Chinese Government Plans Consolidation of Domestic Industry

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On January 22, China's Ministry of Industry and Information Technology (MIIT) led 12 Chinese government departments in the issuance of a guidance document calling for the consolidation of competitors in nine different industries through mergers into a small number of large companies: the Guiding Opinions Concerning the Accelerated Advancement of Enterprises in Key Point Industries through Merger into Concentrated Groups.

The Guiding Opinions are intended to speed the consolidation of smaller competitors into larger group companies as called for by China's State Council in 2010. That effort has progressed slowly as companies and the various government interests behind them have resisted absorption into larger entities and the loss of local employment and tax revenues.

The effort is now likely to receive more support, as the 12 government departments include the most important government regulators, including the powerful National Development and Reform Commission and Ministry of Finance.

The nine targeted industries are automobile, steel, cement, shipbuilding, electrolytic aluminum, rare earths, electronic information, pharmaceuticals and agricultural processing.

In each case the Guiding Opinions identify an industry with many players and call for an aggressive program of consolidation to form a small number of large, globally competitive players.

While there are reasons why a more concentrated industry may be more efficient, the effort to dictate the number and identity of survivors reflects China's planned economy heritage. Rather than allow the market to sort out winners and determine economies of scale, the selection by government of so-called "dragon's head enterprises" is tantamount to creating national champions.

While the Guiding Opinions recognize a need for transactions that meet the relevant turnover threshold to obtain antimonopoly clearance under the Antimonopoly Law, the inclusion of the three antimonopoly enforcement agencies among the issuers of the Guiding Opinions indicates that such clearances are likely to be a formality.

Moreover, while foreign companies are in principle welcome to participate in such industry consolidation, official commentary notes that their participation will be subject to national security review. As such review applies to dozens of industries, even those like pharmaceuticals and agricultural processing that have little or no direct linkage to national security as conventionally defined, foreign businesses are unlikely to find a warm welcome in the industrial consolidation program.

Moreover, use of the word cangu (participate in equity) rather than konggu (control) indicates that any foreign investment in these industries is likely to be limited to minority, non-controlling positions.

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