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Going Global, Going West! Chinese Direct Investment in Germany

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Germany and Asia
Building Bridges – Promoting Progress

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Chinese investors are welcome! Germany's Federal Minister of Economy, Sigmar Gabriel, made this clear at the opening ceremony of the Chinese Chamber of Commerce in Berlin in January 2014. His words were not only meant as an invitation to Chinese companies, but also as a piece of advice for Germany's business community and broader public. Chinese investors are often perceived to be going on a "global shopping spree" with a "political checkbook", not only in Germany but everywhere in Europe. Some observers even suggest stricter controls for investors from specific countries, such as China. The German government is right to pursue the principle of a free trade and investment regime, while insisting that China's government should level the playing field for foreign companies, too.

What do Motorola, Medion and Volvo have in common? They were (fully or partially) acquired by Chinese companies in the past four years. The same is true for some of Germany's "hidden champions", such as Putzmeister and Schwing (manufacturers of concrete pumps), Kiekert and Sellner (automotive suppliers), Solibro and Sunways (PV manufacturers). Chinese companies are increasing their acquisitions of Western businesses. Most importantly, they target high-tech industries and well-known brands. The phenomenon of outward foreign direct investment (OFDI) from China is not entirely new. Their recent expansion to Europe and North America, however, may appear exotic from a western perspective, since large waves of inward foreign direct investment (IFDI) flowed into China for more than two decades, whereas OFDI from China was low. Growth rates have been high, though, especially since the central government proclaimed the "going global" strategy in 2000: In only 14 years, Chinese OFDI

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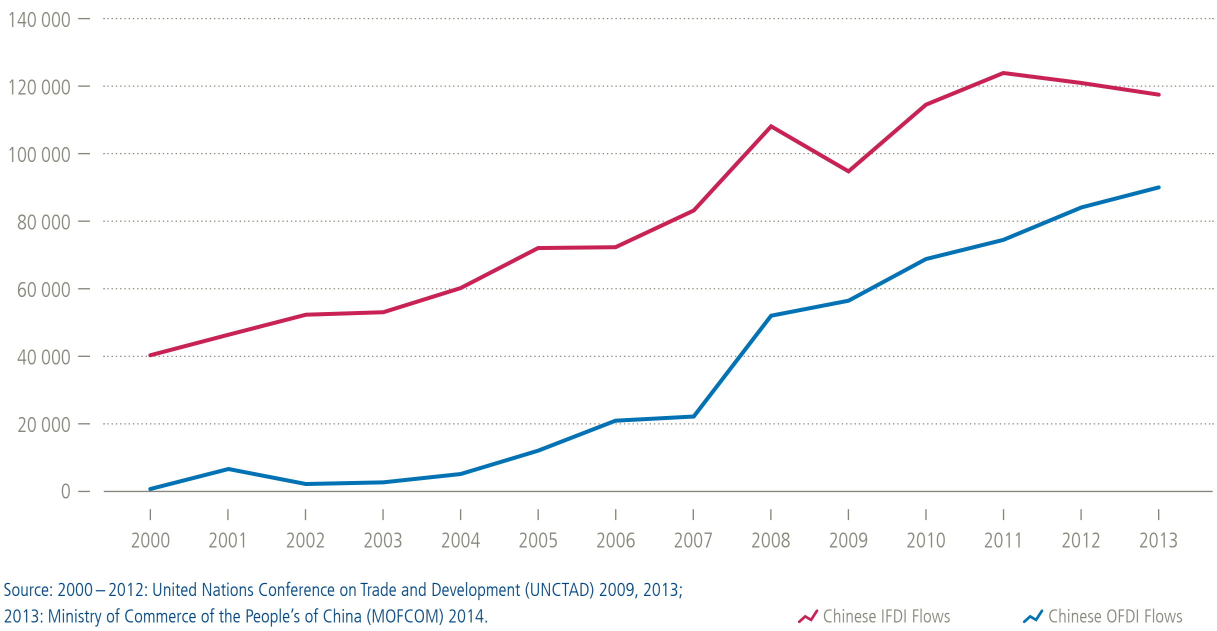
flows grew more than hundredfold and surged from 0.9 billion USD in 2000 to 90.2 billion USD in 2013 (Figure 1).

Core goals of the "going global" strategy include access to markets, resources and cutting-edge technology. The political agenda wants Chinese companies to become truly global players – Chinese Siemens', Sonys, and Samsungs – and to part with their role as original equipment manufacturers (OEMs) to western multinationals. The Chinese government regards this as an important prerequisite to upgrading the country's economic structure, progressing in the global value chain and reducing China's reliance on exports. It also is the explicit goal of the government that China shall no longer be the "factory of the world" in the 21st century, but rather assume the role of the "research lab of the world". Corporate and political interests go hand in hand here, as Chinese companies regard their "going global" as a key to enhancing their international competitiveness, to creating global brands, and to strengthening their research and development (R&D) capacities.

Chinese decision-makers in politics and business assume that these goals will be achieved through OFDI in developed countries. Therefore, these are one of the foci of both the government's "going global" strategy and the internationalization strategy of a large number of Chinese companies that plan to invest abroad or have already done so. While over two thirds of the Chinese OFDI stock are accumulated in Asia, the European Union (EU) and North America have started to catch up in the past decade and, in 2012, held about eleven percent (2005: 3.6 percent). Within the European Union, Germany ranked third as investment destination in this year, right after the United Kingdom and Luxembourg, where – in the past – financial-sector investment played an important

Figure 1: Chinese IFDI and OFDI flows in million USD, 2000–2013



Source: 2000–2012: United Nations Conference on Trade and Development (UNCTAD) 2009, 2013; 2013: Ministry of Commerce of the People's of China (MOFCOM) 2014.

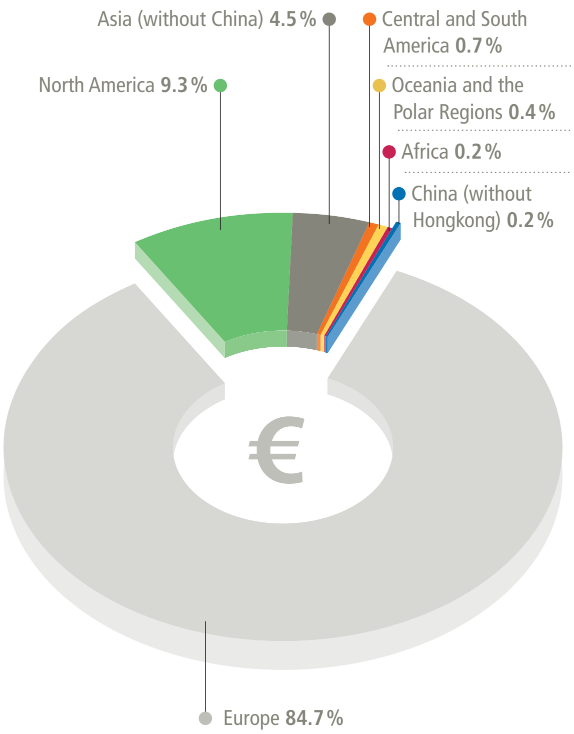
role. In Germany, OFDI in the manufacturing industry have been a focus of Chinese investors. According to the Chinese Ministry of Commerce (MOFCOM), Chinese annual OFDI in Germany grew more than thirtyfold, from 25 million USD in 2003 to 800 million USD in 2012.

Germany – "Fertile soil" of Chinese companies' going global?

Such was the headline of an article in a Chinese trade magazine in 2006, which praised the advantages of Germany as an investment location and recommended Chinese companies to consider Germany as OFDI destination. Since then, Chinese investment flows to Germany have grown on an annual average of 66 percent, following the data of MOFCOM. Also, Chinese companies have bought or invested in at least 80 German businesses according to our own research. Chinese investors stem from a country that is both fascinating and frightening in German public opinion. Their activity in Germany therefore appears to attract above-average attention. Reactions from German politics, business and the media towards Chinese OFDI and especially towards acquisitions are ambivalent: On the one hand, the "shopping spree" could result in German employment, technology and know-how being sold off to China, as it happened with a coking plant in 2006. On the other hand, some recent cases have shown that German companies may profit from a Chinese investor in terms of smart division of labor, improved access to the Chinese market and the creation of additional jobs. Crunching the numbers, it becomes clear that none of the two sides solely meets reality – yet.

Although data on Chinese OFDI differ widely, depending on their source, they show that – no matter which set of data we look at – Chinese investment in Germany still is marginal despite high two-digit growth rates in recent years: According to MOFCOM, Germany held only 0.6 per cent of China's accumulated investment abroad in 2012. Data from the German Federal Bank tell a similar story: Chinese companies contribute only 0.2 per cent to accumulated foreign direct investment in Germany (Figure 2). Chinese investors are a minority when it comes to the acquisition of German companies as well: A recent study by BGM Associates shows that only 16 out of

Figure 2: FDI stock in Germany by geographical origin in percent, 2012



Rank	Country	Million Euro	Percentage
1	Netherlands	140,180	23.5
2	Luxemburg	86,668	14.5
3	United States	53,773	9.0
26	China	1,388	0.2

Source: German Federal Bank 2014

1,170 acquisitions in 2012, or 1.3 percent, were conducted by Chinese investors.

Due to varying definitions, the total number of Chinese companies in Germany is difficult to assess, ranging from 62 (German Federal Bank, 2014, including only those companies with a balance sheet total of at least three million Euro) to over 2,000 (Chinese Embassy in Germany/China Radio International, 2014, no restrictions). Even if one takes the higher number, it is way below the estimated 5,000 to 8,200 German companies in China. This also yields a strong asymmetry in Sino-German investment relations: In 2011, Germany's accumulated investment in China was more than eightfold that of Chinese companies in Germany.

The Chinese government is determined to change this situation. The so-called country-industry register therefore explicitly recommends Chinese companies to invest in Germany, especially in the machine tool and automotive sector, but also in information technology and renewable energy. The guide book "Invest in Germany" by MOFCOM in part even reads like a marketing brochure of a German investment promotion agency: the authors praise "made in Germany" as a token of quality, point to Germany's world-famous consumer and industrial brands, draw attention to the deeply-rooted awareness of environmental protection and emphasize Germany's reputation as a high-tech nation. The section on Germany's business environment also highlights that foreign investors basically enjoy market access equal to German businesses, and that by and large there are no specific restrictions for foreign investors in certain industries. From a Chinese vantage point, Germany offers an open investment environment and does not discriminate against foreign investors in regard to their country of origin.

In the eyes of Chinese companies, access to markets, technology, know-how, brand names and distribution channels are among the top motives for investing in Germany, which thus indeed is a "fertile soil" for Chinese investment. The "going west" initiative of Chinese companies may have started from a modest level, but – assuming that growth rates continue to be high – they have the potential to catch up in the long run. This development will bring about both challenges and opportunities.

(Never) mind the gap? Challenges of Chinese investment in Germany

Germany is a highly industrialized country with a complex regulatory framework and mature markets. OFDI from emerging economies, such as China, imply challenges not only for the investing companies but also for Germany as the receiving entity. There is a wide gap between Germany and China regarding their political, cultural, economic and legal systems.

Chinese companies are buying an increasing number of German technology leaders. Among the Chinese acquirers, there have been a large number of state-owned enterprises, e.g. the new proprietors of Kiekert and Schwing. This has brought about public fears of the Chinese government entering Germany through the corporate backdoor. Chinese government institutions continue to emphasize that state-owned firms are "normal" economic actors. This is not sufficient to ease these concerns, however.

Moreover, the long-term effect of Chinese OFDI in the form of the acquisitions of German companies is difficult to estimate, especially since most of them took place in the last three years. At first glance, it appears that both sides could profit in many cases. The division of labor – high-tech in Germany, low-tech in China – chosen in some cases, e.g. in the machine tool sector, may be good for Germany in terms of value added and the creation of high-skilled jobs for now. It also means, however, that even more less-skilled jobs and production processes are being moved to China or other countries. It further is the explicit goal of most of the Chinese parent companies to use their German subsidiary as a training center for their staff in order to strengthen R&D facilities in China, which has been characteristic especially for acquisitions in the machine tool sector. Transfer of know-how and technology will thus be unavoidable in the long run. This may happen even more quickly than presumed, since Chinese companies have shown in the past that they are able to learn quickly. Which parts of the value chain will remain in Germany after an acquisition, when Chinese companies take more and more links back to China, therefore is an important question.

On the corporate level, Chinese investors have to deal with differences in management styles, notions of doing business and approaches to strategic planning. These challenges intensify in the case of acquisitions, as two diverging corporate cultures have to be reconciled. This post-merger integration, which is crucial for an acquisition to succeed, is a complex task even for companies from the same cultural background. Industry-specific issues may add to the difficulty of the integration process: In the crisis-shaken solar sector, Chinese acquirers appeared to be the saviors of struggling companies and their employees first, but in some cases had troubles to live up to these expectations (e.g. Sunways).

The acquired German company has to develop coping strategies regarding its customers, employees and the public. Customers fear a negative impact on product quality due to the new proprietor from a country known for cheap "made in China" trash. Employees are afraid of their jobs being outsourced to China and the international reputation of their employer being damaged when it suddenly becomes Chinese. Kiekert and Putzmeister had to engage in intensive communication with customers and employee representatives in order to reconcile them with the idea of a Chinese proprietor. Since the role of trade unions and employee participation in corporate decisions in Germany generally differ from the situation in China, Chinese investors themselves will have to learn to deal with this part of Germany business culture, which for most of them is a new and strange experience. Public perception of Chinese OFDI in Germany has become more differentiated in recent years, but fears of Germany's technological sale to China linger on. Even though these perceptions partially are nourished by prejudices, both the Chinese and the German sides have to deal with them.

Small, yet growing – Opportunities of Chinese investment in Germany

Although Chinese OFDI in Germany still is in its infant stage, it is worthwhile to address the opportunities these investments may offer for the German economy and German business. From an economic perspective, growing OFDI flows from China to Germany could gradually ease the imbalance of mutual investment between Germany and China, which would strengthen the interconnectivity of the two markets and their distribution networks. Chinese OFDI may create jobs and additional value added and thus contribute to overall economic growth.

In fact, Chinese investors already have created employment opportunities in Germany and in the case of some acquisitions even saved jobs threatened by the insolvency

Table 1: Characteristics of major foreign investors in Germany compared with Chinese investors, 2012

	Number of companies	Employees (in thousand)	Turnover (billion Euro)
All countries	**14,999**	**2,740**	**1,488.2**
Netherlands	2,821	624	297.7
Luxembourg	1,987	322	136.9
United States	1,406	287	134.6
China	62	5	2.1

Source: German Federal Bank 2014

of the targeted company (e.g. Sellner). Compared to Germany's most important foreign investors, among them the Netherlands or the United States, Chinese companies' impact on the job market has been limited so far (Table 1). They currently employ about 5,000 employees. We must consider, though, that Chinese businesses have only recently started to increase their investments in Germany and thus are latecomers compared with companies that have invested there for several decades.

For German companies, acquisition by a Chinese company can be an interesting opportunity. Just as Chinese investors regard Germany as their "door to Europe", they may in turn help open the "door to Asia" for their German subsidiaries. Especially German *Mittelstand* companies with their restricted resources may find it advantageous to push their expansion on the Chinese market under the umbrella of a Chinese parent company with well-established distribution channels. Kiekert opted for a Chinese company because China is one of the most important markets for the automotive industry. Moreover, a growing number of German family-owned businesses have to look for external investors as successors. Since many Chinese acquirers pursue the goal to gain a long-term foothold on the German market, some of them have been willing to commit to a specific corporate location and even give out a job guarantee to the employees for several years (e.g. Putzmeister and Medion). If this is the case, the fit of Chinese investors with the traditional German *Mittelstand* is far better than that of short-term oriented financial investors from other countries, which may only have the goal of reselling the company bit by bit.

The division of labor mentioned above may create positive synergy effects on the corporate level if the production of technology-intensive components remains in Germany, whereas low-tech production processes are outsourced to China. German companies struggling with high production cost may have the chance to increase their competitive edge on the German and other markets and to concentrate on their core competence in the high-tech segment.

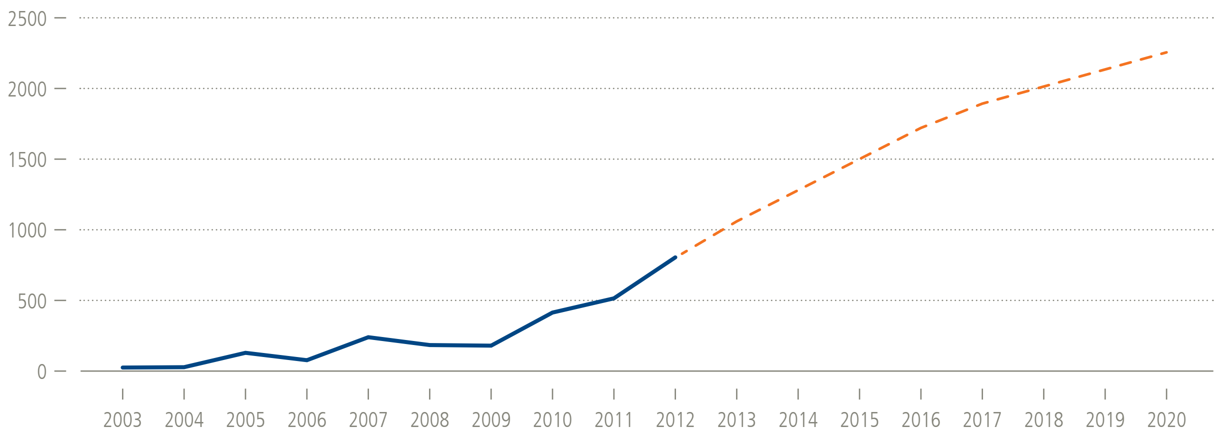
To sum up, the overall effect Chinese investment has on the German economy is still small, especially in comparison with other foreign investors in Germany. For a German company that has been bought by a Chinese investor, the new ownership may imply a range of opportunities, which could even outweigh the challenges.

Outlook on Chinese investment in Germany

Chinese investors go west and come to Germany. Here, Chinese OFDI has been on the rise in the last decade. While its accumulated level is currently too low to have any substantial impact on the German economy, they may positively impact individual businesses. In public opinion, skepticism is still strong in regard to investment "made in China", whereas high-level German politicians have started to actively encourage Chinese investment and to refute possibilities of stricter controls on both trade and FDI, as they appeared on the EU agenda in 2012 and 2013, respectively. The German government is right to pursue the principle of a free trade and investment regime, while insisting that China's government should level the playing field for foreign companies, too.

It is crucial to strengthen the exchange between policy-makers, industry associations and companies in Germany so to better understand mutual expectations and to reduce misunderstandings. This was an important topic during the first two rounds of Sino-German intergovernmental consultations in 2011 and 2012. It was against this backdrop that China founded the Chinese Chamber of Commerce in Berlin. The Chamber pursues the goal to help Chinese investors to find their footing in the German business environment. It also aims to engage with government institutions and the broader public in both countries. The next round of intergovernmental consultations will take place in fall of 2014 and

Figure 3: Chinese OFDI flows to Germany, 2003–2020



Source: 2003–2012: Ministry of Commerce of the People's Republic of China (MOFCOM).
2013–2020: Prognosis by Prognos AG on behalf of Bertelsmann Stiftung based on MOFCOM data.

may present an opportunity for a first discussion on the Chamber's work.

For Chinese companies in Germany, it might prove helpful to put a stronger emphasis on direct and transparent communication not only with their customers but also with other important stakeholders in German business and society. Especially when it comes to an acquisition, the communication strategy of the Chinese acquirer may play a crucial role in allaying the fears of those actors directly involved, such as the employees, and also in easing the more diffuse concerns of the broader public. The results will impact public perception on specific cases of Chinese acquisitions, but also on Chinese OFDI in Germany in general.

In the future, Chinese companies will intensify their efforts to catch up in terms of market access, technology and management know-how through OFDI. Given its technology leadership in key industries, its central geographic position in Europe and its highly skilled workforce, Germany has all the advantages to remain highly attractive as a destination for Chinese investment. Our prognosis based on MOFCOM data shows that annual Chinese OFDI flows to Germany will at least triple again until 2020, reaching 2.2 billion USD that year (Figure 3). As the number of Chinese companies in Germany and that of their German employees continues to grow, both sides will face the challenge to contribute to narrowing down the gaps between them. Chinese companies may have to find an approach to their new identity as part of German business and society. The latter might have to come to terms with the fact that Chinese companies – just as Japanese and South Korean ones did before – will become an integral part of the German economy. It will be interesting to see in how far this leads to mutual impact, i.e. Chinese companies influencing Germany's business environment and vice versa.

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Further reading:

BGM Associates. Dragons and Tigers Hunting in Germany: Chinese and Indian acquisitions of German firms 2002–2012. January 2013. http://www.bgmassociates.com/fileadmin/downloads/publications/bgm_research/BGM Associates Research - Dragons and Tigers Hunting in Germany.pdf

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