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China, S.A. as a Local Company in Latin America

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The relationship between the People's Republic of China (PRC) and Latin America has entered new stage, defined by the new physical presence of Chinese firms "on the ground" in the region. The new presence does not supplant the exponential growth of trade between China and Latin America, but, rather, changes the dynamics and imperatives faced by both sides at both a commercial and a political level.

Background

From the 2001 entry of the PRC into the World Trade Organization until approximately 2009, the expansion of Chinese manufactured goods entering the region primarily involved Western multinational firms outsourcing production to the PRC or Latin American traders importing products from Chinese hubs such as Shanghai, Shenzen, or Yiwu. Thus, for most Latin Americans, the new flood of Chinese merchandise did not involve direct contact with Chinese people or companies, except for the small communities of ethnic Chinese present in Latin American cities since the nineteenth century. Similarly, with some exceptions, the expansion of commodity purchases by Chinese companies from Latin America involved large, simple transactions leveraging existing logistics and financial mechanisms. "Getting the goods" required very few Chinese to set up shop in the region.

All of this began to change by the end of the last decade due to a confluence of factors: the growing capabilities of Chinese firms, accompanied by growing experience in doing business abroad; new government-to-government agreements; and new legal, intellectual and financial infrastructures for doing business across the Pacific. The result was a sudden dramatic expansion in the physical presence of Chinese firms operating on

Latin American territory whose impact is only now beginning to be recognized. The new presence of Chinese firms on the ground in the region is impacting local political and economic dynamics, and creating new challenges for the Chinese companies involved, their local partners, and their competitors. It is also impacting the relationship between the Chinese government and its Latin American counterparts, with new questions of when and how to promote or defend the interests of Chinese companies, Chinese citizens, and ethnic Chinese in the region.

The New Chinese Physical Presence in Latin America

The new Chinese physical presence in Latin America principally involves five areas, each with its own logic: (1) extractive industries; (2) loan-backed construction; (3) manufacturing and retail; (4) telecommunications; and (5) logistics.

In extractive industries, large Chinese state-owned enterprises such as Sinopec, CNPC, Chinalco, and China Minmetals significantly expanded foreign acquisitions following the 2008 global financial crisis, generally pursuing proven assets whose owners needed an injection of capital to develop them. Major examples include the $3.1 billion acquisition of Statoil holdings in Brazil and the $7.1 billion investment in the Brazilian holdings of Repsol; the $3.1 billion Bridas acquisition and the $2.4 billion deal for Oxy in Argentina; as well as important deals to acquire minority shares in Galp ($5.2 billion), CBMM, and Perenco, among others.

It is important to emphasize that these transactions did not, in themselves, expand the Chinese physical presence in Latin America, but rather, transferred funds from Chinese banks to largely U.S., Canadian, and European stockholders. Nonetheless, they enabled the new Chinese owners to begin to introduce their managerial and technical personnel and to use Chinese construction and service companies when developing the acquired assets. In Ecuador, for example, the 2005 acquisition of the Canadian firm EnCana allowed the resultant consortium, Andes Petroleum, to bring allied petroleum service companies such as Kerui and CPEB Engineering into the country on subcontracts. The 2006 purchase of Omnimex (now Mansrovar) by CNPC and the Indian firm ONGC Videsh, and the 2008 acquisition of Emerald Energy by Sinochem has helped to bring petroleum service firms such as Kerui and Great Wall Drilling into Colombia.

In the construction sector, the entry of Chinese companies into Latin America reflects the adaptation to Latin America of a model first employed in Africa, involving collaboration and synergies between the Chinese state, Chinese banks, and Chinese construction and equipment companies. The ability of Chinese companies to provide their own financing was proved a competitive advantage, especially in dealing with small countries in the Caribbean and regimes such as Venezuela, Ecuador, and Argentina, who had cut themselves off from Western financial markets. Ecuador's decision to require self-financing in the Coca-Coda Sinclair hydroelectric project, for example, eliminated all contenders but the two Chinese competitors. As a condition, the majority of the value added, including not only workers, but subcontractors and even supplies, is outsourced to China, in inverse proportion to the bargaining power of the regime negotiating the deal. Major Chinese loan-funded infrastructure projects include the Jamaica Development infrastructure program, a new railroad and port and thermoelectric facilities in Venezuela, and eight major hydroelectric projects in Ecuador.

In addition, a number of construction projects by Chinese firms involve Chinese investors, backed by Chinese banks, working with Latin American partners who provide legal access and knowledge. Examples include the Baha Mar resort in the Bahamas, Punta Perla in the Dominican Republic, and Bacholet Bay in Grenada.

In manufactured goods sectors, in about the same time frame, Chinese firms had begun establishing final assembly facilities in Latin America to better serve local markets, and often to avoid paying taxes on the import of finished goods. Typically, these were smaller, provincially backed firms, whose presence in Latin America was closely tied to a local partner, such as the automaker Chery, backed by Anhui province and represented by Cinascar in Colombia. Chery, as well as and the heavy equipment manufacturers Sany and XCMG are building factories in Brazil. Similarly, the light truck manufacturer Foton may establish a manufacturing facility in Bogota with its Colombian partner Grupo Corbeta.

In telecommunications, the Chinese presence is largely the story of two companies, Huawei and ZTE, which have built an enormous retail and network construction and maintenance business from the ground up in virtually every country of the region. Both have tended to use Chinese personnel for technical and management positions, yet employ local personnel in customer-facing areas such as product sales and technical support.

In logistics, large operators such as Hutchison-Whampoa and shipping companies such as COSCO and China Shipping established an early presence in Latin American ports, yet advances are also occurring in companies that have not traditionally operated outside of the PRC, such as China Airport Holdings, which in 2008 partnered with Colombian businessmen to win a concession in six airports in the central-north region of Colombia and has competed for other airport concessions in Colombia, Peru, and Mexico. The story of the deal is illustrative of how local partners are key to the new Chinese presence in numerous sectors. In that case, it was the Colombian entrepreneur Mario Fernando Pinzón who, inspired by the opportunities represented by the PRC, sought out and convinced the Chinese airport operator to pursue business together in Latin America.

New Challenges

The new Chinese physical presence on the ground in Latin America creates numerous challenges for the companies involved, not unlike those faced by Western companies operating in the region a century before. Moreover, they are compounded by the perceived "cultural separateness" of the Chinese from the Latin American communities in which they are operating, as well as limited understanding of Latin American social, political, and economic dynamics by the mid-level Chinese managers who are responsible for day-to-day operations. Such challenges include resistance to Chinese projects, competing for contracts, operational difficulties involving labor and community relations, resistance from environmentalists and other parties, physical security, and actions by Latin American governments.

Resistance to Chinese projects in Latin America has come in many forms, from the attempt by Mexican interests to block the proposed "Dragon Mart" retail, manufacturing, and warehousing complex as a competitive threat, to the intervention by the British government preventing the Cayman Islands from awarding a cruise ship port construction contract to China Harbor Engineering, to delays by the Argentine government in approving the acquisition of Standard Bank by International Commerce Bank of China, to a campaign by local activists blocking China Zhang Heng Tai from establishing a palm oil production complex in Marowijne, Suriname.

With respect to bids and technical proposals, Chinese firms have been more comfortable in the smaller Caribbean states and countries such as Venezuela and Ecuador, where they could negotiate deals at the state-to-state level without formal competitions. Where they have not been able to do so, in projects such as HydroItuango and Socamisa in Colombia or the contract to operate the port of Valparaíso in Chile, they have been less competitive.

With respect to operational issues, differences between the Chinese management model and Latin American expectations have repeatedly created problems in relations with local labor forces and subcontractors, particularly in the extractive industries. In addition to recurrent strikes against the Chinese management of the Shougang Hierro mine in Peru, violent labor unrest has occurred against Petroriental's oil fields in Orellana, Ecuador, and the Cerro Dragon mine in Argentina, in which the Chinese firm Bridas has a major equity stake. Protests over unmet expectations in hiring local workers or subcontractors has occurred against China Jiangsu in Trinidad, against China Harbor in Jamaica, against the Chinese logistics operator Hutchison Port Holdings in the Bahamas, against China Water and Electric in Iquitos, Peru, and against China Railroad Engineering Corporation in Venezuela, among others.

Because the new Chinese presence is concentrated in environmentally problematic industries such as mining, petroleum, and dam construction (involving the expropriation and flooding of large tracts of land), its projects have generated resistance from environmental groups on numerous occasions, including the successful derailing of the Rio Blanco mining project near Piura, Peru, the Rio Negro agricultural project in Argentina, and the Tiejsu dam project in Chone, Ecuador, as well as national protests against the El Mirador mining project in southern Ecuador. Although Chinese companies are becoming more sophisticated in dealing with such issues (such as Chinalco's hiring of a firm with a good environmental track record to administer the Toromocho project in Peru), they will continue to be hampered by the relative lack of experience with environmental politics in Latin America.

Chinese businesses are also discovering that the remote areas of Latin America where the new Chinese physical presence is concentrated can be dangerous areas to operate. Chinese workers were kidnapped in Tarapoa, Ecuador, in November 2006, in Caquetá, Colombia, in 2011, and on a regular basis in Venezuela. The Chinese-owned Omai bauxite mine in Linden, Guyana, was blockaded in September 2012; the Chinese-owned Colquiri mine in Potosi, Bolivia, was overrun in June 2012; and more than 30 people were killed during the blockade of a Petroriental oil field in Orellana in June 2007.

Finally, the new Chinese presence on the ground in Latin America makes it vulnerable to the actions of the governments where it operates. This is a particular problem, since the new Chinese projects are disproportionately concentrated in the countries in the regions with the worst track records of respecting investors, such as Venezuela and Argentina. Chinese construction of a new petrochemical complex in Tierra Del Fuego has been blocked by the Argentine government's restrictions on importing supplies. In Venezuela, Chinese frustration in dealing with PdVSA has paralyzed progress in negotiating the development of the new Junin-1 and Junin-8 oilfields in the Orinoco. Similar frustration with delays in China-financed construction projects led the PRC to deny Venezuela a new $4 billion line of credit in February 2013.

The ability of the Chinese companies to deal with these problems will depend on the interaction between three dynamics simultaneously set in motion by the new physical engagement: increased conflict, accelerated learning that comes from operating on the ground, and increased "soft power" from being a local employer, provider of revenue to the government, and part of the local business community. Chinese embassies in the region and the Chinese government will also have to re-think how to respond to the legitimate requests from Chinese companies and nationals for assistance as they occasionally brush up against the Chinese policy of "non-interference in the internal affairs of other countries."

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