South Korea's response to ethnic Chinese capital injection into the world

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China's foreign exchange reserves were USD 3.24 trillion at the end of June, 2012. By the end of August, they had reached USD 4 trillion, including Taiwan's USD 394.2 billion, Hong Kong's USD 298.2 billion, and Macau's USD 16.7 billion. Combined with the ethnic Chinese capital of Southeast Asia and the rest of the world, the total Chinese capital becomes enormous.

China is leading the rapid globalization of Chinese capital. China's sovereign wealth fund and state-owned companies are taking advantage of the global economic crisis to push through massive M&A deals with companies in the U.S., Europe, Japan and other advanced countries, which allow them to easily acquire their technology and knowhow and thus become more competitive. China also continues to invest in resource-rich countries in Latin America and Africa. Chinese capital is even making inroads into North Korea's resources and market, and increasing investment in South Korea, thereby accelerating the sense of urgency. Now South

Korean companies face competition with Chinese capital not only in the global market, but also in Korea.

Chinese capital across the world

According to statistics released by the Committee of Overseas Chinese Affairs in Taiwan, the number of ethnic Chinese living outside China, Taiwan, Hong Kong, and Macau, is 40.31 million: 30.04 million or 74.5% live in Asia, followed by 7.5 million in the Americas, 1.56 million in Europe, 950,000 in Oceania, and 250,000 in Africa. Indonesia accommodates the largest number of ethnic Chinese at 80.1 million people. Singapore is home to 28.1 million ethnic Chinese, who comprise more than half of its total population.

Ethnic Chinese capital is playing a pivotal role in Southeast Asia, including Indonesia, Malaysia, Singapore and Thailand. Indonesia's top 10 companies were once owned by ethnic Chinese entrepreneurs. Currently, the number of ethnic Chinese entrepreneurs in Indonesia totals 250,000. Ethnic Chinese companies have a huge influence in Thailand: the 200,000 ethnic Chinese companies doing business in Thailand account for 80% of the market capitalization of the country's listed companies. The largest real estate development, hotel management, and financial company in Singapore is Hong Leong Group (豐隆), which is owned by the ethnic Chinese Kwek family. Wilmar International, an ethnic Chinese company headquartered in Singapore, is the world's largest palm oil producer, ranking 328th out of the top global 500 companies in 2011.

In advanced countries, including the U.S. and Japan, the most notable ethnic Chinese are those who have immigrated since the 1970s. Howard Lee, who was born in Guangdong in 1948, immigrated to the U.S. in 1976, and founded Weitex International, a model case for successful small and medium-sized enterprises (SME) in the U.S. Rather than focusing on simple processing, Howard Lee started his own brand and established a global

Geographical distribution of ethnic Chinese in 2011

(Unit: 10,000 people, %)

Continent/Country	Number	Share	Continent/Country	Number	Share
Asia	3,004	74.5	Europe	3,004	74.5
Indonesia	801	19.9	France	801	19.9
Thailand	751	18.6	U.K.	751	18.6
Malaysia	654	16.2	Italy	654	16.2
Singapore	281	7.0	Spain	281	7.0
Philippines	124	3.1	Netherlands	124	3.1
Myanmar	105	2.6	Germany	105	2.6
Vietnam	99	2.5	Oceania	99	2.5
Japan	67	1.7	Australia	67	1.7
Americas	750	18.6	New Zealand	750	18.6
U.S.	416	10.3	Africa	416	10.3
Canada	151	3.7	S. Africa	151	3.7
Chile	99	2.5	Mauritius	99	2.5
Brazil	25	0.6	Nigeria	25	0.6

Source: Overseas Chinese Affairs Council, R.O.C. (Taiwan)

system for ordering, procurement, and distribution, which has succeeded in connecting the global market. Another successful Chinese immigrant is Yim Ho (嚴浩), who moved to Japan in 1981 and established Ever Process System (EPS), a company specializing in clinical trials, which became the first ethnic Chinese company to be listed on JASDAQ in 2001 and Tokyo Stock Exchange in 2006.

The globally ubiquitous ethnic Chinese capital has rushed into China since the early 1980s following China’s reform and opening-up. Ethnic

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Chinese companies, such as Hong Kong's Hutchison Whampoa and Li & Fung, Taiwan's Acer and Hon Hai (Foxconn), Singapore's Hong Leong Group and Wilmar, and Thailand's Charoen Pokphand Group, have grown exponentially in China's market in close relations with the Chinese government. As the Chinese economy faces stagnation after the spread of the 2008 financial crisis and the recent European sovereign debt crisis, ethnic Chinese capital is displaying a new momentum. Until recently, ethnic Chinese capital focused all its efforts on China, but is now shifting its focus to spread the influence of China around the world. The ripple effects of ethnic Chinese capital are all the more powerful because it can easily utilize the local networks that ethnic Chinese immigrants have established in their respective countries. Ethnic Chinese companies such as Hutchison Whampoa, which entered Britain in 1989, and Li & Fung, which has established global distribution channels, have shown the power of Chinese capital in the global market. Taiwan's Hon Hai sent Japan's electronics industry into shock last March when it acquired about 10% of Sharp's shares.

China accelerating globalization under the global financial crisis

China's cumulative outbound direct investment (ODI) was USD 424.8 billion by the end of 2011, ranking 13th in the world. This figure is equivalent to 9.4% of the total U.S. ODI, 24.5% of the UK total, and 44.1% of Japan's. Given that China began its ODI later than these other countries, China's contribution to global foreign direct investment is expected to increase. Chinese investors have set up 18,000 enterprises in

177 countries and regions.

In 2011, China's ODI reached USD 74.7 billion, of which USD 68.6 billion was investment for non-finance sectors—almost 10 times the USD 6.9 billion recorded in 2005. China's ODI in advanced countries accounted for USD 13.4 billion. China's ODI in the U.S. increased by 38.5% to USD 1.8 billion year-on-year, while investment in Europe and Australia increased by 26.8% to USD 7.6 billion, and by 86% to USD 3.2 billion, respectively. Investment through mergers and acquisitions was USD 27.2 billion, accounting for 36.4% of China's total foreign investment. M&A's were still focused on the energy, mining, and manufacturing industries.

Seizing upon the 2008 global financial crisis as an opportunity, China has accelerated its overseas investment, almost doubling from USD 25.6 billion in 2007 to USD 52.1 billion in 2008. Seeing another opportunity in the recessions in the U.S. and Europe, Chinese companies went on an overseas M&A spree this year. In the first half of this year, China's ODI was USD 35.4 billion, a 48.2% increase year-on-year. A third of the investments were made through overseas M&As. China's interest is still largely limited to mine development and energy. Last July, the China National Offshore Oil Corporation (CNOOC) agreed to acquire Canada's oil company Nexen for approximately USD 15.1 billion, pending final approval from the Canadian authorities. In the same month, China Petrochemical Corporation (Sinopec) also reached an agreement to acquire a 49% equity interest in Talisman Energy's assets in the U.K. North Sea for USD 1.5 billion. Recently, China has been expanding its areas of overseas investment. Last May, the Chinese real estate developer Dalian Wanda Group (大連萬達) bought AMC Entertainment, the second largest U.S. movie theater chain, for USD 2.6 billion. In August, China Railway Construction Corporation (CRCC) agreed to buy a 15% stake in Inter Milan for EUR 500 million.

Chinese capital's accelerating globalization poses three major threats to Korea. First, competition will become fiercer in the global market. Chinese capital will encroach on Korea's traditional export market, such as automotive, shipbuilding, steel, solar energy, and display panel markets. Korean companies urgently need to improve competitiveness, for example, through cost cutting, differentiation, and technological advancement. Second, Chinese capital is taking over North Korea's resources and markets. According to statistics released by China's Ministry of Commerce, China's direct investment in North Korea, which had only been USD 1.12 million in 2003, hit a record high of USD 41.23 million in 2008. In 2010 it decreased to USD 12.14 million, but the figure is much larger if China's informal investments are included in the total. Although China's investment in North Korea accounted for an insignificant 0.02% of its total overseas investment in 2010, China's tremendous influence over North Korea's economy leaves the latter in danger of subordination. The two Koreas should strive for inter-Korean economic cooperation as soon as possible. Third, South Korea's domestic market faced more serious risk factors as more Chinese capital is injected into it.

○ ● Countermeasures to the flood of Chinese capital into South Korea

China's holdings of South Korean bonds significantly increased from KRW 1.87 trillion at the end of 2009 to KRW 6.57 trillion in 2010 and to KRW 11.24 trillion by the end of September 2012. China has become the third largest holder of South Korean bonds, accounting for 12.8% of the bonds held by foreign investors, after the U.S. and Luxembourg. China's holdings of South Korean stocks were USD 4.90 trillion at the end of September 2012, a 21.4% increase year-on-year, far surpassing the average annual increase of 15.5%. If combined with investors in Singapore and Hong Kong, ethnic Chinese investors were the third largest holders of South Korean stocks, after American and British nationals. In particular, Hong Kong's holdings of South Korean stocks had surged by 137.5% from the

Foreign holdings of South Korean bonds

(Unit: KRW 10 bil. %)

Country	End of 2011	End of Sep. 2012	+/-
U.S.	16,369	16,586(18.8)	1.3
Luxembourg	12,971	14,292(16.2)	10.2
China	10,230	11,247(12.7)	9.9
Malaysia	7,991	7,596(8.6)	△4.9
Thailand	9,761	6,749(7.6)	△30.9
Singapore	3,229	3,292(3.7)	2.0
U.K.	3,309	2,807(3.2)	△15.2
Hong Kong	2,559	2,735(3.1)	6.9
Total	83,027	88,317	6.4

Note: ( ) refers to the country's share; +/- refers the increase or decrease from the end of the previous year; figure for Malaysia includes Labuan

Foreign holdings of South Korean stocks

(Unit: KRW 10 bil. %)

Country	End of 2011	End of Sep. 2012	+/-
U.S.	144,068	161,059(39.7)	11.8
U.K.	37,865	39,466(9.7)	4.2
Luxembourg	23,572	26,564(6.5)	12.7
Singapore	17,915	20,592(5.1)	14.9
Saudi Arabia	12,922	15,009(3.7)	16.2
Hong Kong	3,542	8,412(2.1)	137.5
Japan	6,093	6,743(1.7)	10.7
China	4,036	4,898(1.2)	21.4
Total	351,455	406,000	15.5

Source: Financial Supervisory Service of Korea end of 2011 to the end of September 2012.

Up until the third quarter of this year, the accumulated investments by China, Taiwan, Hong Kong, and Singapore in South Korea were reported to be USD 19.6 billion. Singapore was the largest investor in South Korea at USD 8 billion, followed by China at USD 4.2 billion, and Taiwan at USD 1.2 billion. These three regions substantially increased their investments in South Korea during the 2008 financial crisis: Taiwan by 706.1%, Hong Kong by 83%, and Singapore by 77.4%. Their investments in South Korea have also been increasing this year, the total through the third quarter already surpassing the total of the previous year. Most notable is Hong Kong whose investment in South Korea through the third quarter totaled USD 1.5 billion, a nearly three-fold increase from the previous year.

The massive inflow of ethnic Chinese capital into Korea is all attributed to the fact that South Korea's financial market is relatively advanced with high returns compared to other Asian markets, and to the ethnic Chinese investors' view that Korea belongs to the Chinese cultural sphere. However, a swift inflow of ethnic Chinese capital into Korea has many side effects for the latter: the less effective monetary policy, creation of financial asset bubbles in the domestic market, and threats of hostile M&As for Korean blue chip companies. In particular, an abrupt outflow of ethnic Chinese capital in the event of an unforeseen crisis on the Korean peninsula will bring unmanageable difficulties to Korea. To address these risk factors, South Korea should take anticipatory measures including setting up a bilateral or multilateral system of mutual assistance between the interested governments and companies. It is South Korea's job to attract ethnic Chinese capital to the domestic regions and areas that are in most need of capital, and utilize it to our advantage.

Korean companies and ethnic Chinese capital in the Chinese market

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According to the Hong Kong-based weekly *Yazhou Zhoukan* (亞洲週刊), the aggregate market value of the world's top 1000 ethnic Chinese merchants was USD 6.4 trillion and their total assets were USD 16.7 trillion at the end of July 2011. These ethnic Chinese merchants are located in China, Taiwan, Hong Kong and other Southeast Asian countries, but most of them are Chinese companies, which accounted for more than 75% of the aggregate market value and 85% of total assets. Hong Kong companies had the second largest share after Chinese companies. Listed in the Hong Kong Stock Exchange are not only Hong Kong companies, established and grown in Hong Kong, but also mainland Chinese, Taiwanese and Southeast Asian companies in need of financing. When it comes to ethnic Chinese capital, Southeast Asian and Taiwanese companies doing business outside China form the nucleus. They are also the source of Chinese capital most influential to Korean businesses.

Insignificant outcomes from alliances with Chinese companies in Southeast Asia

Since the mid-1980s Korean companies have made direct investments in Southeast Asia, and forged relations with ethnic Chinese merchants as partners or competitors. Except in cases where they were the sole investors, most Korean companies made an alliance with ethnic Chinese merchants when entering Southeast Asia. Samsung Electronics and LG Electronics, for instance, entered Indonesia in joint venture with ethnic Chinese companies. Samsung Electronics also entered Thailand in the same way. As a growing number of Korean companies entered Southeast Asia, so did Korean financial institutions. Korean short-term finance companies, including composite financial services companies, actively lent funds to ethnic Chinese companies from the late 1980s to the mid-1990s. After the financial crisis occurred in Southeast Asia, Korean financial institutions had trouble recovering funds, aggravating the financial crisis in Korea.

In fact, cooperation between Korean companies and ethnic Chinese companies did not bear significant outcomes. Since the 1960s, leading Chinese companies in Southeast Asia had maintained strong alliances with Japanese manufacturers in the automotive, electronics and chemical industries. In many cases, Korean companies competed with Japanese companies in alliance with ethnic Chinese companies in the Southeast Asian market. In the 1990s, an ethnic Chinese company revoked its alliance with a Korean company out of differences in management. The 1997 financial crisis in Southeast Asia brought financial difficulties to Chinese companies in the region, and as a result there was an increasing number of cases in which Korean companies acquired shares of the joint ventures from their Southeast Asian partners.

Ethnic Chinese capital in China

In the late 1970s, China adopted reform and opening-up policies for economic growth. The first to side with China's policies were Chinese entrepreneurs in Southeast Asia. As they had already been making donations to their homeland, they were the first to step forward when China drew back the bamboo curtain and attracted foreign investment. After Charoen Pokphand Group, the largest Chinese company in Thailand, became the first foreign company to receive investment approval from China in 1978, other Chinese companies in Thailand, Indonesia, and Malaysia soon followed suit. Chinese capital in Southeast Asia had been relatively uncompetitive in the manufacturing sector, but through its bold entry into China, it contributed greatly to China's economic take-off when Western capital was reluctant to enter China.

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Taiwanese companies have wider and deeper ripple effects on the Chinese economy than Chinese companies in Southeast Asia. Having paid close attention to China since the late 1980s, Taiwanese companies started making massive investments in China in 1991 when the Chinese government began to allow indirect investment. A representative example is the Taiwanese company Mater Kong, which is the largest instant noodle manufacturer in China. Master Kong conducted its first market survey in China in 1988, and established the first instant noodle plant in Tianjin in 1991. As the Chinese government opened up to foreign investment in cutting-edge products, including laptop and personal computers, in the 2000s, Taiwanese companies shifted the focus of their investment in China to information technology. Currently, Taiwanese electronic manufacturing services (EMS) manufacturers and original design manufacturers (ODM), such as Foxconn, Quanta and Acer, are manufacturing products in China.

China is a country with a vast market and rich resources. Realistically, Chinese companies in Southeast Asia or Taiwan cannot fully control such a vast China's market. After the establishment of formal diplomatic ties between South Korea and China in 1992, Korean companies started to enter China in earnest. At the early stage of entry, when Korea focused on labor-intensive manufacturing for commodity shunting, Korean companies were not interested in Southeast Asian companies. However, as China's domestic market became increasingly important, Korean companies had no choice but to compete directly with ethnic Chinese companies. The Chinese market turned into an arena for cooperation and competition between Korean companies and ethnic Chinese capital.

Risks and opportunities posed by ethnic Chinese companies

Southeast Asia- or Taiwan-based ethnic Chinese companies doing business in China are a potential threat to Korean companies. With the exception of the automotive and home appliance industries, in which Korea is absolutely competitive, Korean companies are vying for the Chinese market with ethnic Chinese companies in Southeast Asia and Taiwan. In the semiconductor and LCD panel industries, Korean companies are competing with Taiwanese companies not only in the Chinese market but also in the global market. In China, Taiwanese companies are a big huddle for Korean companies especially in the food sector, which promises high potential. Taiwanese food companies, including Master Kong, Wang Wang, and Uni-President Enterprise, control China's instant food, cooking oil, and confectionary markets. In the hospitality and distribution industries, ethnic Chinese companies have an overwhelming competitive edge compared to Korean companies. It is questionable whether Korean companies can overtake ethnic Chinese companies in the future.

Major indicators of the world's top 1000 ethnic Chinese merchants

(Unit: USD 100 mil.)

	Aggregate market value	Sales	Total asset	Shareholders' equity
China	48,651	27,902	141,626	19,709
Taiwan	2,526	464	2,429	594
Hong Kong	7,765	3,436	13,264	5,053
Macau	17	15	10	5
Indonesia	228	108	931	130
Malaysia	2,970	4,040	5,078	1,235
Philippines	892	622	859	356
Singapore	1,068	699	2,851	517
Total	64,271	37,303	167,111	27,621

Source: *Yazhou Zhoukan*

For many reasons, ethnic Chinese companies are more competitive than Korean companies in domestic-driven light industries, distribution, hospitality, and real estate development. One of the reasons is that China regards Taiwan as part of China and ethnic Chinese entrepreneurs as "Chinese living overseas". *Guanxi* (關係), which refers to relationships based on cultural and emotional bonds, is the most important source of competitiveness for ethnic Chinese companies. In this regard, Southeast Asia-based resource companies will find opportunities in China as long as the country continues to grow, while Taiwanese companies will likely maintain their competitive edge if China fails to fully overtake Taiwan's IT technology.

Of course, Korean companies and ethnic Chinese companies are not just competitors. From a macroscopic perspective, the two are competing with each other, but from a microscopic perspective, there are many areas

Ethnic Chinese companies' competitive edge in entering China

Competitive edge	Details
Guanxi	- Cultural and emotional bonds are a source of competitiveness. - Guanxi is particularly important for big companies.
First-mover advantage	- Ethnic Chinese companies were the first investors. - Combined with *guanxi*, it was important for business expansion.
Resources	- Southeast Asia-based ethnic Chinese companies lacked experience in the primary resource processing industry. - Ethnic Chinese companies kept friendly relations with China due to China's resource shortages and rising imports.
Product and service competitiveness	- Taiwanese IT companies have the capacity for rapid product development. - Southeast Asia-based ethnic Chinese companies have accumulated knowhow in hospitality, distribution, and real estate development. - Product and service competitiveness is still a significant factor in competitiveness. - China's real estate bubble burst will have a negative impact on Southeast Asia-based ethnic Chinese companies.

Taken from various sources

for cooperation. As Southeast Asian production networks become intensified, the distinction between cooperation and competition among companies becomes blurred. The same is true for the relations between Korean companies and ethnic Chinese companies. For example, Taiwan's Foxconn, which produces Apple's iPhone in China, procures major parts from Korean companies. According to studies by IHI iSuppli, a market research firm, and Dr. Lee Gyu-bok of the Korea Electronics Technology Institute, the 16G byte version of the iPhone 4 manufactured by Foxconn in China carries a bill of materials of USD 187.51, but Foxconn buys many of the parts from Samsung Electronics: USD 10.75 for the application processor, USD 13.80 for the DRAM memory, and USD 27 for the flash memory. In addition, the analysis reports that Foxconn procures the 3.5-inch display from LG Display, the battery from Samsung SDI, and the camera module from LG Innotek.

Cooperation with ethnic Chinese companies

Korean companies are able to cooperate with ethnic Chinese companies in various ways in various fields. In Southeast Asia, Korean companies can cooperate with resource-based ethnic Chinese companies. In the 2000s, agricultural processing firms, utilizing the boom in the global resource market, became the leading ethnic Chinese companies. As China and India continue to grow, the resource market will continue to prosper, and ethnic Chinese resource companies will grow further. Therefore, Korean companies should cooperate with Southeast Asia-based ethnic Chinese companies to secure resources in the region, such as timber, palm oil, and coal. They can also cooperate with service companies in Southeast Asia. There is a high possibility for cooperation in traditional sectors like distribution and finance and emerging sectors like media and IT services.

Realistically, Korean companies can hope for cooperation with ethnic Chinese companies in only limited areas in China. As China is highly likely to pursue domestic demand-driven growth rather than export-driven growth, Korean companies should strive to enter China's domestic market. In particular, Korean companies in the service sector need to find ways to cooperate with ethnic Chinese companies that are competitive in distribution, tourism and hospitality. The Chinese market is very likely to become a strategic place for Korean service companies. It is imperative to find areas for cooperation rather than just regarding ethnic Chinese companies as competitors. Japanese companies are involved in many strategic alliances with Taiwanese companies entering China, for instance in the form of capital participation. In areas where they do not compete directly, Korean companies should consider ways to cooperate with Taiwanese companies. In the service sector in which they have low competitiveness, for instance, Korean companies may be better off seeking indirect management through capital participation rather than direct management. C