a developing country, far from having 'caught up' with the advanced economies. Although its population is nearly 300 million larger than that of all the high-income countries combined, China's national output is less than a fifth of theirs, and its exports around a tenth. Chinese firms have grown enormously in terms of their sales and stock-market capitalization, and have made significant technical advances. Yet they face real challenges in meeting the PRC's development needs: innovative technologies for transport, energy generation and transmission, carbon capture and sequestration, construction and food production. The relationship between foreign multinationals and indigenous firms in the country's technical progress is still evolving. Meanwhile, the intensity of inter-firm competition has increased drastically during the globalization period, as company size has grown and global markets have become tightly integrated. The relative weakness of China's large firms in international competition was reflected in the fact that they played little part in merger and acquisition activity during the financial crisis. At the same time, China is centrally important for the long-term growth prospects of the multinational companies that dominate the apex of the global business system. A long and complex process lies ahead.