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Thesis Topic

# Chinese Foreign Direct Investment to Germany


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# Abstract

China successfully attracted massive inflows of foreign direct investment since the beginning of its open door policy in the late 1970s. Recently however, this trend has been reversed and China itself became a major supplier of FDI for other parts of the world. This development is part of a larger strategy termed *The Go Global Policy*- officially adopted in the tenth five-year plan and creating a host of OFDI-friendly policies for Chinese enterprises. While China primarily invests into other developing and emerging economies, it also slowly emerges as an investor in developed markets- a development furthered by its massive holdings of foreign reserves. In particular Germany has developed into one of the primary locations attracting Chinese OFDI. While extensive attention has been devoted to Chinese OFDI flows to developing countries, little is known about its activities in developed markets like Germany. This case study based research paper concludes that Chinese FDI to Germany is largely limited to urban- and industrial clusters. While M&A in industrial clusters is the fastest growing entrance strategy for the Chinese, the takeover process is increasingly welcomed by German companies seeking to be taken over for own strategic reasons. The Chinese capacity to preprocess at low prices, access to the Chinese market and supply with funds are all key factors in shaping such a consensus-based M&A. However, as European governance provides for a variety of social and governmental stakeholders, the investment process is also highly regulated. Given a loophole on European level, the federal Republic has been able to extend its capabilities to direct and impinge upon Chinese FDI across all sectors. As this potential for regulation is largely not employed in practice, conflict between social and governmental stakeholders becomes increasingly likely, as unions already point to malpractice and violations by Chinese investors. Furthermore, hollow Chinese investments on municipal level may cause a general bias towards OFDI from China, which will make approval of future projects unlikely.



**Key Words:**

Foreign Direct Investment, OFDI, Go Global Policy, China

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# Abbreviations

**BIT**- Bilateral Investment Treaty

**BMWI**- German Federal Ministry of Economics and Technology

**BRIC**- Brazil, Russia, India, China

**CEO**- Chief Executive Office

**CIC**- China Investment Corporation

**DAX**- German Stock Index

**DB**- Deutsche Bank

**EME**- Emerging Market Economy

**EP**- European Parliament

**FDI**- Foreign Direct Investment

**GIGA**- German Institute of Global and Area Studies

**GTAI**- Germany Trade and Invest (National German Investment Promotion Agency)

**IMF**- International Monetary Fund

**MNC**- Multinational Corporation

**MOFTEC**- Ministry of Foreign Trade and Economic Cooperation

**NDRC**- National Development and Reform Commission

**OECD**- Organization for Economic Co-operation and Development

**OFDI**- Outward Foreign Direct Investment

**PRC**- People's Republic of China

**SAFE**- State Administration of Foreign Exchange

**SETC**- State Economic and Trade Commission

**SEZ**- Special Economic Zones

**SME**- Small and medium enterprises

**SOE**- State-Owned Enterprise

**SWF**- Sovereign Wealth Fund

**TNC**- Transnational Corporation

**UNCTAD**- United Nations Conference on Trade and Development

**WTO**- World Trade Organization

# 1. Introduction

## 1.1 Motivation

***"China is taking over the European Union- and we Europeans sell our soul."*** [1]

- German EU Commissioner Günther Oettinger

The emergence of Foreign Direct Investment is a central result of ongoing economic globalization. Investment flows between countries establish new contexts of economic exchange and integration. Formerly, triad countries like Japan, Germany or the United States exclusively dominated Foreign Direct Investment, making the Western World the central source of FDI. (Dunning/ Kim/ Park 2008, 1) During the early 1980s, new players from East- and Southeast Asia started to emerge. These co-called tiger states; usually referring to Singapore, South Korea and Taiwan; started to intensify their investment relations with the outside world rapidly. (Mathews 2006, 5) Only recently have new players entered the stage and gained hold in this type of capital movement, stirring much concern. The emerging BRIC economies (Brazil, Russia, India and China) all have their staggering size and rapid speed of development in common- leading to the assumption they will eventually move beyond their mere potential. (Deng 2008, 17) One of the most discussed examples is China, which started to appear as an investor in developing countries early on, but recently also extended its activity into the developed markets. (Schüller/ Turner 2005, 11)

China has been successfully attracting Foreign Direct Investment since the beginning of its open door policy in the late 1970s. For the first time, in 1993, China became the largest single recipient of Foreign Direct Investment among all developing economies, continually improving its rank among all other nations since 2006.[2]

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[1] Original: *China übernimmt die EU, und wir Europäer verkaufen unsere Seele*. Quoted from: SZ 09.13.2011

[2] UNCTAD's *World Investment Report 2004* (Annex table B.1, pp. 367 /370); UNCTAD Investment Brief Number 1, in 2007 China was ranked No. 2 (after the U.S.) in 2004

As mentioned above, China however is not only experiencing an inflow of FDI, but has itself become a major source of FDI for other parts of the world. This development is part of a larger strategy dubbed *The Go Global Policy* (走出去, Zǒuchūqù), which was officially adopted in the tenth five-year plan of October 2001. (Cheng/Ma 2008, 8) In the following years, Chinese companies have set up shop abroad and entered foreign markets as investors. Accordingly, Chinese outward investment rose from around 2.7 $ billion in 2002 to 56.5 $ billion in 2009, while direct investment rose from 29.9 $ billion to 245.7 $ billion for the same time-span.[3]

Extensive research exists with regards to FDI flowing from China to countries of the Global South (such as in Asia, Africa and Latin America), yet little research has been undertaken on the role of China as a source of outward FDI (OFDI) to developed markets in particular.
With the establishment of the China Investment Corporation, a Sovereign Wealth Fund with resources of more than US $200 billion, Chinese OFDI has received growing scrutiny in the US and Europe. (Berger/ Berkofsky 2008, 2) And indeed, Germany has in the past years developed to become one of the primary locations attracting Chinese OFDI. (Cheng et al 2008, 13) Media have picked up on the story and reacted with a mixture of fear and enthusiasm to the new development. The notion that China will eventually buy up German companies' technological advantages, and particularly target them for their know-how, creates negative sentiments in the wider public. (Milleli/ Hay 2008, 12)

Since then, media and politicians warned of a Chinese buying spree in Germany. Where China's economic potential and staggering growth rates are concerned, outward direct investment from China may soon become an important factor for further economic development in Germany. (Chow 2010, 60) While there is a multitude of research on the Going Global Strategy and OFDI to Germany, there is no actual in- depth analysis of the integration between the Chinese and the German economies. Some cases underline the potential dangers of inviting Chinese FDI in, while others highlight the positive impact this has had on German companies in

[3] Refer to: 2009 Statistical Bulletin of China's Outward Foreign Direct Investment. Ministry of Commerce, http://hzs.mofcom.gov.cn/accessory/201009/1284339524515.pdf

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financial distress. (Chuang 2010, 18) Largely left in the dark however, remains the capacity of Germany's governmental and social actors to regulate and shape Chinese OFDI. This study aims to bridge the gap between a wider discussion of Chinese OFDI flows and the largely ignored roles of managing institutions in government and society alike.

## 1.2 Research Objective

While Chinese Outward Foreign Direct Investment is by no means a new phenomenon, little research has been undertaken with regards to the managing capacity of governmental and social actors in Germany. As perceptions of OFDI from China to Germany have shifted quite considerably; now ranging between suspicion and fear; it seems all the more important that such a study be undertaken at this point in time. OFDI from China is not simply a free-flowing phenomenon, happening largely on its own terms in the respective recipient countries, but is subject to- and regulated by local legal frameworks and vested interests of different stakeholders. Therefore the study of these stakeholders and their respective roles -embedded into a wider discussion of Chinese OFDI- will contribute to a more thorough understanding of these developments.

The possibilities of- and roles played by governmental and social stakeholders alike are an exciting and highly relevant question. This thesis takes a wider perspective, thus not only narrowing itself to the analysis of the individual actors, but also embedding it into a wider discussion of China's OFDI rationale, trends, perspectives, resistances and overall developments to Germany.
For this purpose, the development of OFDI flows from China to Germany needs to be analyzed before the background of standard theory of direct investment determinants, the general investment behavior of companies, and FDI flows from developing and emerging economies. Since China's economy is highly susceptible to state influence, the particularities of Chinese OFDI need to be discussed and taken into consideration here.

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The analysis of Chinese OFDI to Germany needs to comprise of statistical aspects beyond the theoretical discussion. How large has Chinese FDI become, how has it developed and what are the characteristics of its sector- and geographical distribution? Furthermore the motivation of Chinese companies needs to be taken into consideration- is there any sector focus that requires specific attention?

Only with a thorough understanding of the background of Chinese OFDI, its size and motivations, can a fruitful discussion of its local management be undertaken. Without this background, conclusions on the management capabilities of German stakeholders fall short of acknowledging the complex and comprehensive parameters determining Chinese FDI flows.

## 1.3 Research Design

As stated above, this study will attempt an examination on a currently insufficiently explored subject. The actual setting of the issue to be discussed is one of wider political and economic relevance, since developments in economic relations between states are concerned. While for many years investment exclusively flowed from the Northern hemisphere to the Global South, and then later on from South to South, we still know little about the specifics of South to North investment flows. This research therefore aims to make a contribution as to providing further in depth analysis in this sense. Germany and China are both economic heavyweights with increasing cooperation that now flows both ways. There is little research available on where this relationship may be leading before the background of increasing OFDI. The access of Chinese companies and Chinese state funds will likely impact increasingly on Germany, yet we know little about the capability of the German government and society (let alone the EU) to respond to- and influence these OFDI flows.

In the light of the diverse body of literature available with regards to the topic, in the first half this study employs a deductive approach- starting from basic theoretical models of Foreign Direct Investment and then closing in on the topic of Chinese OFDI in several steps.

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First, primary data is employed to provide a general overview of developments and the nature of OFDI flows from China to Germany. This is done through theoretical literature, existing research and statistical data from multiple sources. Since variations exist with regard to congruence of data, statistics are employed to provide insights into general trends. After this, secondary data such as existing research papers, journals, books, and media sources are utilized to enhance further the outcomes of this analysis. They further contribute towards the analysis of Chinese OFDI in terms of quality as well as its spatial- and sector distribution.

The second half of the paper is primarily based on case study research, secondary data an additional expert interview. The interview has been conducted in a wider fieldwork with a high-ranking official from a state ministry of Economics. Furthermore, press releases were supplied through the federal Ministry of Economics.

Secondly, the role of social agents in Chinese OFDI is assessed through secondary data. Since their means of influence are clearly stated by law, case studies suffice to highlight their role. For social actors in particular, media analysis was used as a helpful tool in exploring their capabilities and strategies vis-à-vis Chinese investment.

To sum up, the research will discuss the topic along **four basic research questions**:

- How has Chinese OFDI to Germany developed?
- What can be said with regards to nature, quality and size of Chinese OFDI to Germany?
- What is the spatial- and sector distribution of Chinese direct investments in Germany?

And as my **central research question**:

- What influence is the German government (or the regional states/ or EU) able to exert on Chinese investment today and in the future? What is the influence of social agents (esp. workers unions) on Chinese investment in Germany?

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## 1.4 Literature

The first chapters of this analysis will be based on existing research that is available in abundance, albeit its individual limitations.

The study of direct investment is a comparatively young discipline, emerging around the 1960s and 1970s. Several theoretical models have developed as groundwork for this discussion, most notably John H. Dunning's elaborations on FDI. As his theoretical assumptions have undergone considerable critique (as FDI and its stakeholders have evolved over time), diverging theoretical models will be taken into consideration as well. Yet his *Eclectic Paradigm* and *Investment Development Path Hypothesis* have remained the foundation of any discussion on Foreign Direct Investment.

A host of literature exists on the specifics of FDI from emerging economies and China in particular. These range from theoretical discussion to case based studies. The very basic assumptions however, are mostly derived from the United Nations Conference on Trade and Development (UNCTAD) which not only provides a numerical analysis but furthermore a qualitative review of emerging economies' FDI activity. Further statistical discussion is based on not only UNCTAD's statistical program UNCTADstat but also on the statistical data provided through the German Central Bank, Chinese official statistics, and the European Statistical Agency Eurostat.

Third, literature on China's specific and particular economic development and FDI formation is available in abundance. This entails literature from an economics- as well as a developmental perspective. In particular the discussion of China's Outward Foreign Direct Investment and China's Go Global Policy by Li Zhaoxi (in Larcon 2009) are employed to explain the specific configuration of Chinese FDI activity. Li Zhaoxi's discussion, published in cooperation with the *École des Hautes Études Commerciales de Paris* and *Tsinghua School of Economics and Management*, is the most current publication on the Chinese OFDI regime.

Academic literature on Chinese OFDI flows to Germany has remained more or less sparse until to date. While various publications exist, their respective depth, extent and

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reach is limited, leading to fragmented analysis. Nonetheless, several papers by non-governmental institutions such as the German Institute of Global and Area Studies (GIGA), the EU-China Civil Society Forum, the German Center for Market Entry and Bertelsmann Stiftung all elude on the topic.
Correspondingly, the later half of the paper on respective management roles of German stakeholders in government and society is based on individual research and fieldwork.

## 1.5 Organization of Chapters

Step one is a theoretical introduction to OFDI as such. The basic concept (theoretical and practical) is explained and motives of OFDI are discussed. This is followed by a discussion of the most important theoretical models and explanations. The general theoretical excursion is followed by an in-depth discussion of OFDI flows from BRIC countries and provides further clarifications on the context of Chinese OFDI. This chapter provides a basic introduction to the state of the Chinese economy, its Going Global Policy and China's Sovereign Wealth Fund.

The second half comprises the main body of the research. It brings together the findings of existing literature on Chinese OFDI and includes for a thorough analysis of Chinese OFDI to Germany. Thereafter the study concludes with an assessment of development, nature, quality and size of Chinese OFDI to Germany. In its course, questions of spatial- and sector distribution of Chinese OFDI in Germany are addressed. The chapter does further aim to provide several short case studies of Chinese companies, which offer exemplary insights into the results reaped from the macro-perspective analysis. The last step rounds up the analysis by shedding light on the ability of governmental and social stakeholders to shape and influence the inflows of OFDI from China. This section explains their roles in past and present, as well likely future developments. Furthermore, it assesses the conflict potential between the different spheres of institutions engaged and the trends that can be derived from the analysis.

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# 2. Theories of Foreign Direct Investment

## 2.1 Terminology and Distinction

The common understanding of the term Foreign Direct Investment is that of a capital investment (i.e. acquisition of a substantial share of a company) with the aim of exerting influence on the management. (Duce 2003, 2) Often several aims prevail, yet control is central to the definition of direct investment. (Haas, Neumair & Schlesinger 2009, 80) FDI can either take the form of equity capital investment, reinvestment of profits, investment of real assets as well as financial- and business loans. The direct investment is only termed "*foreign*", if giver and receiver do not reside in the same country and a monetary flow across borders is created. In Foreign Direct Investment, capital is transferred from one actor to another. This capital can take many forms, including not only money, but also goods, trademarks, knowledge or technology. The term FDI needs to be distinguished from that of Portfolio Investment. Portfolio Investment only aims to reap profit and diversify risks, yet has no interest in creating actual managerial control on the side of the investor. Portfolio Investments are furthermore capital based, i.e. they do not entail the transfer of intangible assets. (Neumair 2006, 41-60)

Admittedly, the ambiguity of the term *Foreign Direct Investment* may not be realized at first sight. In managerial practice, it is difficult to establish any clear notion of the term "influence / control" that is central to FDI. Following a definition by the International Monetary Fund, a direct investment requires at least 10 per cent shareholding from abroad to be termed Foreign Direct Investment. Other sources suggest a number of around 25 per cent with regards to a credible influence to be exerted. The German Central Bank has long followed this approach, but has returned to the 10 per cent threshold in 1999. (IMF 2004) This paper will therefore proceed in accordance to the established term of understanding of 10 per cent.

## 2.2 Categories of FDI

Foreign Direct Investment takes several distinct forms. First a line needs to be drawn between fully controlled enterprises and those where only partial ownership is held. Fully controlled enterprises are usually termed Greenfield Investments, since they are either the product of a company foundation (be it a subsidiary or representative office) or result from the acquisition of an already existing company. If a plant previously employed for another industrial purpose is remodeled in the investment process, this is termed Brownfield Investment. It entails a significant change in the means of production and personnel. (Lukas 2004, 83)
The second form of FDI is the partial holding (below 100 per cent) by a foreign investor. This can either be the case in the foundation of a cooperative venture between two or more companies, usually termed Joint-Venture or a partial acquisition as well as partial consolidation. Today, acquisition and consolidation are most often termed Mergers & Acquisitions.

Furthermore, OFDI can be separated into horizontal and vertical investments. Horizontal investment refers to investments within the same or similar part of the value chain of a parent company. Vertical investments refer to either a position in the value chain that lies before or after the position of the parent company. This means that vertical investment would either engage in raw materials or in sales, both located before and after the actual production activity of the parent company.

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## 2.3 Motivations behind Foreign Direct Investment

Foreign Direct Investment can furthermore be categorized according to its motivation. Overall, several motivations at the same time may apply for a single case.

The first category of objectives is *market-seeking*. In this case, FDI has the aim of developing or maintaining economic activity with a foreign market. This investment can on the one hand be done with the aim of furthering export activity (export-oriented market seeking) or on the other with the domestic market in mind (internal

market seeking) if the investment primarily furthers activity in this internal market. Suppliers often internationalize with this objective in mind. If their customers outsource abroad they are forced to undertake market-seeking investment in order to ensure their competitive positioning in the outsourcing market of their customers and on the domestic market alike. For suppliers in such constellations, this investment may further be encouraged through custom duties, import quotas and additional taxes if they keep production domestic yet need to supply at competitive prices to their customers abroad.

Secondly FDI may be *efficiency-seeking*. This type of investment aims to improve cost- and profit structures through the remodeling of the value chain. The effective balance between different markets and locations helps a company to remain profitable. This type of investment is largely known under the term "*Outsourcing*"- i.e. the relocation of production facilities into countries with lower labor cost. This has particularly been the case for companies from developed countries that move their labor-intensive manufacturing or services abroad in order to cut costs.

Third, FDI may be *resource-seeking*. The motivation behind such investment aims to ensure the supply with resources needed for production purposes. These may include natural resources like oil and gas or pre-processed parts for further production. This type of direct investment has gained increasing prominence with regards to mineral products, so called "rare earths". Most countries not only control the export quota for their domestic production of this resource, but also place large investments in extracting companies in Australia, to name just one example.

Fourth, FDI may be *asset-seeking*. This type of investment aims to secure man-made assets, such as knowledge or technology. As these are man-made products, they come in forms like patents or brands that contain their own market value, but can also come in the form of management know-how or technological expertise.

Fifth, FDI may be encouraged by various other aspects. Countries acknowledge the importance of foreign direct investment in developing their economy. Most countries therefore vie for investors through monetary or regulatory incentives. Monetary

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incentives can either come in the form of subsidies or tax reductions and regulatory incentives mostly in the form of particularly soft legal regulatory frameworks (for example in environmental standards or company foundation procedures) for foreign investors. Many countries are furthermore actively promoting themselves through national investment agencies and even cities try to attract investors through regional marketing.

Not only the host country plays a prominent role in shaping an investment decision, but also the OFDI framework of the sending country. The investment may be politically encouraged through governmental agencies, consultancy, financial aid and preferable access to capital or simply be ordered as in the case of many State-Owned Enterprises (SOE).

# 3. Theoretical Approaches toward FDI

## 3.1 The Eclectic Paradigm

The standard literature explains FDI flows as being based on market imperfections. This means that companies entering a foreign market need to possess advantages over the local competition. (Vernon 1966, Kindleberger 1969, Johanson/ Vahlne 1977) The most prominent theoretical framework applicable to this strand of theory is Dunning's Eclectic Paradigm (as has been developed and laid out in his publications in the years 1974, 1978, 1981, and 2005). According to his theory, firms only employ FDI if three specific advantages are available: The Ownership-Advantage, the Location-specific Advantage and the Internalization- Advantage.

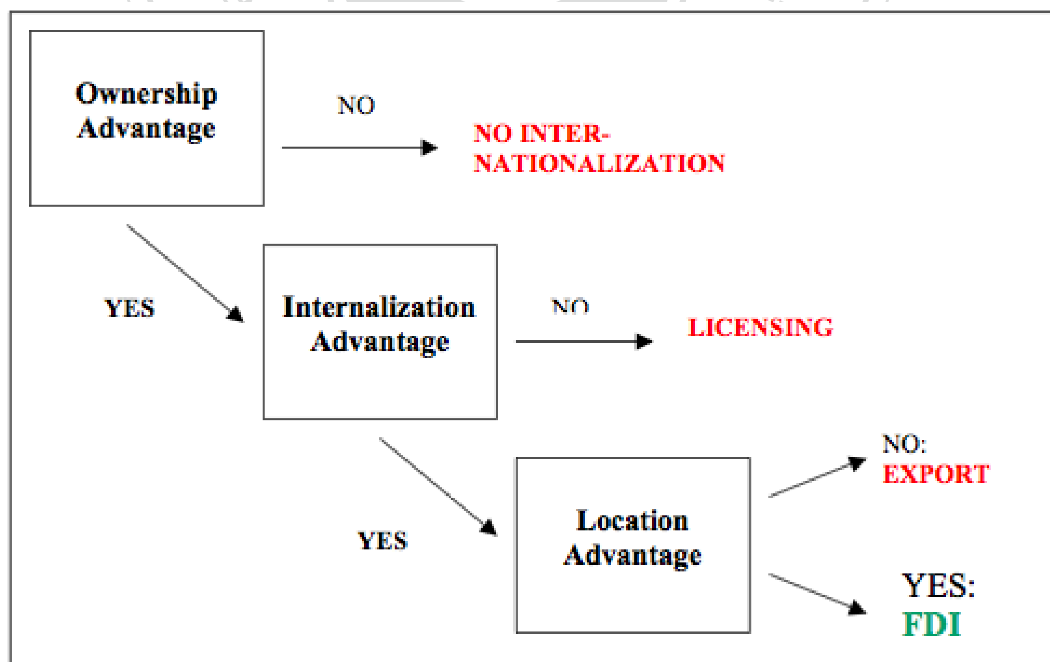
The *Ownership Advantage* is based on the understanding that companies need to possess firm-specific advantages over their competitors. Often, this advantage builds on the assumption of economies of scale: a company is able to realize larger profit from their product than a local competitor could. A company may also hold exclusive rights of patents, brands, or management skills that are intangible assets. The company could also have better access to resources or suppliers than its competitors. If the firm is choosing to set up a foreign subsidiary, this company may further have competitive access to controlling, marketing and accounting through its holding company in the home country- thereby effectively downsizing the cost of operations. The ownership advantage can also be constituted by aspects as simple as size of a company, as large companies have much easier access to resources that allow for market dominance. Taken together, these advantages must outbalance the market constraints such as costs for communication or cost of fending off discrimination in the host market.

The *Location Advantage* refers to factors that make it more desirable for a company to set up shop in a foreign market, rather than just supplying it through exports. It is based on the spatial distribution of sourcing markets, price variations on these markets (i.e. through taxes and duties), quality standards, productivity (of labor, energy, resources, etc.) as well as costs deriving from transport and communication. A company may for example translate favorable transportation costs between two

locations into a Location Advantage- effectively making prices competitive with regards to local competitors. Advantages can however also be persisting within a fixed location, meaning stable political conditions, trade barriers that keep out competitors or tax incentives. Thus location advantages refer to the overall framework of FDI in its relation to geographic position.

The *Internalization Advantage* exists when internal production operations across borders are cheaper than sourcing in the free market. Moving into another market through the means of direct investment can effectively help safeguard quality standards or copyrights that may well be infringed in a licensing process. Secondly, Internalization Advantages entail the concept of economies of scope, building on cost reduction through product diversification along the lines of modular product line extension. (Dunning 2001). This can include the use of pre-processed materials, available technological specialization in another location and subsequent cost reduction through standardization. Should a company not- or only to a small degree possess such internalization advantages it could license its production to another company abroad instead, see picture below:

**Figure 1: The Eclectic Paradigm**




Source: Eschlbeck 2006, 223; in accordance with Dunning 1981, 32.

## 3.2 The Investment Development Path Hypothesis

Dunning further proposed that the stage of development is correlated with OFDI- the richer a country, the higher its levels of OFDI: the Investment Development Path Hypothesis. Dunning hereby provides the basic analytic framework for Foreign Direct Investment analysis. (Dunning et al 2008) His observation is that developing countries undergo certain stages in their outward investment, which are linked to their own stage of development. According to the respective developmental stage of the country, the OLI advantages all show differing variations.

Dunning distinguishes four phases. In the first phase, the development level of the economy is low. The local companies have little or no comparative advantages and thus do not enter international markets as investors. Neither can the country provide for any incentive to draw in investment from abroad. Outward and inward investment flows remain small.

In the second phase, the gross domestic product is rising slowly. Foreign companies are increasingly taking an interest and undertake asset-exploiting investments (i.e. they tap into the local consumer market or cheap labor market). The comparative advantage however remains small and they are only engaging in export activities. Therefore outward FDI are still not growing.

The third phase sees the start of learning processes, which improve the overall capabilities of national companies. Thereby the local companies develop their own advantages and are ready to enter the international markets as investors. However the inward investment by foreign investors remains comparatively dominant.

Only in stage four can the national companies reap such substantive OLI advantages from their development that the outward investment increases over the inward investment. This experience is largely mirrored by entities like Singapore or Hong Kong. (See Figure 2 below)

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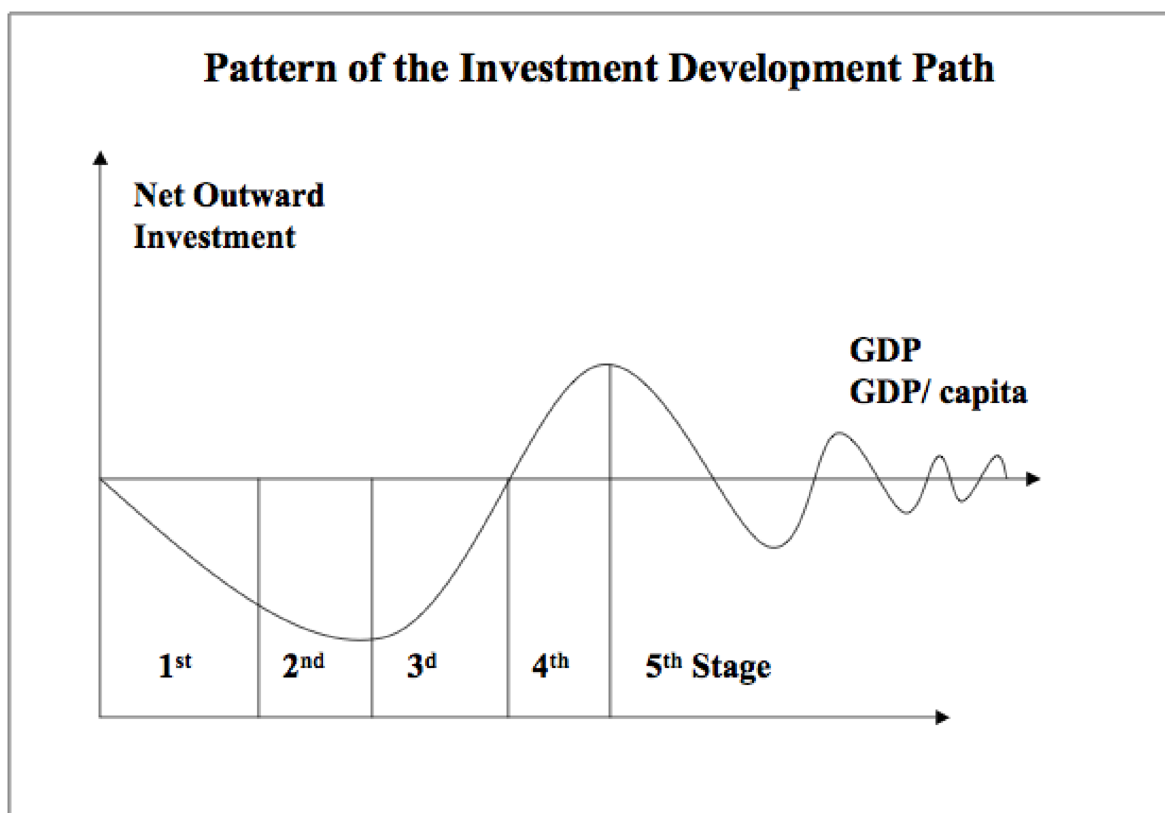
**Figure 2: The Pattern of the Investment Development Path in 5 Stages**




Source: Dunning/ Narula 1996.

However most developing countries never emerge beyond the second stage. It needs to be noted that the respective size of the country is not taken into consideration here, thus the internal development in a large domestic market and its positive effects may be underrated.

## 3.3 Critique of Dunning's Approach

The Eclectic Paradigm and Investment Development Path Hypothesis by Dunning both provide a solid groundwork for the discussion of Foreign Direct Investment. However the approaches established by Dunning have their limitations.

Dunning based his assumptions on the experience of private companies from developed economies. As we see a surge in OFDI from countries with a large share of State-Owned Enterprises, it is questionable whether this theory can capture the actual parameters of state roles played in the Foreign Direct Investment of such companies.

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Furthermore, the experience of many emerging economy companies contradicts to large parts the basic assumptions of the Investment Development Path Hypothesis. While Dunning acknowledges their emergence in his publication of 2009, their very early emergence on the global stage basically contradicts his hypothesis.

And finally, Dunning's theorem seems somewhat outdated with regards to the abundance of possibilities for companies to go abroad today. His hypotheses do not include cooperative forms of market entrance strategies currently employed by many companies- including Joint-Ventures or various forms of Franchises.

## 3.4 Latecomers and Born Globals

New theoretical approaches have been created to capture the emergence of OFDI from emerging economies. The prime example are the tiger states during the 1980s. Two theories emerged to best capture the phenomenon: The Born Globals and the Latecomer Theory.

The concept of *Born Globals* assumes that there is a subset of companies, usually very young, which internationalize quickly based on cooperation with market leaders. These companies may have been founded by managers already in possession of sufficient experience and vital contacts in international business, but this is not a general rule. Through their cooperation with firms from developed markets, skills are transferred while organizational structures remain flexible. (Madsen/ Rasmussen/ Servais 1997) The main characteristic of a Born Global is thus its ability to innovate and expand internationally quickly.

The *Latecomer Theory* assumes that companies from emerging economies derive an advantage from their structural flexibility. Their perspective is inherently global since they are not constrained by previous structural buildups. Thus they can easily innovate and incorporate new ideas, thereby internationalizing fast paced. (Buckley/ Cross/ Tan/ Xin/ Voss 2007) Considering the framework they operate in, their very lack of



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structural borders (i.e. established forms and processes) allows them to change quickly and thus become highly efficient and adaptive to their surrounding.

These new global companies have certain aspects in common. First, they purchase complementary assets such as brand names or technology in order to expand quickly without much time spent on R&D activities. Second, they reap advantages from lower production costs in their home-countries, which they later employ on the foreign market. Third, they form transnational networks to help them innovate quickly and learn. Fourth, they expand at rapid pace and catch up to established companies while circumventing the traditional steppingstones of development.

# 4. Foreign Direct Investment from Emerging Economies

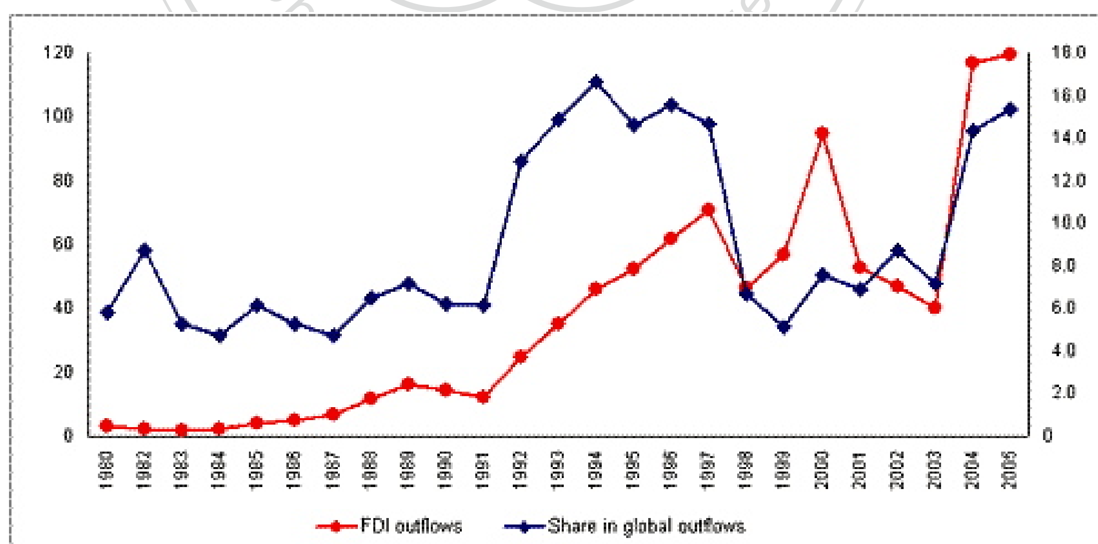
## 4.1 Development of FDI from Emerging- and Developing Countries

The overall development of Foreign Direct Investment flows has been staggering in its speed and its expanse since the 1980s. Starting at a level of around US$ 50 billion per year between 1980-85, flows have grown by factor forty until 2007. (Sauvant/ Maschek/McAllister 2009, 1) A large share of these flows is now emerging from former developing countries. Had they between 1995 and 2000 on average accounted for a mere 0.3 per cent of global flows, their share reached 2.4 per cent of flows in 2007 and subsequently increased to 3.1 per cent in 2008. (Sauvant et al 2009, 2)

Therefore it can be said that OFDI is no longer exclusively coming from developed countries, but has been extended through new stakeholders from developing and transitioning economies. (UNCTAD 2007, 1) These types of economies increasingly develop Multinational Corporations (MNCs) and thus increase their FDI outflows and share in global outflows. (see graph below)

**Figure 3: FDI Outflows from developing and transition economies 1980-2005**

In US$ billions and per cent (excl. Bermuda, British Virgin- and Cayman Islands)




Source: UNCTAD 2006.

The liberalization of foreign direct investment regimes has had a great impact on the worldwide environment for Foreign Direct Investment. In a similar vein, advancements in logistics and communication technology have allowed for increasing transnational cooperation to emerge:

> *"Driven by information technology and its mutually reinforcing wealth creating interaction with globalization, both the internal and external business environments are being transformed. Business is becoming less hierarchical, faces shorter product life cycles, industrial restructuring based on deconstructed value chains, new competitors from unexpected sources and countries, virtual corporations (...)"* (Aggarwal 1999, 83)

This has not only had a positive impact on firms from developed countries, but has likewise made it easier for companies from developing- and transitioning markets to adjust their strategies accordingly and move abroad as investors.

According to Sauvant et al (2009), OFDI flows from emerging or transitioning markets have developed with particular speed starting from 2003- however remained mainly driven not by developing economies, but by emerging- or transitioning economies, such as the Russian Federation, India or China. (Gammeltoft 2008, 8) As Dilip Das notes, this development goes hand in hand with a wider economic revival of these nations on the global stage:

> *„Towards the end of 2007, after the post-sub-prime mortgage crisis in the United States (US) economy, it seemed increasingly evident that the global economy was on the cusp of a defining historic transformation; economic power was in the process of making a secular shift from the industrial economies to China and the major emerging- market economies (EMEs).“* (Das 2008, 3)

As will be shown subsequently, it is particularly these emerging economies, that have extended their reach beyond their direct vicinity into the global markets and were among the first to enter the developed countries as investors.

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## 4.2 New Parameters for FDI from Emerging Countries

While formerly restraining the outflow of capital, developing- and transitioning economies have recently started to liberalize and even actively promote OFDI outflows. Several factors have contributed to this development:

One prominent factor is the large deposits of **foreign reserves** some former developing countries have been able to build up over time. These give them the financial means to send their companies abroad to make crucial investments in foreign markets. While many countries have amassed these reserves in similar fashion, they are particularly pronounced in the case of China. (Swartz 2010, 1) Its combined reserves in 2010 measured US$ 2.7 trillion and thus are nearly three times the combined value of those held by Russia, India, and Brazil together:

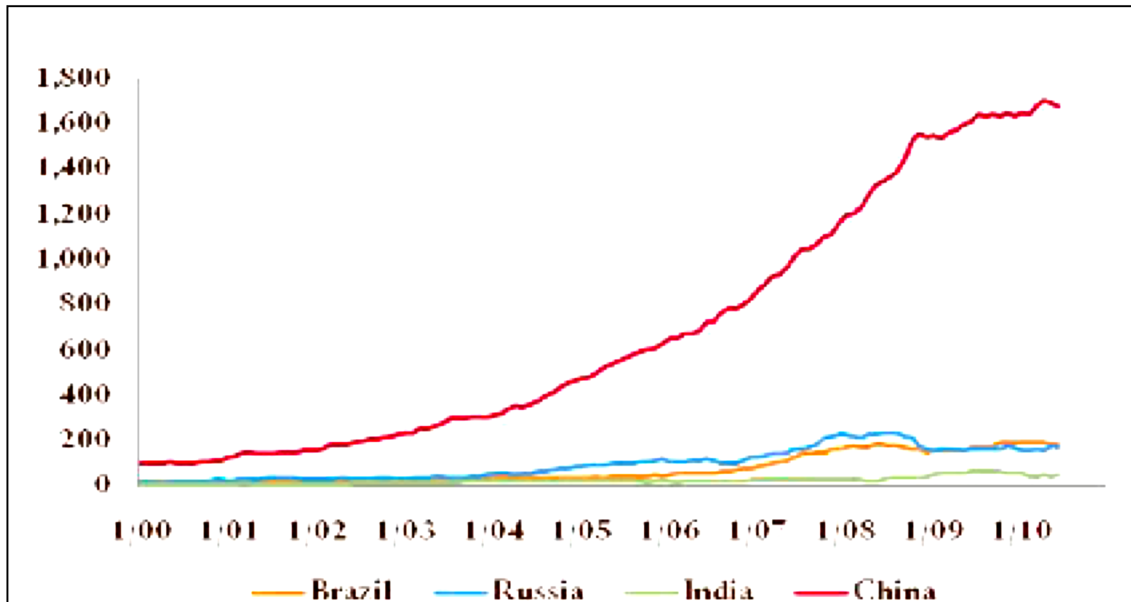
> *„In the near future, in view of the pressure generated by China's bursting foreign reserves (US$ 1.4 trillion by September 2007) on its money supply and its exchange rate, it is now China's official policy to encourage foreign reserves to leave the country: "To open the flood gate," according to the official policy speak."*(Cheng et al 2008, 23)

The amassed foreign reserves make it possible (or even a necessity) for emerging economies to invest abroad despite economic crisis. The crisis itself lending even more momentum to the already large financial means:

> *„SOEs in countries with high foreign currency reserves, in particular, remain in a position to expand abroad, the regulatory environments of host countries permitting. Their ability to take a long- term horizon helps in this regard, and the fact that asset prices in a number of potential host counties are low or in distress encourages cross-border M&As"* (Sauvant et al 2009, 12)

Most often discussed is the large-scale engagement of China with US financial assets. Here again, China is leading the pack. (see graph below)

**Figure 4: Estimated Holdings of US Financial Assets by BRIC Countries**
in US$ billions, 2000-2010




Source: Swartz 2010, 2.

Companies from emerging economies nowadays not only have access to capital through their government, but are furthermore increasingly able to access it through advanced market institutions such as listings at the US stock exchanges. (Khanna/ Palepu 2004, 4) By moving abroad, they effectively overcome the restraints of their domestic environments. (Luo/ Tung 2007, 484) Local restraints mostly exist in the form of underdeveloped financial institutions and banking systems.

A second explanation for the increasing FDI outflows is global competition emerging on the home-markets of emerging- and developing country MNCs. The increasing competition from outside forces them to go abroad in search for market access and to secure knowledge to safeguard their respective position on the home market. China is exemplary for this situation:

> *„Chinese market-seeking investments are common in both developing and developed countries. One of its main reasons is excessive competition in the domestic market, based on the large number of foreign TNCs entering and investing in China. This has caused profit margins to fall and resulted in overcapacity in some mature industries, such as textiles or clothing,*

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> *pushing Chinese firms to find new markets overseas (...).“* (Krusievicz 2011, 7)

However, type of investment activity, its formation and structural components, differ according to the respective economic parameters in host countries. (Khanna et al 2004, 1)

Another aspect is the increasing need to secure resources vital to the sustained economic growth in an emerging economy. Again, China is a case in point. Chinese companies, channel a large share of their investment into resource extraction activities in other developing countries:

> *„Of particular interest to the West is China's growing expansion into Africa's oil markets (…) China is actively seeking resources of every kind; copper, bauxite, uranium, aluminium, manganese, iron ore etc. are all objectives for acquisition for Beijing.“* (Taylor 2007, 3)

These resources are needed for China's manufacturing- and heavy industry.
Other emerging economies likewise follow an interest based investment policy. India - in concurrence with its economic focus on IT- channels large shares of its OFDI into high-tech- and knowledge intensive industries. (Luo et al 2007, 487) Russia, somewhat similar to China, has mainly invested into resources and strategic commodities- not least with regards to its geo-strategic positioning in regions such as Central Asia. (Gammeltoft 2008, 11) Brazil also developed its OFDI in line with its economic structure- channeling its OFDI into oil, gas, metals, mining, cement and food/ beverages. (Sauvant et al 2009, 8-9)
Thus, investment behavior not only reflects upon a country's means for investment, be they financial or other, but also on needs and long-term strategies.

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## 4.3 Geographic Distribution of Emerging Country Investment

The geographic distribution of emerging OFDI flows shows a clear trend towards Asia becoming the predominant source of OFDI outflows. It has thus overtaken both Latin America and the Caribbean in this regard.
These investments are largely channeled into other developing or emerging economies. (Battat/ Aykut 2005, 1; Aykuth/ Ratha 2004, 154) Most notable are the investments undertaken by Chinese and Indian investors in Africa, where they focus on a wide range of industries but primarily on the extraction of natural resources and production of foodstuffs such as grains and palm oil. (Rocha 2007, 23; Meier zu Selhausen 2010, 22)

Nevertheless, companies from emerging- and developing countries increasingly also invest in the developed markets. These flows mostly include investments into service industries, and trade supporting industries. China underlines this fact through its large trade supporting investments in developed markets for its multinational companies:

> *„In developed countries, an access to markets remains one of the main motivations for investment. (...) Chinese investments were mainly defensive market- seeking, e.g. FDI following trade, as firms set up foreign affiliates in order to serve their customers better and to increase customer loyalty, while for later entrants, after 2000, they were mainly aimed at raising company profiles in a large market, where growth potential for their companies had been identified, e.g. trade following FDI." (*Krusiewicz 2011, 8)

According to Sauvant et al (2009, 4) the number of developing economy Multinational Companies is above 21,000, while those from transition economies measured a total of 2,000. Out of the firms from developing economies, around 3,500 were from China, 1,000 from Russia, 815 from India and 220 from Brazil.

This particular group of Brazil, Russia, India and China is also referred to as the BRIC countries. This group among developing- and transitioning economies has

experienced vast growth in recent years and now contributes 13 per cent of global GDP- highlighting the potential of emerging economies in worldwide FDI flows. (Deutsche Bank Research 2009, 1)

Due to their overall economic importance, the BRIC countries are a special case. According to Deutsche Bank Research (2009, 1), these countries have (taken together) accumulated external assets surpassing US$ 4.1 trillion in 2007, which marks a 45 per cent year on year increase. Even though assets grow fast-paced, the outward FDI in flows and stocks from these countries remains small to date. Yet as their economic potential grows, so will likely do their OFDI outflow as they already account for the majority of the Southern FDI total. (Dicken 2007, 39) Furthermore, many BRIC countries actively seek to promote and further this development through policy reforms:

> *„Often, various liberalizing and promotional measures have been put in place by governments of emerging market countries in a phased manner, starting with an approval process and ceilings for OFDI that are progressively set higher until they are abolished.“* (Sauvant 2005, 647)

For China as well as India, their respective catch-up potential seems to leave sufficient room for further expansion of OFDI- China nevertheless outpacing its peers Brazil and India. (DB Research 2009, 2) A table of OFDI from BRIC economies according to UNCTADstat serves to exemplify this trend until 2010.

**Figure 5: OFDI Outflows BRIC economies 2004-2010,** in US$ millions

| Year | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|
| Brazil | 69,196 | 79,259 | 113,925 | 139,886 | 155,668 | 164,523 | 180,949 |
| Russia | 107,291 | 146,679 | 216,488 | 370,161 | 205,631 | 306,252 | 433,655 |
| India | 7,734 | 9,741 | 27,036 | 44,080 | 63,338 | 79,164 | 92,407 |
| China | 44,777 | 57,206 | 73,330 | 95,799 | 147,949 | 229,600 | 297,600 |

Source: UNCTAD 2012.

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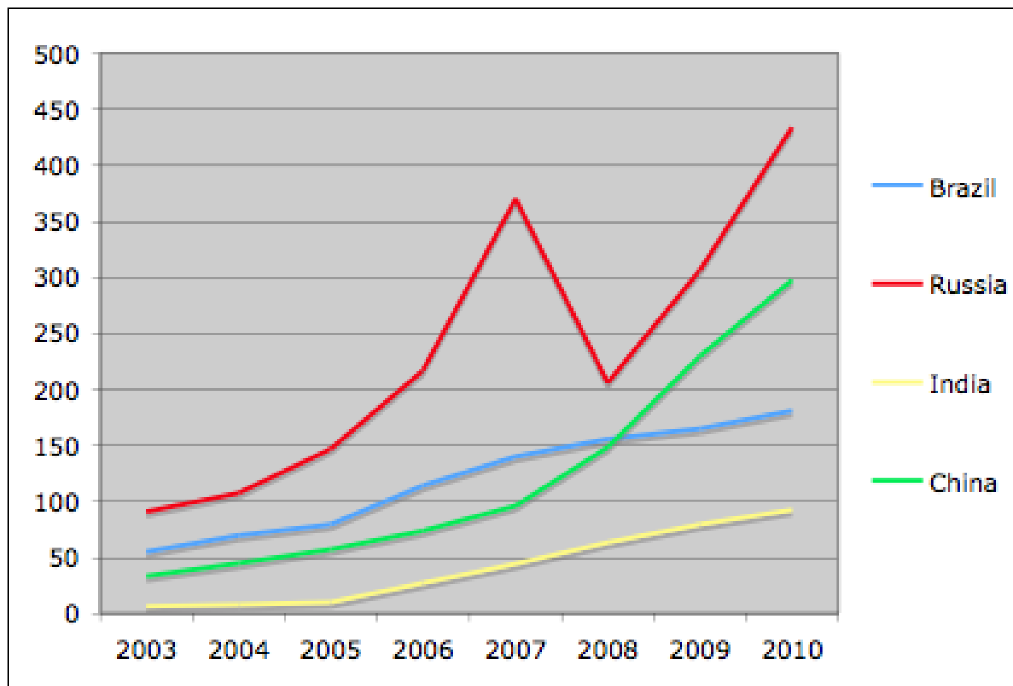
**Figure 6: BRIC outflows are taking off**, in US$ millions




Source: UNCTAD 2012.

Considering the eminent potential of these countries and their increasing drive for investments in developed economies, the BRIC countries underline the paradigm shift in Foreign Direct Investment, as some emerging economies increasingly become key players beyond their direct geographic vicinity. (Yeung/ Liu 2008; Khanna et al 2006; Tung/ Luo 2007) While other countries have also facilitated extensive investments in developed markets, the case of China needs to be seen before a somewhat different background given its size and economic vigor:

> *„China's re-emergence and economic status is often compared to the growth performance of "miracle" Asian economies that came into their own during the post-War era and carved a niche for themselves in the global economy. While there are many commonalities, this comparison is not entirely correct because, unlike them, China's economic ascent as it is progressing is going to be to the status of an economic superpower." (Das 2008, 4)*

# 5. China's (Economic) Rise

## 5.1 China's Economic Development

The Chinese economy is the second largest economy worldwide. It recently surpassed Japan and Germany and has had the by far fastest growing economy for the past 30 years. Its growth rates average around ten per cent per annum- even projected into the future a steady growth of the same magnitude is foreseen, making it bound to become an economic superpower.[4]

The primary accumulation of the Chinese economy as we know it today has taken place between 1978 and 2008. This stage is characterized by the development of an export-oriented economy, as has been the case for many of the second-tier newly industrializing countries in Asia. The first region to be developed was the Pearl River Delta during the 1980s, followed by the Yangtze River Delta in the 1990s and the Bohai Bay area since 2000. Analyzed with consideration of Hu's line[5], dividing China between Heilongjiang and Guangxi, one can find that the impact of development in this stage has been greater on the eastern regions, which are home to the coastal development areas of Pearl River Delta, Yangtze River Delta and Bohai Bay area. (Yang 1990, 231; Waters 1997, 76)

Before the 1970s however, the PRC underwent little successful economic development. In its early years, the People's Republic relied on an economic policy closely resembling that of the Soviet Union. It promoted heavy industries and collectivization against all odds, leading to unsatisfactory results- reaching a peak in the Great Leap Forward campaign. The Great Leap, aiming to use a process of rapid industrialization and collectivization to jumpstart China into a modern communist society, led to economic devastation and famine. The country, closed off to the world, started to adjust its economic policies only after Deng Xiaoping attained the position of paramount leader after 1978. He opened China to the world and is considered to be

[4] Refer to: IMF (2011). *World Economic Outlook Database, Report for Selected Countries and Subjects* for further information.

[5] 黑河-腾冲线 （Hēihé-téngchōng xiàn)

the architect of economic reforms labeled as the “Socialist Market Economy”. (Shirk 1993, 24)

After 1987, the Chinese government gradually allowed economic initiatives to emerge in Southern China. Within the coastal regions of the south, The People’s Republic established Special Economic Zones (SEZ). (Zeng 2010) In these zones, a liberal and market oriented economic setup was offered to investors. The primary aim of the SEZ was to attract foreign investments, or business activities by Chinese-foreign Joint-Ventures. The production of an SEZ is primarily meant for exports and thus adheres to market principles. In a sense, these zones were early gateways for foreign investors into China, offering tax incentives and access to cheap labor beyond the borders of the SEZ. This developmental model has led China to become the largest recipient of FDI among all developing countries:

> *“In recent years, FDI to China accounts for 1/4 to 1/3 of total FDI inflow to developing countries. Foreign investment has become an important source for China’s investment in fixed assets. Its share in total annual investment in fixed assets grew from 3.8% in 1981 to its peak level of 12% in 1996.”* (Fung/ Iizaka/ Tong 2002, 2)

Induced by the inflow of capital, economic momentum emerged, which helped China to position itself as the largest producer of consumer goods and simple industrial products. China's economic development is to this day based around this industry. Exports and investment are crucial caterpillars for its growth – as has been the case in the last four decades. (DB Research 2011)

China has come a long way since the early reforms started in 1978, which were directed at the agricultural sector. Price reform and financial rewards were to induce increasing initiative in farmers and rural enterprises. In 1984 this idea was extended to also cover the industrial sector- allowing companies to use any surplus production for their respective benefit. This move set in motion the growth of a fairly liberal market of foodstuffs and consumer goods, while at the same time maintaining a *dual track system* with an additional state controlled market in place. (Brandt 2008, 10)

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At the XIV. Party Congress in the fall of 1992, the Socialist Market Economy was enshrined as the central economic policy objective. This affirmation towards continuous reform set in motion an unprecedented inflow of FDI from abroad. This went hand in hand with a gradual liberalization of China's policies toward FDI. Before the establishment of four SEZs in Shenzhen, Zhuhai, Shantou and Xiamen, the National People's Congress had already granted legal status to foreign investments in 1979.[6] In 1984 fourteen other coastal cities and Hainan Province were awarded SEZ status and finally in 1986 wholly foreign owned enterprises were permitted to operate in China. (Fischer 2006)

The adoption of the "*Provisions of the State Council of the PRC for the Encouragement of Foreign Investment"*, entailing "(…) *preferential tax treatment, the freedom to import inputs such as materials and equipment, the right to retain and swap foreign exchange with each other, and simpler licensing procedures (...)"* (Fung et al 2002, 3), were the first crucial steps towards providing actual incentives to foreign investments rather than simply allowing them to operate. This in turn also served the interest of the Chinese government. Beyond aspects of job creation, China managed to link its FDI promotion activities to its domestic objectives. These objectives include technology transfer and progress in areas with substantial weaknesses. Through a "*Guiding Catalogue of Foreign Investment Projects"*, investments were channeled into areas of national interest to help upgrade products, improve efficiency, save energy and control pollution. (Perkins Coie LLP 2012; Fung et al 2002, 4)

As can be seen from the discussion above, China has turned into the most important host to Foreign Direct Investments from Western Countries, as well as from Taiwanese and overseas Chinese businesses. Its policies towards FDI have developed gradually and over time, from mere permission of FDI inflows to active promotion and subsequent selection:

> *„China's policies toward FDI have experienced roughly three stages: gradual and limited opening, active promoting through preferential*

[6] Law of the People's Republic of China on Joint Ventures using Chinese and Foreign Investment (1979)

*treatment, and promoting FDI in accordance with domestic industrial objectives. These changes in policy priorities inevitably affected the pattern of FDI inflow in China.“* (Fung et al 2002, 5)

However, China has not remained a manufacturing giant for cheap consumer products. As is already indicated above, China managed to upgrade its own industrial potential and extend its domestic capabilities, slowly moving up the value chain. Yet, as the traditional export markets for Chinese products undergo economic reshuffling and experienced continuous crisis since the year 2000, China was again forced to reconfigure its economic strategy.

## 5.2 China's Evolving Role in a Global Economy

In the eyes of most observers, China remains the manufacturing giant, responsible for sucking up a large share of industrial jobs in developed countries. However, as of recently China has seen its development from global vacuum for investment put on reverse by the promotion of its domestic consumers market and by becoming a major investor to other countries itself.

The 12th Chinese five-year plan marks a decisive turning point in China's economic development. The country increasingly aims to develop its own consumers market and set free the potential of its large population. Before the background of the severe Financial Crisis of 2008, the plan refocused attention away from increasingly problematic export destinations (US and EU) towards the domestic market. The new development path favors local consumption and key industries in services and particularly consumer products. (Xinhuanet 2011) As Guanyu Li and Jonathan Woetzel of McKinsey's Shanghai office note: "*China's recently announced 12th five-year plan aims to transform the world's second-largest economy from an investment-driven dynamo into a global powerhouse with a steadier and more stable trajectory.*" (Li/ Woetzel 2011)

In order to create such a national consumers market, the 12th five-year plan aims to establish greater income parity and promotes inclusive growth to overcome the

growing wealth gap. To this end, China has developed two strategies. The first is to move up the value chain in the eastern regions, including promotion of advanced sectors: biotechnology, new materials, new energy (nuclear as well as solar and wind), new IT, and high-end manufacturing (particularly aerospace and telecom). (Stanley/ Xu 2011, 2) Simultaneously, China speeds up its development of the poor western regions started in 2000 by setting incentives for companies to move further inland.[7] This will create jobs for former working migrants, increase the domestic customer base to the hinterland and encourage domestic spending. (KPMG 2011, 2)

China also targets a higher quality growth, as questions of sustainability arise. While lifting millions out of poverty, China has paid a dear price by infringing on environmental standards and preservation. Development has come at the expense of resource depletion through extensive energy use and related pollution of air, water and land. Not only are current generations already suffering from exploitation of resources, but the cost to future generations is yet unknown. Therefore *"(...) the low carbon sector, and other priority sectors identified in the plan, will benefit from increased investment and incentives."* (Stanley et al 2011, 4)

China is increasingly focused on its own domestic markets with a potential customer base above one billion people. Setting free its domestic potential would allow China to decrease its dependency on overseas markets in Europe and the US. But China also increasingly looks abroad for lucrative investment opportunities and starts to become an investor itself.

When the Chinese government initiated its Open Door Policy in 1979, it had virtually no FDI outflows. Its FDI emerged slowly between 1982 and 1991, but the annual sum did not exceed $1 billion at any point (Buckley/ Clegg/ Cross/ Voss, Zheng 2007). This was due to government policies, which restricted both investment approval and foreign exchanges, and the weak competitiveness of Chinese firms. Outward investment policies were relaxed between 1991 and 1994, only to be tightened again until 1995, in order to cool the rate of domestic economic expansion. In 1998, the outflows declined again, because of the Asian Economic Crisis, which led to

[7] 西部大开发, Xībù Dàkāifā.

increased foreign exchange controls and an economic downturn in most neighboring countries. With the official introduction of an investment policy, Chinese FDI flows accelerated markedly. Since 2003, Chinese investments have accelerated even further, making China one of the fastest growing investors to the world (OECD, 2006).

Through its investments, China actively pursues its interests abroad. As a transitioning economy however, China has interests different from those of developed nations. Its status as an emerging economic powerhouse and the related need for resources, knowledge and technology associated with such an economic rise, shape its investment policy abroad.

## 5.3 Motivation behind Chinese Investments

Given China's background as an emerging economy, we can identify three basic motivations with regards to investment flows from China. These interests are not mutually exclusive, but may apply in concurrence with one another:

The first is the *efficiency motivation*. China has accumulated the largest sum in foreign reserves worldwide and is keen to put them to use in investment opportunities. (Buckley et al 2007) This aspect may be counted as one central push and pull factor, severely affecting incentives to move abroad and the investment decision as such. (Dunning et al 2008) This view is further extended by Liu/ Buck/ Shu (2005), who link the national development path to the individual investment decision. From this point of view, each investment corresponds to- and is in line with national development goals. OFDI would thus not only be a singular event, but heavily enmeshed with larger strategic implications. (Child/ Rodrigues n.d.)

Second is the *learning- or catch-up motivation*. Companies from southern countries do not generally enjoy an advantage with regards to technology or knowledge- this is what sets them apart from the preceding surges in FDI. (Goshal/Bartlett, 2000) Theorists therefore state that the basic interest must be that of a catching up strategy. (Gammeltoft 2008) China promotes national champions, which enter the foreign market in order to improve their competitiveness and global reach (Berger et al 2008;

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Ramkishen, Kumar & Virgill 2006). As Matthews (2006) underlines, these companies have a clear strategic interest in investing abroad. In the case of China to developed country OFDI this must lie beyond the plain acquisition of resources of production and financial interests. (Deng 2004) Learning processes, especially when it comes to Chinese investment, may play a key role and could be the overriding factor for an investment decision. (Rui/Yip 2008; Milleli et al 2008) As Morck (2007) describes, Chinese companies increasingly need this intellectual capital in order to sustain against international competition on their home market too. Li (2009) adds that China is in need to acquire foreign technology abroad not only with regard to its position in the world market, but also in order to further the readjustment process of its growth mode towards sustainable development. (Chuang 2010)

The third is the *market access motivation*. Buckley et al (2007) find that the acquisition of strategic intellectual capital initially played little role for Chinese OFDI. Companies much rather pursued basic economic strategies, such as market share development. This may be especially true for a country like China. The Chinese economy is based on export oriented growth, thus pursuing market access and increasing market share in key markets like Europe may be one of the major motivations behind Chinese OFDI to developed countries. (Zhan 1995/ Buckley et al 2007) Before this background the acquisition of local brands can be seen as a market access strategy, using the brand value as a strategic asset for gaining market share by selling own products through a well established brand. As Deng (2008) notes, the asset seeking conduct of Chinese companies is based on their need to acquire brands that allow them to access markets via strong and well-established networks.

Chinese global investments are said to mostly focus on *resource-seeking*, which is in line with the need for supplies to sustain continuing economic growth. As some of the Chinese investment destinations, for example the European Union, largely do not possess such strategic assets the investment in such areas does not comprise a noteworthy aspect. It may however be said, that resources could be interpreted in a broader sense encompassing technological assets and knowledge. Thus the acquisition of technology or knowledge based products could be interpreted as resource-seeking investment as well.

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According to findings from Gu (2009), most Chinese FDI is conducted by State-Owned Enterprises. Thus, for the case of China institutional frameworks impinge on an investment decision and are more than just background conditions. China actively promotes and supports its companies on their move abroad, while they are in turn required to further national development objectives through their investment projects. In the past ten years, the Chinese government has put in place an investment promotion policy called "*Go Global*" and actively promotes Chinese companies in their move abroad. This policy however is only the preliminary end point to a wider development of an OFDI regime developed over time.

## 5.4 China's OFDI Policy

In the case of China, the state plays a key role in shaping and encouraging Foreign Direct Investment by companies abroad. According to Li (2009), the development of a Foreign Direct Investment regime in the form of the Go Global Policy is linked to the overall economic development of China. As China entered the World Trade Organization in 2001, Chinese companies faced much stiffer competition from foreign companies now able to enter the domestic market. This created the need to go abroad to enhance standing vis-à-vis international competition, with the support of the Chinese government. However the Chinese OFDI regime has taken shape even before the formulation of the Go Global Policy in the tenth five-year plan of 2001. The Go Global Policy is thus only one step among many, embedded into a wider framework of outward investment reform in China. Chinese overseas investment policy essentially has undergone four stages, each showing different configurations either limiting or enabling Chinese OFDI (Li 2009, 38-41):

Stage one ranges from 1979 to 1983. This phase is essentially described as a trial period in which little outward direct investment was made and maximum control by the government was exercised. The State Council formulated the very first regulation on OFDI in 1979 in the form of 15 economic reform measures that would permit to set up companies abroad. However all OFDI related projects necessitated approval by the State Council. Only in 1983 were approval procedures transferred to MOFTEC-Ministry of Foreign Trade and Economic Cooperation. For investments exceeding the

limit of US$1 million, the investors still had to attain approval from municipal-, provincial- and (autonomous) regional governments and by the Chinese embassies, in order to actually implement. Smaller investments could directly seek approval at the embassy. Given the complicated procedures and lack of established standard procedures, OFDI during this period was limited to US$ 9.2 million per year. (Li 2009, 38)

Stage two lies between 1984 and 1992. MOFTEC introduced standard procedures for examination and approval of investment projects in 1985, which was preceded by the "*Notice on the Authorization and Principle of the Approval of the Establishment of Non-commercial Overseas Enterprises*" and the "*Trial Regulation on the Approval Procedure and Administration of Establishing Non-Commercial Overseas Enterprises*". Due to subsequent irregularities and failures in OFDI projects, the motion was later revised through the "*Notice on Strengthening the Control of Foreign Investment*" in 1991. From then on, the State Planning Commission (now called NDRC- National Development and Reform Commission) examined feasibility reports for each proposed OFDI project. For investments of over US$ 30 million several stakeholders were involved: ranging from NDRC, to MOFTEC and ultimately the State Council. This strengthened the governmental control considerably and set new bureaucratic standards for the approval of OFDI related projects. (Li 2009, 39)

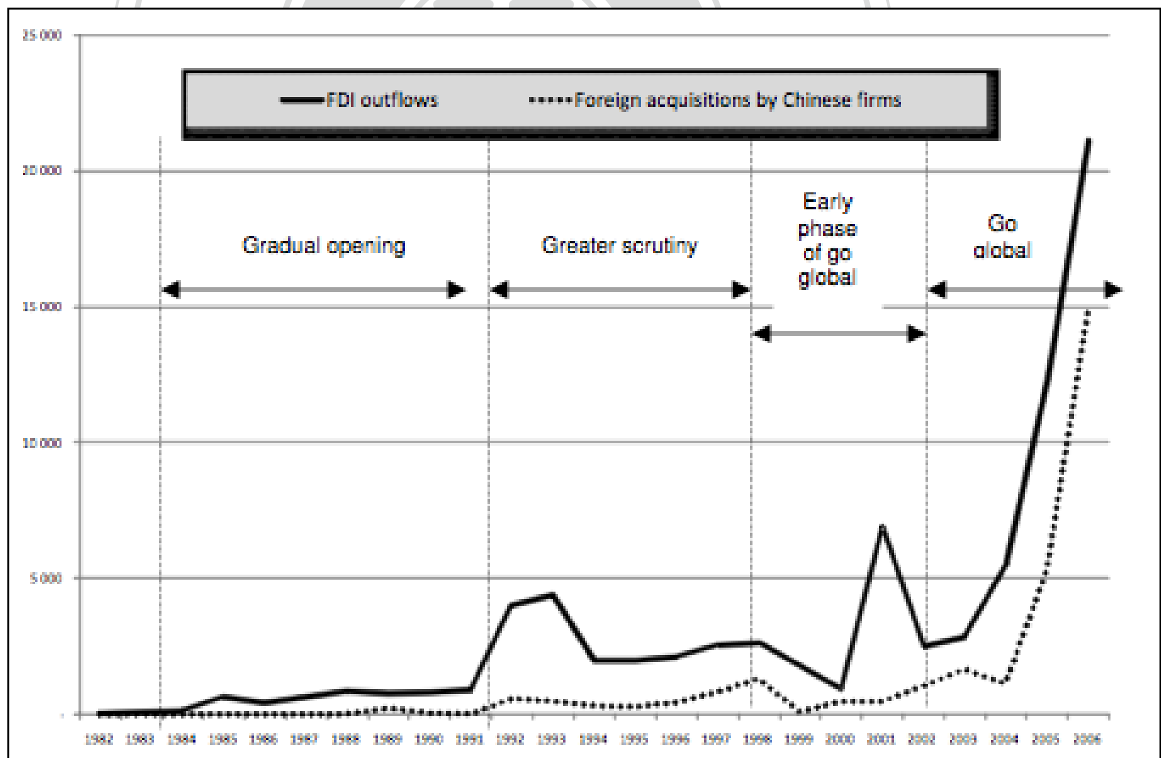
Stage three lies between 1993 and 1998. In 1993 MOFTEC drafted the "*Regulation on the Administration of Chinese Overseas Enterprises*". It set forth that MOFTEC was to be in charge of the approval and examination process. The NDRC was to evaluate the project proposal and feasibility report. The provincial level Foreign Trade Departments were to be the governing bodies of the overseas enterprises, with the Chinese embassies' economic and commercial departments coordinating the overseas enterprises. Due to the efficient administrative division, OFDI grew to US$ 0.7 billion per year. (Li 2009, 39)

Stage four lies between 1999 and 2001. The State Council allowed enterprises to set up assembly operations and processing of raw materials abroad in 1999. Subsequently the approval process changed: Now, first the State Economic and Trade Commission

(SETC) examined both proposal and feasibility report. Then MOFTEC granted approval based on its own examination and the approval of commercial departments in Chinese embassies in cooperation with the State Economics and Commerce Commission. (Wang 2002, 194). The change in procedure resulted in a doubling of OFDI per company to US$ 2.18 million. (Li 2009, 40)

If not administrative reform, but numbers are concerned, there are similarly four stages to be discerned. It goes without saying that all are interlinked with the administrative developments. What becomes clear when analyzing the graph below, is that Chinese OFDI only took on considerable speed after 2001, when the Go Global Policy was officially adopted.[8] The Go Global Policy was expression to the understanding that Chinese companies were now ready to play an active role in a globalized economy- resulting in rapid increase of OFDI and foreign acquisitions by Chinese firms.

**Figure 7: China's Outward Direct Investment and Cross-Border Acquisitions,**




Source: Nicolas/Thomsen 2008, 3.

[8] The official starting year of the Go Global Policy is still contested. Proposed starting dates range between 1998 (Cai 2006) and 2003 (Kaartemo 2007). This paper assumes the position of the tenth five year plan being the official start date, thus making it the year 2001.

Accordingly the key initiative put forward in the tenth five-year plan was to encourage the State-Owned Enterprises to invest abroad, and they received considerable support from the government for this end. (Voss/ Buckley/ Cross 2008, 15) As China was forced to open its protected domestic markets to comply with its accession protocols to WTO, especially private enterprises found themselves forced to expand abroad in order to secure their position in the domestic realm and to explore new opportunities abroad. (Taylor 2002, 223)

As Voss et al (2008, 16) note, the accession to WTO has sparked a host of initiatives to aid companies move abroad, essentially leading to the body of the Go Global Policy. First, the investment approval process has been moved to sub-national authorities and now only investment in selected countries required approval from national level. Furthermore, the requirement of conducting a financial feasibility study was abolished or simplified to speed up the overall investment approval process. (Yin/ Stender/ Song 2003, 75) Also, sourcing of funds on international financial markets was gradually permitted and control of capital movement relaxed:

> *"Previously, companies planning to take any foreign exchange out of China to finance investment, would have to place a minimum sum of five per cent of the value of the proposed investment with a bank designated by SAFE as a security deposit. (...) After October 2002, firms were no longer required to pay the security deposit to SAFE, and they could now go directly to the foreign exchange market to acquire the needed foreign currencies to invest overseas."* (Wong/ Chan 2003, 283)

Foreign exchange risk assessment, foreign exchange deposits, and exchange rate risk analysis requirements were all abolished during and after 2003. (Yin et al 2003, 76) The financial management approval process was further liberalized through the SAFE Circular "*Issues Relevant to Further Intensifying the Reform of Foreign Exchange Administration on External Investments Circular"*, which established de-facto equal treatment for private and state owned enterprises. The State Administration on Foreign Exchange (SAFE) allowed for the increasing use of foreign exchange in the

set-up process and abolished the limit of foreign exchange for outbound investment in place before 2006:

> *"The 2006 Circular (SAFE) removed the previous limit on the overall annual amount of foreign exchange that may be approved on a nation-wide basis for use in outward foreign direct investment transactions. This limit was raised to US$5 billion under the 2005 Circular from the previous level of US$3.3 billion."* (Stender/ Yin/ Sheets/ Cui 2006, 26)

The decentralization of foreign exchange purchase for OFDI from national SAFE headquarters to regional SAFE bureaus in 2005, further eased the implementation process of OFDI projects. (Zhao 2006, 20)

The host of initiatives sparked through Go Global has also changed the role of MOFCOM in the approval process. MOFCOM's regional subsidiaries now review all applications and the national level MOFCOM only reviews those applications by companies under state supervision or with investment projects in selected seven countries (such as the US or Iraq). Furthermore, the size of investment now defines the merits of administrative management:

> *"Resource-seeking FDI exceeding an investment value of USD 30 million and non-resource seeking FDI exceeding USD 10 million have to receive approval from the NDRC (...) Resource-seeking investments above USD 200 million and non-resource seeking investment above USD 50 million have to be approved by the State Council (...)"* (Buckley et al 2008, 17)

As the overall administrative process was eased for average OFDI projects, stricter regulations remain in place to control OFDI flows to countries that do not hold diplomatic relations with the PRC and for Taiwan- these are monitored by the State Council and National Development and Reform Commission (NDRC).
The Chinese OFDI is now coming from various industries, accordingly the involvement of more specialized agencies, such as the Chinese Insurance Regulatory Commission or the Ministry of Foreign Affairs has evolved over time. The overall OFDI regime in China is expected to loosen further, as the Chinese Central Bank now

allows RMB to be used in OFDI projects. As Sun Lujun, director of capital management department at SAFE, told China Daily (2011), China aims to further liberalize capital control until 2015. (LanLan 2011) This official endorsement goes beyond mere tolerance- it entails access to acquisition funds and loans. (Antkiewicz/Whalley 2006, 4) Access however is granted based on government strategic preferences, thus channeling investment into certain target countries and industries:

> *"In July 2004, Mofcom and the Ministry of Foreign Affairs jointly issued the Investment in Foreign Countries Industry Sector Catalogue (Outbound Catalogue). This sets out a list of preferred industry sectors in 67 countries and is backed by a broad range of incentives offering priority access to finance, tax concessions and preferential customs treatment to companies that comply."* (Deschandol/ Luckock 2005, 31)

Accordingly, the Go Global Policy is heavily enmeshed not only with trade relations and strategic decision-making within the companies, but also backed by a whole set of foreign relations initiatives. State visits and the conclusion of treaties and agreements with investment markets further facilitate a smooth flow of OFDI. This is particularly visible in the case of Chinese investment to Africa, where extensive diplomatic overtures are applied from the Chinese side. (Rotberg 2008, 3)

## 5.5 The Chinese Sovereign Wealth Fund CIC

China has been under growing scrutiny, as many suggested it would employ its foreign reserves to fund direct investment in other parts of the world. In 2007, the China Investment Corporation (CIC) -a Sovereign Wealth Fund- was established by the Ministry of Finance. CIC, according to its own website, is *"(...) an investment institution established as a wholly state-owned company under the Company Law of the People's Republic of China and headquartered in Beijing."* It manages parts of China's foreign exchange reserves and is among the largest SWFs of its kind. In actuality, the CIC is not the first fund of its kind in China, but *"(...) was established in*

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*2007 by the amalgamation of the government-run investment bodies, Central Huijin Investment Company and China Jianyin Investment Limited."* (Voss et al 2008, 16)

Its budget was set at 200 billion US$, but has subsequently doubled until 2010. In its first year of operation alone, CIC handled transactions amounting to 21 billion US$. Given that this was still in times of grave economic crisis, it seems little surprise that in the following year a rise to 58 billion US$ had taken place. These investments focused on traditional areas of interest to China: natural resources such as coal, oil and gas, but it also ventured into renewable energy. Accordingly, investment destinations were established resource producers, such as Canada, Russia or Kazakhstan. While this may suggest a regional focus, CIC itself states that *"CIC's investments are not limited to any particular sector, geography, or asset class and include equity, fixed income, and alternative assets."* According to an analysis piece in *Wirtschaftswoche* (German Economic Times), a leading German economics paper, 90 billion of the starting 200 billion US$ were intended for investments abroad, the rest was to be used in support of Chinese companies and banks setting up shop overseas. (Giesen 2008)

While most Sovereign Wealth Funds rely on tax funds, CIC's seed capital is based on state bonds, which were issued by the Ministry of Finance in 2007. Given the fact that the CIC has to pay interest on such loans, requires it to achieve a comparatively high returns ratio on its investments. To date, the most widely known investment by the CIC is its controversial stake in Blackstone, a US private equity firm. It further acquired a stake in Morgan Stanley, which was later expanded to a substantial 10 per cent stake. Its rather unsuccessful investments in the past and the pressure of interest payments lead to the conclusion that the CIC is effectively relying on subsidies by the Chinese state.

Currently the CIC is diversifying its operations on a global scale. In 2010, the CIC established both a subsidiary in Hong Kong and opened an office in Toronto. (Anderlini 2010; Hoffmann 2011) The office in Canada is the first foreign location of the state fund and follows several large-scale investments in local mining and resource extraction industries. However the CIC is not simply focused on resource rich nations, but diversifies its investments to a global reach and across all sectors. Its most current coup is its 8.68 per cent stake in Thames Water, the London water supplier. (Reuters

2012) The CIC and with it the entire spectrum of multinational companies from China, have thus reached a turning point towards establishing a global reach- making it possible to acquire a foothold across all industries, worldwide.

## 5.6 Geographic Distribution of Chinese FDI

If the amount of media coverage were taken into consideration for this analysis, it may appear that the PRC has indeed been steadily on track to buy up the entire global M&A market. Given its immense foreign exchange reserves, this view appears all the more likely. In a similar vein, the statistics of the Chinese ministry of trade, as well as those issued through OECD and UNCTAD appear to underline the tremendous increase in FDI outflows from China over the past years. While already starting in the billion dollar range, analysts underline that OFDI from China multiplied by factor nine between 2002 and 2007 alone.

It is indeed breathtaking how quickly Chinese enterprises appear on foreign markets even in the most remote parts of the world. However this should not obstruct the observation that China's OFDI is still rather limited. In 2009, it measured up to only one quarter of that of Hong Kong. (Heidel 2010a, 9) While if Hong Kong and Mainland China were counted together it would make for around the same amount of OFDI as Germany, still the parity is considerable. Furthermore, a large share of Chinese FDI is regionally concentrated. In 2009, 75 per cent of Chinese investments went to neighboring Asian countries. According to the Chinese Ministry of Trade, Asian countries were followed by Latin America with around 12 per cent, Africa with only 4 per cent and Europe accounting for a mere 2.6 per cent.

Those leading the pack as Chinese investment destinations in Asia were Hong Kong, Singapore and Macau. This is by far no surprise- all of the above serve as tax havens to Chinese businesses. In fact, if all streams of OFDI emerging from China are analyzed on a global scale, we can find a surprisingly large amount of money going to tax havens such as the British Virgin Islands or Bermuda:

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*„The top locations are Hong Kong and Caribbean tax havens. These consistently account for about 70% of the flow. These countries provide confidentiality to foreign investors, and so are commonly used by multinational firms to store wealth beyond the purview of tax authorities (Harris, 1993). (...) Chinese subsidiaries in these countries might serve as holding companies for investments elsewhere (...)"* (Morck 2007, 4)

Indeed this poses a grave analytical problem. If a substantial part of Chinese OFDI is in fact flowing to tax havens and is then redistributed through holding companies, it becomes difficult to comment on the true size or geographical distribution of Chinese FDI. (Quer/ Claver/ Rienda n.d., 7) As FDI that is channeled into tax havens and offshore financial centers will typically be invested elsewhere, or remitted to a prior destination at favorable terms, these tax havens are not the ultimate point of investment for the FDI. (Cheng et al 2008, 19)

This may well indicate, that a substantial part of Chinese FDI is indeed not FDI in the actual sense of the word, but much rather *"(...) flows following circuitous routes through tax havens (Virgin Islands, Cayman Islands or Bermuda)"* (Milleli et al 2008, 10) and ultimately back into China. Indeed this raises another question with regards to Chinese OFDI, as some officials from Chinese firms may use tax havens moving funds abroad to acquire them for self-enrichment- thus casting doubt upon the very *"(...) extent to which economic fundamentals genuinely drive China's outward FDI."* (Morck 2007, 5)

While this may cut down the actual amount of OFDI from China, other factors further obstruct our knowledge from another angle. As China has gradually opened up the possibility to raise funds abroad, a large share of what is raised (through reinvestment of earnings, loans through the parent company or new equity through financial markets) is not taken into consideration by official statistics. Beyond this, a Chinese company may prefer to discount the amounts invested for fear of facing foreign exchange controls. (Milleli et al 2008, 10) However given the gradually liberalized FDI regime in China, this influence should have substantially diminished in size and importance.

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While numbers themselves are clearly more obstructing than in any way helpful, the only possibility is to analyze Chinese OFDI excluding the dominant tax havens of Cayman Islands and British Virgin Islands. If analyzed exclusively, *"(...) the top 10 recipients of China's FDI in 2005 were Hong Kong (which is also a tax haven), South Korea, US, Russia, Australia, Germany, Sudan, and Kazakhstan. In 2004, Indonesia, Singapore, and Nigeria replaced South Korea, Germany, and Kazakhstan."* (Ma/ Cheng 2007, 9) Interesting to note is the mixture of highly developed countries and resource rich nations alike. The China Council for the Promotion of International Trade found in its 2010 Survey on *"Intentions of Outbound Investment by Chinese Enterprise"*, that developed countries (EU and US) have an increasing appeal for Chinese investment. (CCPIT 2010, 8) The most attractive countries for Chinese investors are *„(...) the United States, followed by Japan, France, Germany and Hong Kong. Chinese companies seem thus to prefer big markets by investing in the Triad but also geographically close markets (...)"* (CCPIT 2010, 54)

Likewise, the growth rates for Chinese FDI in markets that are either resource rich or highly developed have increased faster than in other investment destinations. In Africa, the Chinese investments grew by factor 19 between 2003 and 2009. The same is true for the European countries, which experienced a growth of FDI from China by factor 18 within the same time-span. While Chinese investment has overall experienced a growth rate by factor four between 2005 and 2009, the rates achieved in Europe and Africa by far outpace those achieved in Asia or other parts of the world. (Heidel 2010a, 10) In general, two types of thriving destinations for Chinese FDI can thus be distinguished:

> *„Europe and North America aiming at strategic-assets and efficiency seeking investments (in capital and technology-intense goods and services) and Asia, including Central Asia and Russia, Middle East, Latin America and Africa as a market and resource-seeking (OFDI labour-intense)."* (Krusiewicz 2011, 10)

Furthermore it appears, that while China follows one motive in developing countries (resources and markets), its strategies in the developed markets are multifaceted and

driven by a host of motives. These include access to markets, technology, knowledge, management skills, brands and efficiency gains. (Zhang/ Filipov 2009, 10)

The developed markets take a special place among Chinese investment destinations. While technology and skills are what drives Chinese investors to them in general, still the sectors of interest for Chinese FDI are different from US to Europe. The largest proportion of investment towards the USA was in the banking and finance sectors (with a total value of 19,50 billion US$, accounting for two thirds of all Chinese OFDI in North America). Europe, on the other hand has been the main target for investment in energy, power and transport sectors. (Krusiewicz 2011, 24)

The US as well as Europe are both on the cusp of becoming important investment destinations for the Chinese. Both US and Europe are themselves investors to other parts of the world and have experienced an inflow of investment to their domestic markets. Thus both the US and Europe are familiar with foreign investment, yet the case of Chinese OFDI is somewhat of a different nature:

> *„Prima facie, the rise of Chinese investment in Europe differs from earlier waves of investment from the United States and later from Japan. Many Chinese firms are going abroad to become globally competitive rather than to exploit advantages developed at home."* (Nicolas et al 2008, 2)

## 5.7 Chinese FDI to developed economies: Europe

Recently China appears to be on its way to make Europe its latest economic conquest. It buys state bonds of highly indebted European countries, including Spain, Portugal and Greece. (Reuters 2010) Chinese companies participate and win tenders for public infrastructure works in Poland and in the Balkans. (BBC 2009) Chinese brands suddenly appear on European markets- formerly unknown Chinese brand names like Huawei, Haier or even Changyu are carving out a new presence on their own terms. And Chinese enterprises are buying up European companies like there is no tomorrow- or so at least the media say.

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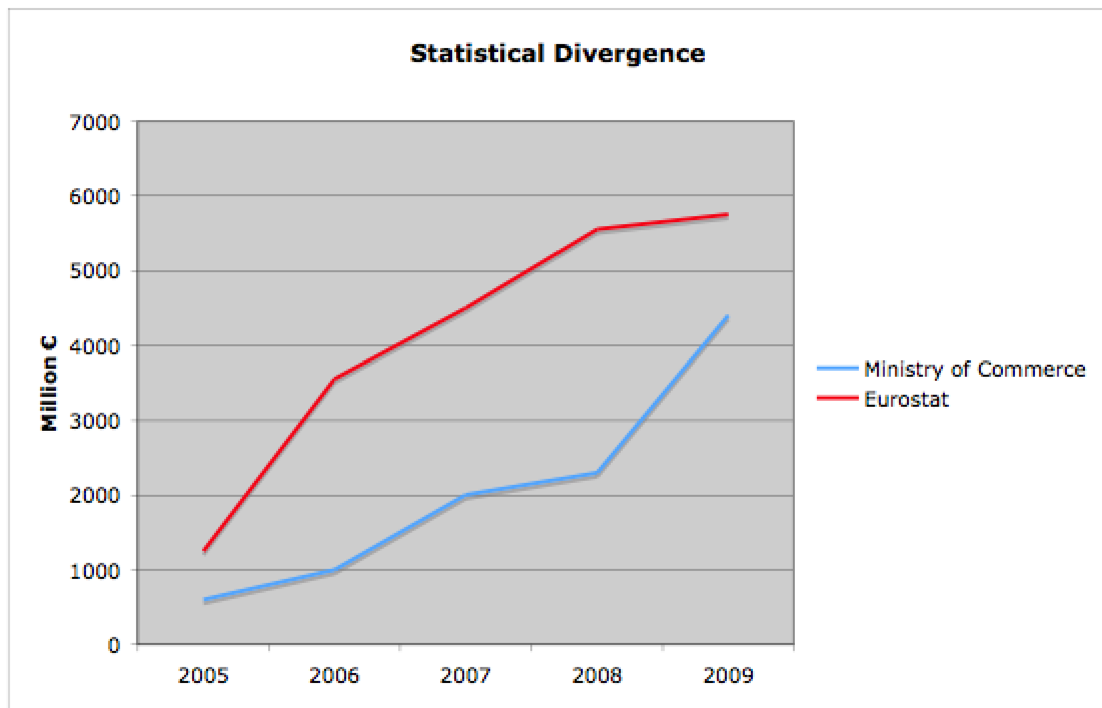
Chinese investment to European countries has increased rapidly in size. Overall Chinese investments have grown by factor 18 since 2003- more than 3 billion US$ have been invested by Chinese companies. The State Fund CIC- China Investment Corporation has already invested more than 20 per cent of its holdings in Europe. (Kamp 2010) And indeed, Europe is an attractive investment location for Chinese enterprises. The integrated market of the EU 27 and its single currency system in addition to good regulatory framework are all key factors in shaping an environment conducive to investment. (CCPIT 2010, 63)

Even during times of crisis, Chinese investors have increased their involvement in Europe.  Currently, China is planning to set up a new investment fund with a budget in excess of more than 300 billion US$, targeting Europe in particular. The fund is to conduct investments only in the mature markets of the US and EU countries. The new fund is set to be under management of the People's Bank of China, which also manages the foreign reserves. (NfA 2011)

Nonetheless, we still know very little about the actual size of current Chinese investments and investment locations in Europe. Statistics of the European agency *Eurostat* show that data gaps prevail with regard to Chinese investment to the European Union. In 2009 around 36 per cent of all Mainland Chinese investments could not be attached to specific investment destinations. Yet, based on the available data, it is still possible to identify a certain recent regional focus on Western Europe, as *"(...) the United Kingdom, France and Germany focus to 60 percent of Chinese investments since 2008."* (Shi/ Hay/ Milleli 2010, 14)

Secondly, the statistics provided by the statistical office of the EU, assume the factual Chinese investment (including Hong Kong) to be much higher than indicated in Chinese statistics. Between the years 2006 and 2008 this divergence was the most pronounced:

**Figure 8: Chinese Investment in the European Union**, comparison between statistical data of Chinese Ministry of Commerce and EU Statistical Agency Eurostat




Source: Heidel 2010 b, 16.

It is assumed that the official Chinese statistics on OFDI understate its actual amount, since only the investments of registered Chinese firms are accounted for. Also, lacking systems on national and local data make a clear analysis for the time prior to 2003 impossible, since investment below US$350,000 as well as debt financed OFDI were not considered in national level statistics. (Nicolas et al 2008, 6)

Though on the rise, Chinese investments are currently still of marginal importance to the overall EU economy. Compared to all other non-European investors, in 2009 China only held 0.29 per cent of all foreign investments in Europe. Adding in the investments originating in Hong Kong, the total Chinese investments still accounted to a meager 1.6 per cent. In a list compiled by the American Heritage Foundation, sampling all Chinese investments above a 100 million US$ threshold, destination Europe comes in last with only 8 per cent of such investments. (American Heritage Foundation 2012)

Thus it is safe and sound to state, that until now, Europe is only a secondary investment destination for Chinese OFDI, as compared to a primary one like Asia. However, given the current rise in OFDI-rates to some (primary) European destinations, the nature of the game may soon be much more in flux. The economic crisis has provided ample opportunity for takeovers of so far inaccessible market leaders in technology, manufacturing or IT- the backbones of European economy.

When entering the European market, the majority of Chinese companies primarily concentrate on Greenfield Investments. (Shi et al 2010, 10) The creation of local subsidiaries minimizes risks and transaction cost, which would increase manifold with a takeover procedure in a legal context literally foreign to the investor. Another growing entry-route however is the acquisition of a former subcontractor or partner, particularly if opportunity arises due to financial vulnerability of that enterprise:

> *„Cross-border M&As by Chinese firms are gaining in importance (...) In Europe, one can identify three main categories of firms targeted by Chinese acquirers: ailing or financially distressed firms (...), competitive niche producers (...) and former partners or sub- contractors/suppliers (...). They can take the form of outright acquisitions or start with a strategic investment which is eventually followed by a complete takeover.“* (Nicolas et al 2008, 20)

For obtaining protected know-how or technology, it is more convenient for Chinese investors to acquire a foreign firm rather than start a Greenfield operation. Through acquisition they can directly gain access to the firm's knowledge and technology, as well as existing customer base. This may in turn also allow them to channel know-how back to the domestic market to upgrade production there. (Deng 2004, 11)

Chinese investors in general are very focused on specific areas of expertise in Europe. They tend to gravitate around local strong points; thus in each country they tend to show a different interest: Chinese investors focus on electrical and electronic equipment mainly in France, Italy and Spain; on automotive equipment in the UK; and on mechanics and telecommunications in Germany. A recent addition to this

preferred portfolio is in energy. Investment in renewable energy from China, which was practically non-existent prior to 2008, occupied a significant 11 per cent of Chinese investments to Europe after the crisis. 41 per cent of these investments are directed to Germany and 22 per cent to France. (Shi et al 2010, 15) Furthermore, Chinese investors are starting to dive into R&D projects- while by the turn of the century R&D was accounting for virtually zero per cent, investments into R&D grew from zero to considerable 2.8 per cent in 2006. (Nicolas et al 2008, 15)

This investment activity towards European industries is still highly focused and selective on key countries within the European framework. To Chinese investors, Western Europe is a repository of technological assets required for international competitiveness. However Chinese investors increasingly also make use of the free market within the European Union- using eastern Europe as a gateway for market entrance in other parts of Europe:

> *„(...) Europe represents a particular case, mainly due to the European integration. (…) by entering only one member state, Chinese companies de facto get access to the entire Single European market."* (Zhang et al 2009, 5)

This new strategy is underlined by increasing investments in (still "low-pay-") locations such as Romania and Bulgaria, using these new member states as platforms for European operations. (NfA 2012)

In the past years, reports on China and its M&A behavior in Europe have often seen the extensive use of aggressive vocabulary: Chinese investors have been termed "*dragons*", that are "*hungry*" for European companies. (Drewe 2010) Indeed, the climate for M&A transactions in recent years has been favorable for Chinese companies, as the continent was heavily affected by the economic downturn since 2008. This crisis drove a lot of smaller and medium sized companies into financial problems, if not bankruptcy, opening convenient alleys for takeover. This has not been limited to the already weak Southern European economies, but likewise impacted mature economies like France or Germany. As Li Jian, a researcher at the Chinese Academy of International Trade and Economic Cooperation notes: "*The global*

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*economic crisis allows Chinese companies, with their ample cash reserves, strategic cross-border partnerships with cash-strapped international companies (...)"* (China Daily 2011) A concurring publication issued by the German federal Ministry of Economics and Technology states that the economic crisis did not hamper Chinese investments- the Ministry on its part instead notes that the currently low prices for takeovers instead represent favorable conditions for foreign investment. (BMWI 2009c) As the crisis did not affect the Chinese economy on a similar scale as it did with the US- or EU economy, observers worry that *"Beijing will be in a position to assist other nations financially and make key investments (...) at a time when the West cannot."* (Altman 2009) This means only a few states are able to benefit from the financial crisis, but those who do, will ultimately strengthen their global position through investment.

While this has created much ado about Chinese investments on the European side, the Chinese themselves point out that by deploying hard currency to buy assets in European countries, China is getting more than just low prices. They argue that China is setting an example as a responsible global power, securing or creating jobs and helping Europe overcome the crisis through its increased consumption of European goods. (Becker 2011) However, where China has in the past stretched out its monetary arm to ailing European countries, it naturally did expect something in return. Many investments helped to advance the interest of Chinese companies- one example by Liz Alderman in the NY Times: credit lines of 4.5 billion US$ were extended to troubled Greek shipbuilders in 2010, but only under the condition of using the money to purchase Chinese materials. (Alderman 2010)

On the whole, Chinese investments to Europe have –so far- clearly not gained an economic importance that would be on par with the media attention paid towards it. Nevertheless, growth rates of Chinese OFDI to the EU point to a substantial importance in the years to come. This may indeed become more of a problem, as investing companies from the PRC are not only mostly state owned (Zhang et al 2009, 19), but seek to acquire the crucial resources of European companies: technology, knowledge and know-how. (Milleli et al 2008, 13)

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China has liberalized its FDI regime and actively promotes investments with the aim to enhance capabilities of its domestic firms, creating fierce competition to their European counterparts. (Berger et al 2008, 3) Given the regional concentration currently prevailing to Western Europe, this effect will be more significant to some European countries rather than to others (or persist in substantially different ways). Among the countries under increasing scrutiny should therefore be Germany, as *"(...) Germany is the top target country, in Europe, for the investments and acquisitions made by Chinese companies (...) German medium-sized companies with specific and valuable technical know-how and customer bases are of particular interest (...)"* (Milleli et al 2008, 12; Cooke 2008, 240)

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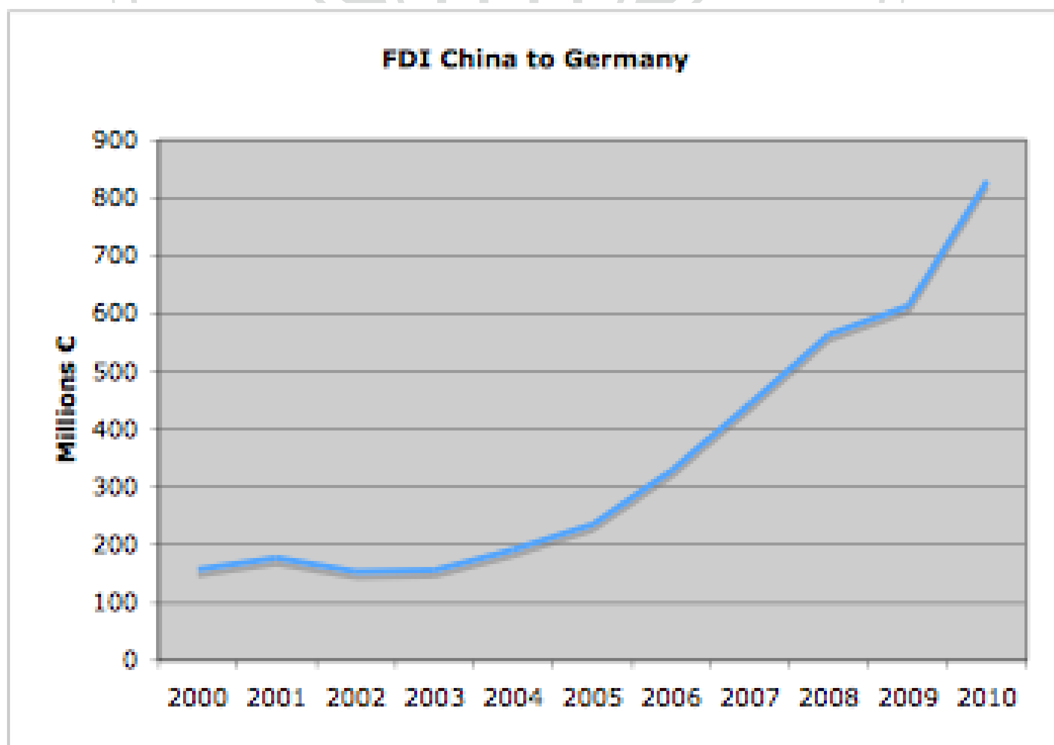
# 6. Chinese Investment to Germany

## 6.1 Between Facts and Fallacies

Germany is currently among the most important investment destinations for Chinese enterprises in Europe. Considering the volume of investment, Germany was only rivaled by the UK, France and Switzerland. (Nicolas et al 2008, 15) While being on the rise in Europe in general, the growth rates for Chinese investments realized in Germany in particular, are rather exceptional: From 2003-2008, the investment flows from China to Germany have increased by impressive 265 per cent. (Heidel 2010c, 24) In 2007, a record 1.7 billion US$ were invested in Germany by Chinese companies or public funds, with quicker spikes in growth rates over time. As can be seen from the statistics of the German Central Bank Database, Chinese investment grew modestly between 2000 and 2005 and started to gain speed between 2006 and 2009, only to finally take off from the end of 2010:

**Figure 9: Chinese FDI to Germany between 2000-2010**




Source: German Central Bank 2011.

The influx of investments from China is largely due to the special economic positioning of Germany as the largest economy in the EU and its role as one of the largest exporters globally. Germany further attracts foreign investors through its high technological standards, stable political system, sound legal protections, quality of workforce and location in the heart of the EU. For Chinese investors in particular, the positive reputation of the "orderly", "punctual" German may play a secondary role- yet remains somewhat relevant for the choice of location. (Sohm/ Linke/ Klossek 2009, 13)

Given the current surge in Chinese OFDI to Germany, it may seem that FDI from China were a recent phenomenon. However this is by no means the case. Starting as early as the late 1980s, large State-Owned Enterprises set up subsidiaries in Germany. A well-known example is Baosteel, which established its Baosteel Europe Holding in Germany in 1993. However, at that time Chinese companies in Germany were exceptional. Today, Chinese investors seem to have discovered the German direct investment market for themselves, as many companies from the PRC are now drawn to Germany.

While it is impossible to say how many Chinese companies operate in Germany today, governmental estimates speak of 800 to 1000 Chinese holding companies and branch offices of Chinese companies. (BMWI 2009, 11) Some estimates range even higher and reach up to 2000 companies. Based on data analysis, this study finds it likely that a number of more than 2000 Chinese companies are currently present in Germany. Yet it remains difficult to determine a precise number, since the statistics of the German Central Bank only track those foreign investments into companies with total balance sheet assets of at least three million Euros and a foreign equity stake of more than 10 per cent.

The overall majority of Chinese companies entering the German market are SMEs, so called small to medium sized enterprises. These Chinese companies on average have less than 10 employees. This however is not unusual for the sectors in which they operate, as knowledge intensive industries- like engineering, services and telecommunications- are in general less labor intensive. (Tirpitz/ Groll/ Ghane, 1) Furthermore, the realized investments of the average Chinese investor range below the

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50,000€ threshold. It needs to be pointed out though, that Chinese investors usually employ a "*crossing the river by feeling for the stones strategy*" strategy. Their companies start out with a smaller strategic investment, later often followed by a complete takeover. (Nicolas et al 2008, 20)

There are two equally favored entrance strategies employed by Chinese investors to Germany. The first is the foundation of a branch office, which can later be grown into a subsidiary. The other is the acquisition or merger with an already existing German company. (Sohm et al 2009, 138) It can be said, that the two strategies are employed by two different kinds of companies.

While smaller companies tend to undertake a Greenfield Investment by setting up a local branch office, larger companies tend to use acquisitions of ailing companies to gain quick market access. (Tirpitz et al, 29) In this way, Chinese companies have been able to acquire not only small niche producers.

Recently Chinese *Sany* was able to target Putzmeister- a global market leader in manufacturing of cementation pumps. The deal led to public controversies, as the company is a traditional family-owned enterprise and was sold off to a Chinese competitor. Putzmeister was by far not an ailing company at the time of takeover, like many other acquisition targets, but market contraction and availability of funds for Chinese companies changed the game. This made it possible for an unlikely outsider like Sany to take over a market leader. (Klawitter/ Wagner 2012) An exemplary (and by no means comprehensive!) compilation of other takeovers between 2002 and 2011 can be found in the table below and shall exemplify Chinese M&A activity in Germany. The information compiled below stems from a variety of media outlets, individual company homepages and the chambers of commerce.

**Figure 10: List of Chinese Acquisitions in Germany between 2002-2012**

| *Year* | *Holding* | *Acquired Object* | *Chinese Acquirer* |
|---|---|---|---|
| **2002** | 100 % | Schneider Electronics AG | TCL International |
| **2003** | 100 % | Boewe Textile Cleaning | Sail Start Shanghai |
| **2003** | 100 % | Welz Industrieprodukte | Huapeng Trading |
| **2003** | 100 % | Lutz Maschinenbau GmbH | ZQ Tools |
| **2004** | 94.9 % | Dürkopp Adler AG | Shanggong |
| **2004** | 51 % | Schiess AG | Qinchuan Machine Tool |
| **2004** | Majority | F. Zimmermann GmbH | Dalian Machine Tool Group |
| **2005** | 50 % | Hoechst AG Research | Sunstar Membrane Technology |
| **2005** | 100 % | Kelch GmbH & Co KG | Harbin Measuring Cutting Tool |
| **2005** | 100 % | Grosse Jac | Qingdao Hisun Garment |
| **2005** | 100 % | Waldrich Coburg GmbH | Biejing No.1 Machine Tool Plant |
| **2007** | 100 % | NOI Nordhausen | Sinoi GmbH/ CNBM Group |
| **2008** | 70 % | Vensys Energy AG | Goldwind Windenergy GmbH |
| **2008** | 100 % | KSL Kuttler Automation | Suntech Power GmbH |
| **2009** | 100 % | Assyst Bullmer | New Jack Sewing Machine |
| **2010** | Voting stock | Ermag | Jiangsu Jinsheng |
| **2010** | 20 % | KHD Humboldt Wedag | AVIC |
| **2011** | 100 % | KSM Castings | Citic |
| **2011** | 55 % | Medion | Lenovo |
| **2011** | 100 % | Saargummi | CQLT |
| **2011** | 74,9 % | Preh | Joyson Investment |
| **2012** | 100 % | Putzmeister | Sany |

Still the overall transaction volume remained limited in all of the above cases, as most of the companies acquired faced serious financial troubles before the takeover. However, as signaled by the takeovers of Medion, Saargummi or Putzmeister, this is not a standard procedure anymore. Chinese investors are increasing their spectrum into more complex and costly acquisitions. Pricewaterhouse Coopers estimates that such a development will necessarily entail the rise of Chinese OFDI flows to Germany to reach more than 2 billion Euros. (PwC 2009, 6) It is also to be expected that Chinese investors will further narrow their focus to match the demands of the Chinese 'outbound catalogue' issued by MOFCOM and NDRC in order to access enough capital for costly acquisitions (Voss/ Buckley/ Cross 2009, 153). In this way they also benefit from Germany's strength in engineering, telecommunications and energy sectors most effectively. (Fuchs 2007)

A warning example for the outcome of such strategic investment behavior can be seen from the experience of the German Solar Electricity Industries. German Sunways, a medium sized solar panel producer, was partly acquired by the Chinese LDK Solar in 2010. (Murphy 2012) Only a few years earlier, this move would have been unheard of, as the German solar industries were ahead in technological leadership and dominated the domestic and international markets. Yet as the Chinese government prioritized the growth of its own solar panel industry, China quickly accelerated growth by offering cheap capital and government support. (Lu/ Liu 2010, 28)
In this way, German companies suffered subsequent loss of market shares, as they were not able to compete with the extremely low prices of Chinese producers (such as Yingli, Suntech, JA Solar or Trina). With crumbling market shares, German companies faced financial troubles and became easy targets for Chinese M&A, although German companies still possessed technologic leadership. In this way, the German solar industries fell prey to Chinese investors- due to circumstances these investors had themselves helped to create. This is in fact the opportunity cost attached to Chinese FDI, as the solar industries employ roughly 150.000 people and its 15.000 companies pay roughly 1.5 billion € in taxes annually. The Chinese influence here does indeed create externalities on behalf of the host economy. (Solarbusiness 2012)

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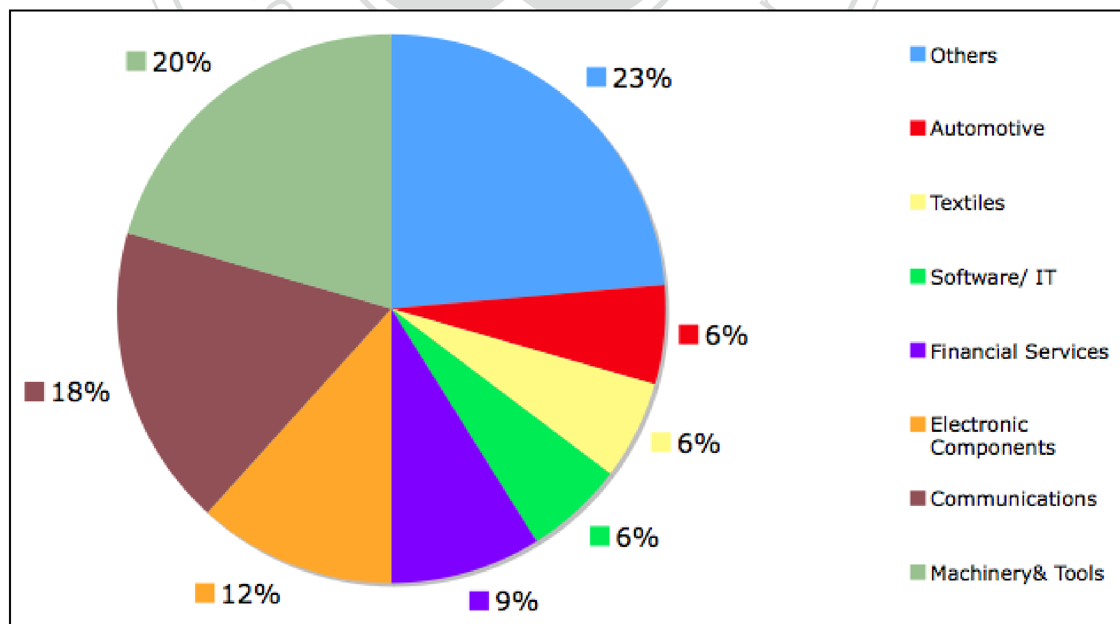
## 6.2 What do they do, where do they do it and how?

### 6.2.1 Sector Focus

Chinese investment projects to Germany tend to be regionally focused and cover a variety of selected sectors. Greenfield Investments tend to focus on three urban cluster regions, while M&A shows a more diverse geographic distribution. Overall Chinese firms tend to be more active in urban clusters and industrial cluster areas, also slowly tapping into the formerly inaccessible family business sphere of Germany.

According Handtke (2009), Chinese projects have a stringent sector focus. Most important remain investments in core sectors of the German economy- these include foremost engineering (machinery and equipment). Between 2003 and 2008 this sector constituted more than 20 per cent of all projects. Communications are also clearly on the rise, as Chinese telecommunication companies have established operations in Germany. These are followed by projects in electronic components, ranging at roundabout 12 per cent and financial services at ca. 9 per cent, software and IT at ca. 6 per cent, textiles at ca. 6 per cent and automotive at 6 per cent.

**Figure 11: Chinese Investment Projects in Germany 2003-2008**




Source: Handtke 2009.

Under particular scrutiny was the quick advancement of investment projects into the auto-industry-supplier market, especially between 2008 and 2011. A study by consultancy firm Roland Berger states, that in the German speaking regions of Europe (Germany, parts of Switzerland, and Austria) emerging market investors appeared with the financial crisis- providing ample opportunity as companies were suddenly for sale at discount prices. According to Roland Berger Consultancy, this has changed the regional breakdown of production volumes on a global scale. Traditional producers in Western Europe, the US and Japan substantially decreased production volume between 2007 and 2012, while China was able to grow its own by 22 per cent. (Roland Berger 2012) Though the numbers are not set in stone, investment flows accelerated at considerable speed and increased in impact, given favorable framework conditions, such as rising business insolvencies in the respective economies. (Creditreform 2009; Orr 2012)

Chinese investment projects are managed widely in accordance with the larger strategic aims proclaimed by the state- reinforced by financial incentives and preferential access to capital. (People's Daily 2009) While governmental subsidies clearly do play a role, the parent-subsidiary relationship in corporate governance of Chinese companies is likewise a key factor in deciding where and when to invest. According to a study by Yun Schüler-Zhou of 2009, around 215 Chinese companies in Germany are directly or indirectly governed through a parent company located in China. Thus the *subsidiary autonomy* (see Taggart/ Hood 1999, 229) is clearly limited with regards to corporate governance decisions taken by the branch office. Schüler-Zhou's study finds that subsidiary autonomy can range between complete autonomy to tight control exerted by the parent company. The deciding factor she finds is, which management task is concerned. While decisions in marketing and sales are handled with a very relaxed attitude towards the subsidiary, financial decisions are usually exercised with tight controls by the parent company from China. Thus investment decisions are, if not entirely managed from overseas, at least decided upon in a context of stringent supervision. Therefore it can be concluded for this study, that investment decisions taken by Chinese subsidiaries in Germany are essentially embedded into the wider framework of interests of the parent companies in China. This framework in turn entails economic as much as administrative and political

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pressures highlighted above. (Voss et al 2009, 153) Given the fact that some of the largest investors from China are subsidiaries of State-Owned Conglomerates, this tells us a lot about how investment decisions by Chinese companies come about and will develop in the future. Chinese governmental priorities are indeed highly relevant to future local investment behavior in Germany.

### 6.2.2 Regional Focus

It appears that Chinese investors have clear priorities with regard to location for their ventures in Germany. When it comes to decision-making on locations, they favor urban centers and metropolitan regions. Based on survey data retrieved from the federal Investment Agency of Germany (GTAI), as well as the state-level Investment Promotion Agencies of the federal states, we get a rather clear picture of this phenomenon.

When it comes to investment decisions in the field of M&A however, the focus is not as clearly focused on urban clusters. All investment decisions by any enterprise anywhere are mainly driven by financial considerations: The deciding factor for a buyout is primarily the cost of the acquisition, clearly overriding any location factor. From the listing of key Chinese investments in chapter 6.1 of this paper, we can see that many of the companies acquired by M&A were located outside of urban clusters, but rather in the rural industrial- and manufacturing hubs of Bavaria and Baden-Wuerttemberg. These two federal states are the strongest economic regions in Germany, and range among the top high-technology production locations in Europe. Innovation there is mainly based on family-owned SMEs, which account for more than 90 per cent of all companies. The technology and manufacturing focus of companies in Bavaria and Baden-Wuerttemberg corresponds to the catch-up needs and interests of Chinese investors. Furthermore, small to medium sized enterprises are easier targets than large companies, as less funds are needed and no unnecessary critical media attention is raised.

**Figure 12: Chinese companies in Germany by Federal State**

| Federal State | Number of Chinese companies | Source of Information |
|---|---|---|
| **North-Rhine Westphalia** | + 750 | NRW Invest 2012 |
| **Hesse** | + 400 | Hessen Agentur 2012 |
| **Lower Saxony** | + 20 | Germany Trade and Invest |
| **Hamburg** | + 420 | Hamburgische Gesellschaft für Wirtschaftsförderung mbH 2012 |
| **Schleswig-Holstein** | + 40 | Wirtschaftsförderung und Technologie- transfer Schleswig-Holstein (WTSH) 2012 |
| **Mecklenburg West-Pomerania** | No data available | |
| **Berlin** | + 230 | Bertelsmann 2010 |
| **Brandenburg** | + 5 | Bertelsmann 2010 |
| **Saxony** | No data available | |
| **Saxony Anhalt** | + 4 | Investieren in Sachsen Anhalt 2012 |
| **Thuringia** | + 3 | Bertelsmann 2010 |
| **Bavaria** | + 130 | Invest in Bavaria 2012 |
| **Baden-Wuerttemberg** | + 30 | Bertelsmann 2010 |
| **Saarland** | + 10 | Bertelsmann 2010 |
| **Rhineland Palatinate** | + 5 | Germany Trade and Invest |
| **Bremen** | + 100 | IHK Bremen 2012 |
| **Total** | *+ 2147* | |

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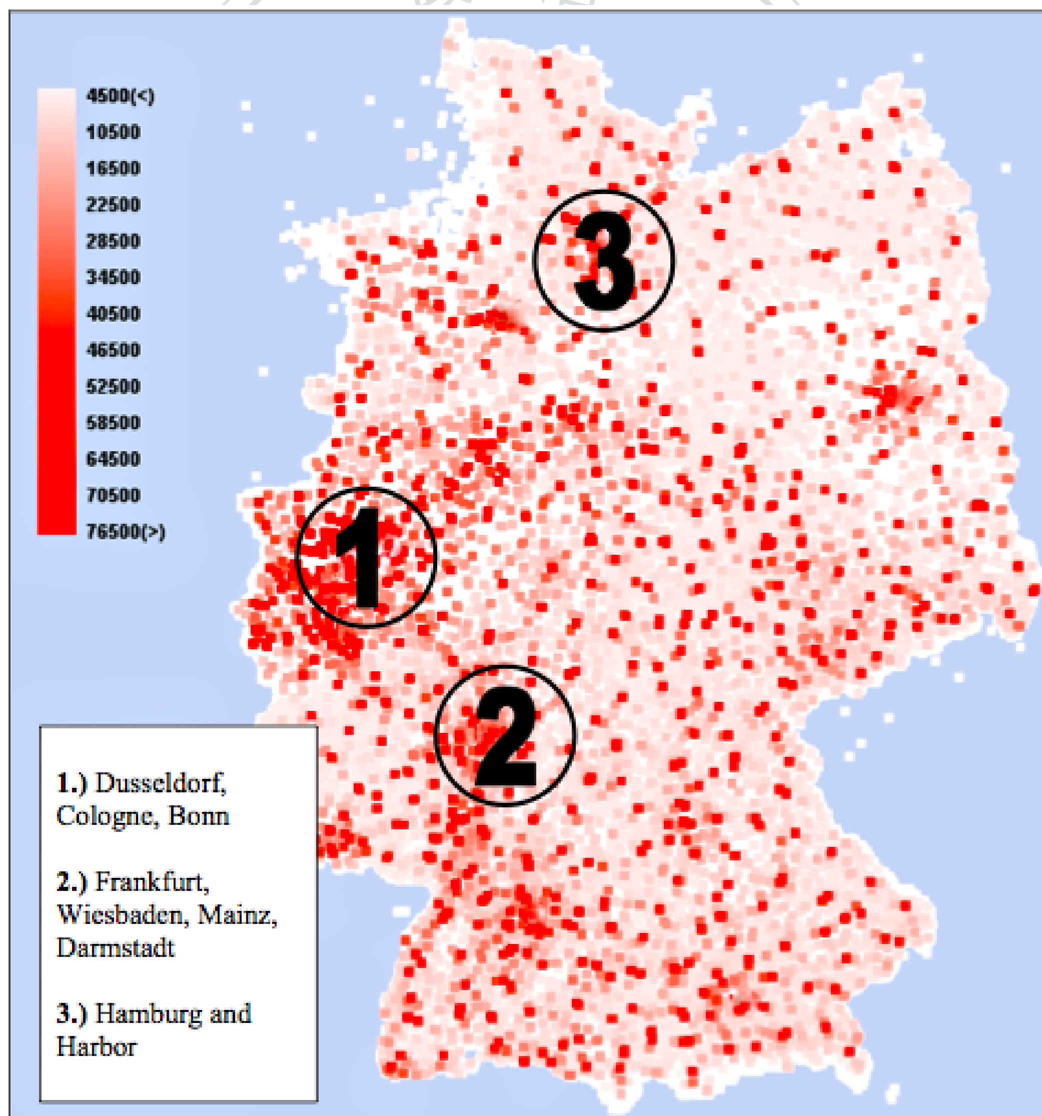
However, the data clearly states, that Chinese investors are most prominent in urban clusters like North-Rhine Westphalia (comprised of three cities: Cologne, Bonn and Dusseldorf), Hesse (with the metropolitan cluster of Rhine-Main region) and Hamburg (a city state with a harbor cluster). Overall, their number also appears to be twice as large as estimated in other studies. While this would likely lead to a wider spread into new locations, an urban focus still prevails. Chinese investors build clusters in metropolitan regions where they are well connected and find a favorable support-, transport- and communication network. The previous existence of a Chinese community in these locations surely places an additional emphasis on choosing to move there.

**Figure 13: Population Clusters with highest number of Chinese companies**




Source: adapted from Population Labs 2011.

The urban cluster consisting of the triangle of **Dusseldorf**, **Cologne** and **Bonn** is the primary location for Chinese companies to settle. The city of Dusseldorf is clearly taking the lead among all three. It is the service capital in Germany, with a strong focus on telecommunications, advertising and consultancy. It also offers a comprehensive banking system and is location of the second largest stock exchange in the country. Many international trading companies, especially Japanese, established their main offices here. The Chinese investors followed suit and now some 275 Chinese companies as well as some 90 Taiwanese companies are based in Dusseldorf. Dusseldorf is of particular interest to trade due to its geographic location: 35 per cent of the entire European population live within a radius of less than 500 km.[9] Taken together, the three cities constitute an urban agglomeration comparable in its size to metropolitan regions like London or New York- making it the largest agglomeration of its kind in Germany.

**Rhine-Main** is the most important transportation hub, as it offers the largest airport in Germany and the third largest in Europe, interlinked with Trans-European rail services and a network of express highways, connecting to the entire Europe. Due to its geographic location in the heart of Germany (and Western Europe), it is not only a major hub, but also a center of the service sector. Services constitute 74 per cent of the total gross value added.[10] Services include banking, insurances and other corporate services, with Frankfurt as the financial center of continental Europe. Frankfurt is host to the Federal German Central Bank and European Central Bank, the largest German Stock Exchange (DAX) and additional 300 banking institutions. Accordingly, Bank of China, Bank of Communications and China Construction Bank chose to locate here. They are joined by several major airline branch offices and telecommunication giants from China, which established their European headquarters here. Through proximity to international transportation links and the world of global finance, Frankfurt attracted over 6,100 Chinese citizens as permanent residents. Two important trading organizations from China followed suit: China Chamber of International Commerce as well as the China Council for the Promotion of International Trade are located here. (see Invest in Hessen 2012) One of the largest Chinese Consulates (if not the largest)

[9] Refer to: China Kompetenzzentrum (2012). Standort Düsseldorf. China Kompetenzzentrum 2012
[10] Refer to: Invest in Hessen (2012). Company Structure, a productive mixture. Invest in Hessen 2012

in Europe is located in Frankfurt. Still, the majority of Chinese companies set up shop no more than 10 years. (Wang 2008, 3)

**Hamburg** is a prime example for how an urban cluster attracts foreign investment from China. The city is a hub for commodity flows, especially in the logistics sector. Its industrial harbor is currently the largest harbor in Germany and second largest in Europe. Boasting such assets, the city is home to a large number of Asian companies, with around 650 companies setting up branch offices here: more than 400 Chinese companies, 60 Taiwanese companies, 40 Korean companies, 40 companies from Hong Kong and the European headquarters of Japanese conglomerates (more than 100 Japanese firms in total). (Matz 2009, 3) Hamburg is home to the European headquarters of some of the largest Chinese conglomerates, including Sinochem Trading Corp., Baosteel, Chinatex Trading Corp., COSCO, China Shipping and Sinotrans. The city further offers a good infrastructure to the large Chinese community of more than 10,000 people of Chinese origin with resident status: The Commercial section of the Chinese Consulate General is located here, a Chinese school was opened, Chinese shops, restaurants and Chinese newspapers are available. The city more or less exemplifies the advantages an urban cluster location offers: infrastructure, services, transportation and community.

Still, urban locations are primarily used to establish branch offices or headquarters. With access to services and important institutions, they provide a strategic location for Chinese business to manage their operations in Germany and beyond. They are however not primary locations for M&A transactions, as most industrial companies are situated in the rural regions of Baden-Wuerttemberg and Bavaria. There, industrial clusters have developed over time, with many of the well-known brand names from cars to appliances located here.

### 6.2.3 Post-acquisition management and employment structure

A thorough explanation of post-acquisition management is crucial to evaluate the impact of Chinese M&A and Greenfield Investment on the organizational structure of the individual company and its effect on the German labor market in general.

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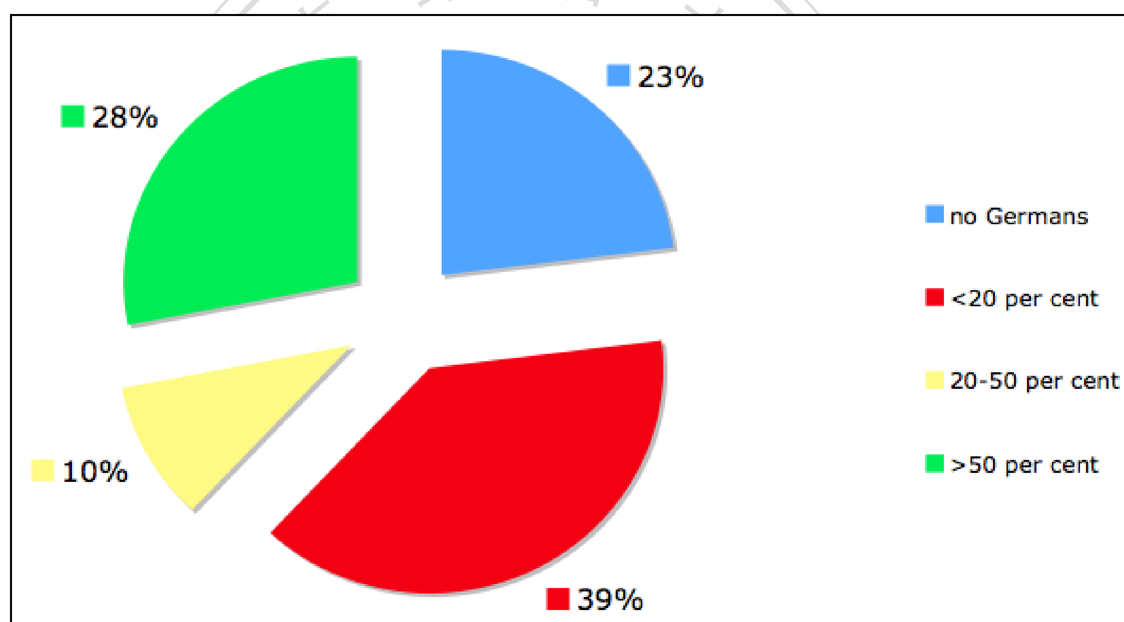
Overall, German employees play a key role in Chinese investments. A study conducted by Yang Wang in 2008 in the federal state of Hesse underlines that 80 per cent of all Chinese companies there (be they M&A or Greenfield Investments) employ German workers (see graph below). These workers are essential for several reasons. Foremost, they possess local knowledge and command of local language crucial to the day-to-day business activities of the investor. German employees are familiar with business customs and know the structure of regulations in their industry. Thus they tend to save the investor both time and money after the foundation of a subsidiary or a takeover.

**Figure 14: Share of German Employees in Chinese-invested companies in the state of Hesse 2009**




Source: Wang 2008.

Crucial for the success of a Chinese investment is the managerial staff. In Hesse, 31 per cent of all Chinese companies do employ a German CEO/ general manager or a deputy manager to operate their businesses. (Wang 2008, 4) While the numbers are surprisingly low, most surveyed Chinese companies expressed their wish to employ a German manager in the future- they however did experience troubles finding a suitable candidate for the position. Employing a German manager is important, because he/ she is aware of all legal regulations and business customs. Furthermore, he/ she possesses valuable business contacts in the country. The German manager is

usually supervised by a Chinese manager dispatched from the parent company in China. In the case of Greenfield Investments, the share of Chinese employees and managers is naturally higher than in the case of a takeover.

In a takeover procedure, Chinese investors face a predominantly German workforce to begin with, thus the share of Germans in the workforce is usually above 90 per cent. It is customary that the investor reaches an agreement with the union of the respective target company, with regard to job preservation and wages. This usually includes a guarantee that no jobs will be outsourced from Germany to China. This is normally agreed upon for an initial timeframe of five to ten years.

The short-term effects of Chinese investments on the German labor market are therefore generally positive. As most takeover targets are financially ailing and bankrupt companies, the starting position for the investor is usually difficult. It is clear that without the investment, jobs would be lost or a rigorous cost cutting scheme with unpaid overtime would be instituted (for further details refer to chapter 6.4). In a worst-case scenario, the company would simply stop its operations and all employees would become redundant. Thus Chinese investments, especially into ailing companies, tend to save jobs on a long-term basis.
According to a study by Margot Schüller and Magnus Brod of the German Institute of Global and Area Studies (GIGA), Chinese investment has not only helped to save jobs, but also created a substantial number of new ones. In their survey covering 463 registered companies, they found that 3,505 new jobs were created by Chinese investors in Germany until 2009. (Schüller/ Brod 2009) This is a rather substantial number, given the high salaries and general employment costs in Germany. However, there is no reliable data on the overall job creation effect Chinese investment has had to date, as such data is neither collected by chambers of commerce nor investment agencies. Thus, this report can also only provide an indication on issues of employment structure and job creation.

## 6.3 Frameworks for M&A Transactions in Germany

The fastest growing sector of FDI flows from China to Germany lies in Mergers and Acquisitions. In M&A procedures, both the individual company and the home country regulations by which it is governed are to be considered.
For approval of an acquisition, the Chinese administration does not require a board decision to permit the procedure. The decisions are thus taken only from within the company, usually by the shareholder’s board in a Ltd. Company or by the general meeting in a company limited by shares. Should the company be a Joint-Venture, the decision rests with the board of directors. (Schroeder/ Wang-Metzner 2010, 402)
When it comes to State-Owned Companies, this process is more complex, as several management levels are involved into the process.

In general two types of M&A deals do exist: share deals and asset deals. While with asset deals the acquisition of company assets is effected, in share deals the acquisition of shares of a target company is effected. In both modes of deals *“(...) the employees of the business unit concerned are automatically transferred to the purchaser by operation of law.“*(Hörmann 2010, 25) However asset deals are more unpopular with sellers, as they may often entail higher income taxes for him.

Should the shares of the target company be traded on the stock market, a public tender offer can be made to take over- either by way of a voluntary offer or through a mandatory offer. Voluntary offers aim at acquiring control over the target company and are therefore colloquially termed *takeover offers*. A mandatory offer on the other hand, must be made to all outside shareholders upon the acquisition of control (i.e. 30 per cent ownership held by investor or by investors acting in concert) through one of the following four ways: off-market purchase of shares or purchase of shares from the stock exchange or subscription in a capital increase or a merger. (Hörmann 2010, 27)

The acquisition of a company in Germany does not require compliance with further legal regulations or prerequisites, and is generally conducted under contracts governed by private law. The exact procedure for a takeover is only differentiated according to the legal form of the company. The legal forms for companies in Germany include:

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1) **Partnership organized under the Civil Code** (GbR)[11]: can either be a (natural) one person business or be based on a contract signed by two or more (natural) persons.
2) **General Partnership** (OHG)[12]: the partners involved have unlimited liability and are obligated to operate the business based on a contract.
3) **Limited Partnership** (KG)[13]: the general partners (*Komplementäre*) have unlimited liability and the limited partners (*Kommanditisten*) only bear liability to the value of their investment.
4) **Limited Liability Company** (GmbH)[14]: a Limited Company limits the liability to the share capital (of a minimum of 25,000€).
5) **Company divided by stocks** (AG)[15]: an AG is divided by stocks, which can (but must not) be traded on the stock exchange. At least one person must be shareholder to the minimum share capital of 50,000€.

The takeover procedures are stipulated by law and are different for each legal form. The most common form of a German company is a Limited Liability Company (GmbH). In order to acquire equity of a Limited Liability Company, a share purchase agreement is required. The agreement needs to be notarized. This can entail complicated procedures for Chinese investors, as currently no bilateral treaties streamline the process. Furthermore the non-negotiable fees for notarization are customarily borne by the purchaser, with fees that are variable according to takeover price. (Hörmann 2010, 25)
Should the takeover target a Company divided by stocks (AG), no notarized agreement is necessary for the transfer of ownership for buying up shares from individual shareholders. However, some stock companies have special regulations laid out in their charter with regards to transfer of stocks, that may establish special conditions for a transfer. Investors may also enact a *squeeze out* when attaining at least 95 per cent of shares to gain full control, pushing out all other shareholders.
The case of a takeover of equity holding in a non-incorporated firm requires the expansion of the collective of partners. This needs to be done in the form of an

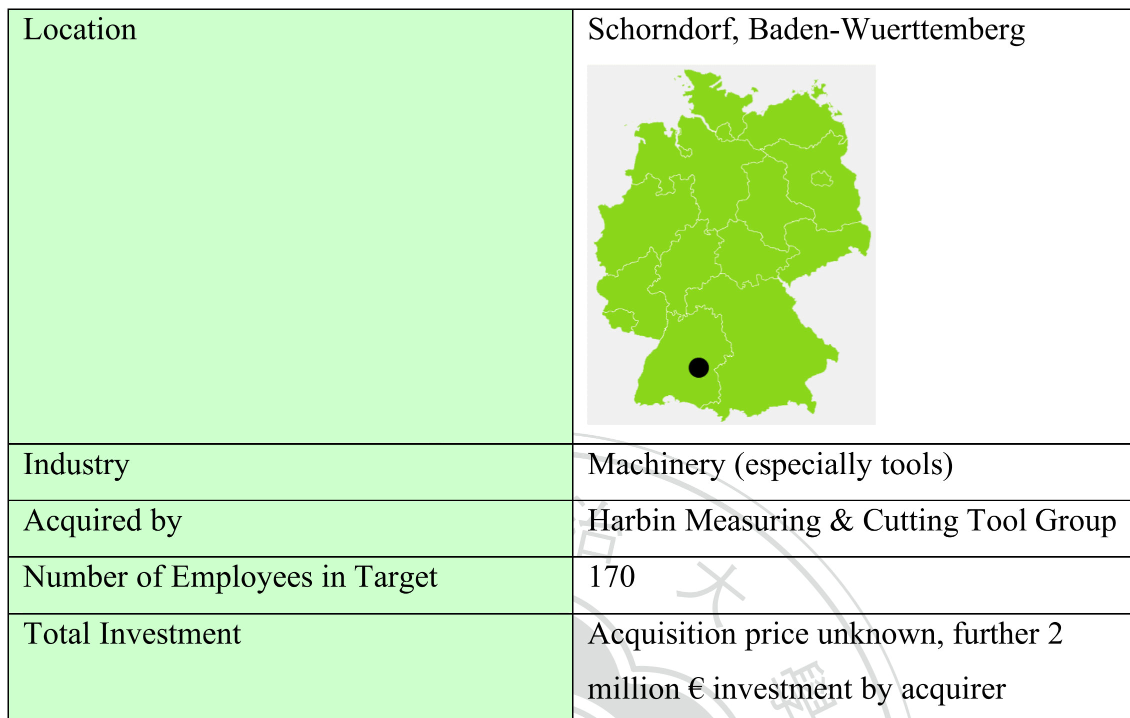
[11] Gesellschaft des bürgerlichen Rechts
[12] Offene Handelsgesellschaft
[13] Kommaditgesellschaft
[14] Gesellschaft mit beschränkter Haftung
[15] Aktiengesellschaft

amendment to the articles of association. Only in the case of a General Partnership (OHG), the inclusion of a new business partner into the association may take the form of an informal agreement (which –if done informally- entails considerable legal insecurities for all partners), for other legal forms this is not permitted. (Schroeder et al 2010, 404)

## 6.4 Case Studies of Chinese M&A in Germany

Given the fact that M&A is the fastest growing segment of FDI flows from China to Germany, case studies will further explain takeover procedures by Chinese investors. Takeovers are highly relevant as they entail aforementioned risks to the German market- loss of critical technology, competitive threats, state control exercised through SOEs and outsourcing. The case studies presented in this research are used to exemplify, rather than to highlight a typical Chinese investment in Germany. Each M&A procedure differs according to size, location, economic framework conditions and the management of both Chinese and German partners. The case study research nevertheless allows for a rough categorization of Chinese M&As: The first case shows the classical scenario of a bankrupt company taken over by the Chinese investor. As integration fails, conflict arises. The second case highlights the potential for business integration across borders, with the Chinese investor pre-processing goods, then refined by the German partner. The third is the newest kind of takeover, in which a healthy company agrees to the takeover without experiencing financial troubles. They instead do so for long-term strategic considerations with regard to market access. The discussion found below also serves to highlight how difficult a takeover can become for a Chinese investor, a cultural proximity is not a given constant in Germany. Oftentimes Chinese investors are not familiar with the German business environment, its legal regulations and emphasis on employee participation. What may appear to be misbehavior to the European side, may not necessarily be born from deviance, but may rather be caused by a lack of through preparation, little cultural knowledge and no knowledge of the local language. (Economist Intelligence Unit 2010, 42) Thus, the following cases are not aimed at establishing any bias towards Chinese investors, but serve to highlight the intercultural contexts and conflicts they necessarily entail.

### 6.4.1 Case Study I: Kelch & Links



| Location | Schorndorf, Baden-Wuerttemberg |
| --- | --- |
| Industry | Machinery (especially tools) |
| Acquired by | Harbin Measuring & Cutting Tool Group |
| Number of Employees in Target | 170 |
| Total Investment | Acquisition price unknown, further 2 million € investment by acquirer |

Kelch & Links is a machinery and tool manufacturing company located in the industrial hub around Stuttgart (home to automotive industry giants in particular). The company is a small to medium sized enterprise with around 170 employees, based only in its main facility in Schorndorf.

Kelch & Links started to face financial troubles since 2004, when the prices for raw materials were rising, while simultaneously price margins for their products dropped. The company offered a restructuring plan shortly afterwards, which entailed a 30 per cent cut on wages and more working hours. As the restructuring plan was rejected by the workers union, Kelch & Links went bankrupt in 2005. (Stern 2006)

The company was then acquired by the Chinese State-Owned Harbin Measuring & Cuttling Tool Group (HMCT). The acquirer has 3600 employees and is located in Harbin. It primarily produces measuring tools and instruments, cutting tools and machine tools.[16] With its investment, HMCT aimed to establish a gateway into the European market and access to critical Know-How. As mentioned by Chinese manager of Kelch & Links, Li Tiehuan, in an interview with the German magazine

[16] Refer to: HMCT Homepage - Company Introduction. Company Website 2012

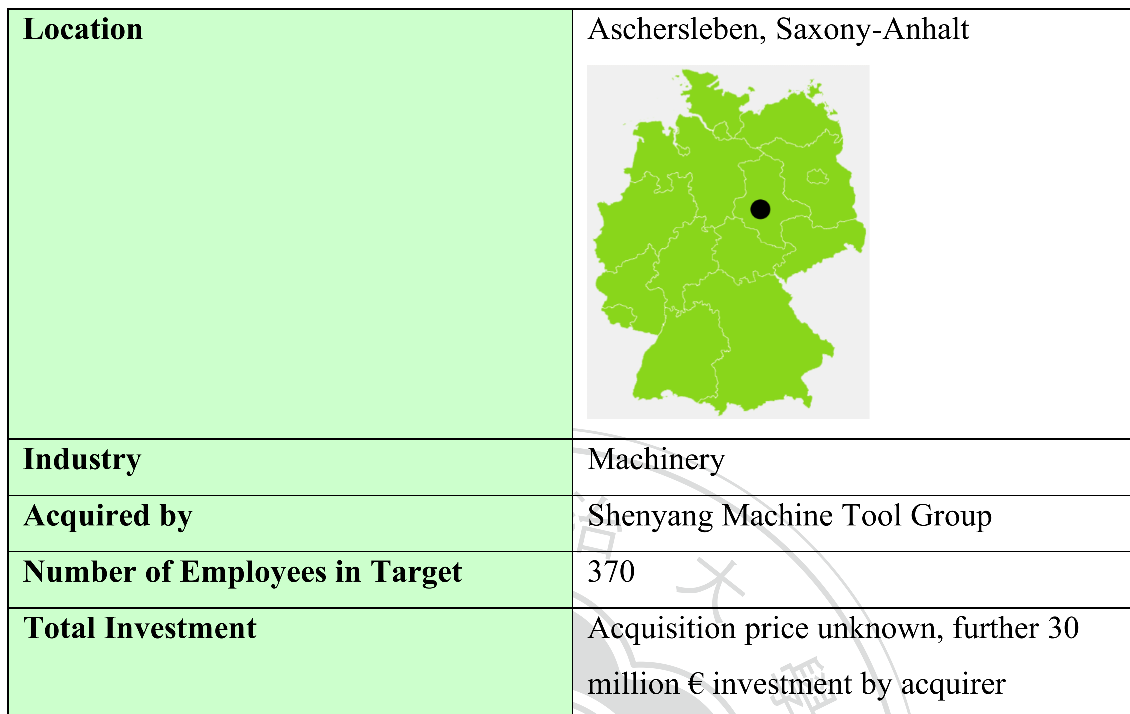
"*Der Stern*", the measuring tools produced by HMCT should be shipped to Schorndorf and be refined there. Through this cooperation, HMCT wanted to gain market access and use distribution channels of the Germans. (Stern 2006)

As is often the case, the union settled an agreement with the investor prior to the takeover, which defined the predicaments of agreements on wages and working hours. As Kelch & Links experienced further financial trouble after the acquisition, the Chinese management supposedly tried to evade its agreement and circumvent especially its wage commitment with the union by setting up a new company and using the old machinery for this purpose.[17] The management later issued a statement that only machinery bought recently was to be transported off for sale to relieve the company from unnecessary financial pressures. (WKZ 2010) The union and workers organized a blockade of the factory gates, in order to prevent the removal of machines from the factory by the Chinese investor and management. (RMR 2010) Later the union even organized a day and night blockade of the company headquarters that would eventually hinder the Chinese investor to relocate production facilities, making extensive use of public relations and strikes to pressurize the Chinese investor.

Meanwhile, the German management (under Chinese supervision) split the company into the former Kelch & Links and a shelf company called Kelch & Links Production GmbH (later called Kelch GmbH), which took over 117 employees.[18] Within the shelf company, the wage agreement was not continued although still legally compulsory and all union representatives were discharged from the company. The union subsequently used a multi-channel media campaign to raise attention for the issue, calling such demeanor "*Shanghai Methods*"- alluding to the notoriously bad image of Chinese employment protection.[19] The shelf company still operates in Germany and relocated its production to a facility only a few miles away from the former headquarters of Kelch & Links.

[17] Refer to: IG Metall Stuttgart (2010). Kelch & Links als Beispiel für die chinesische Art der Übernahme. IGM 03.16.2010
[18] Refer to: Maschinen Markt (2010). Muttergesellschaft der insolventen Kelch & Links gründet Kelch GmbH. Maschinen Markt 03.19.2010
[19] Refer to: IG Metall Stuttgart (2010). Shanghai Methoden bei Kelch und Links. Leaflet by the IGM Union

### 6.4.2 Case Study II: Schiess



| | |
|---|---|
| **Location** | Aschersleben, Saxony-Anhalt |
| **Industry** | Machinery |
| **Acquired by** | Shenyang Machine Tool Group |
| **Number of Employees in Target** | 370 |
| **Total Investment** | Acquisition price unknown, further 30 million € investment by acquirer |

Schiess is a market leader in machine tools, with a particular focus on assembly of large metal cutting machinery and customized machinery systems for the industrial sector. Schiess is based in Aschersleben, in the federal state of Saxony-Anhalt. The company employs 370 people, which are both located in Aschersleben and at a sales subsidiary in Beijing. (Invest in Saxony Anhalt 2011) In 2004, the financially troubled company was taken over by Shenyang Machine Tool Group (SYMG), a direct competitor of Schiess from China.

SYMG is the largest producer of metal cutting machine tools in China and third largest producer of machine tools worldwide. The company realized a turnover of 1.8 billion US dollars last year and employs 18,000 people. It supplies globally and into a variety of sectors, including automotive, defense and military, aerospace and railway. Schiess was acquired by SYMG in 2004, in order to jointly produce high value machinery with German quality standards. Thus the aim of the takeover was an upgrade of production quality on the Chinese side and also an image upgrade through production in Germany. (Bloomberg 2005) Parent and subsidiary put out their first

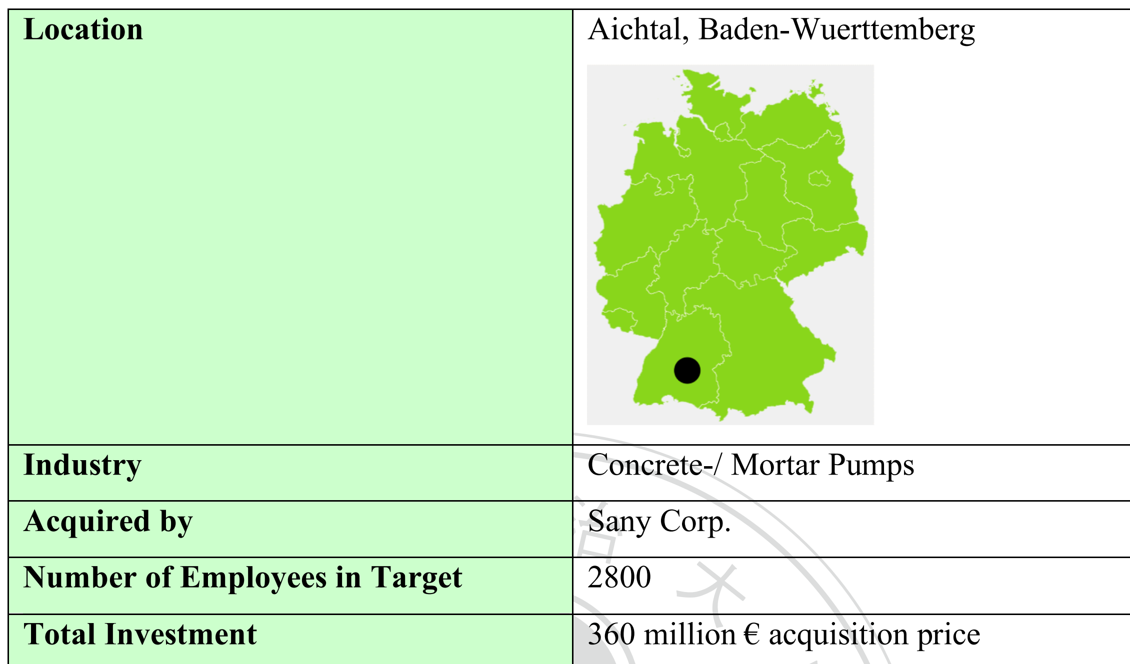
line of mid-range machines produced in cooperation in 2011.[20] For Schiess, takeover and joint production with the Chinese parent company translates into a drop in production costs and makes it possible to compete in the highly contested mid-range machinery market. Schiess was thus also able to increase its sales turnover by factor three, to 50 million Euros. SYMG plans to invest substantially to double the turnover within the years to come. (NZZ 2011) As stated by Schiess CEO Torsten Brume in an interview the Investment Promotion Agency of Saxony-Anhalt:

> *„This type of international partnership is a logical result of globalization. Each product that our collaboration creates is a result of the complementary strengths of our two locations (...) we'll be able to offer our customers machinery that not only meets German quality standards, but also has a reasonable price tag.“* (Invest in Saxony-Anhalt 2011)

Since 2004, SYMG and Schiess have developed a joint production line in the form of a manufacturing plant established in Shenyang. There, machinery is pre-fabricated at low cost and later shipped to Germany where it is tailored to fit the specific demands of the customers. For this purpose, SYMG has already invested 30 million Euros and financed a new production hall in Aschersleben in 2010. (MZ 2010) In Germany, testing and quality control remain in local hands. Through pre-processing in China however, production and innovation cycles can be greatly abbreviated. According to Schiess, it now takes only six months to deliver after serial production begins, substantially reducing waiting time for customers.

[20] Refer to: Maschinen Markt (2012). Schiess und Shenyang bringen vier Baureihen unter der Marke Aschersleben auf den Markt. Maschinen Markt online 03.01.2012

### 6.4.3 Case Study III: Putzmeister

| **Location** | Aichtal, Baden-Wuerttemberg  |
| --- | --- |
| **Industry** | Concrete-/ Mortar Pumps |
| **Acquired by** | Sany Corp. |
| **Number of Employees in Target** | 2800 |
| **Total Investment** | 360 million € acquisition price |

Putzmeister is among the most recent and the most costly acquisitions realized by a Chinese investor in Germany to date. The company insofar represents a special case, as it was neither in severe financial trouble nor a small niche producer at the time of takeover. Putzmeister was (and still is) the market leader in the manufacturing of concrete pumps used at construction sites, particularly for high-rise buildings. It also realized a stable sales turnover of 751 million US$ each year (Bloomberg 2008), with contracts on a global scale. (FAZ 2012) Although being a global market leader, Putzmeister is still a family enterprise, held through a family holding (a common way of evading taxes in Germany). Like many companies in the region, the family enterprise was deemed inaccessible to takeover advances, let alone by a foreign investor. Thus the case of Putzmeister serves to highlight the paradigm shift for Chinese FDI to Germany: from price based decisions to truly strategic investments. (Bryant 2012)

Putzmeister was taken over by Sany Corp. from Changsha, a producer of heavy equipment in construction, heavy machinery, cranes and concrete pumps. The company's main shareholder is Liang Wengen, the richest man in China according to

Forbes 2011. Sany employs 70,000 people and is present in more than 150 countries.[21] The company has realized growth rates of up to 60 per cent in the past years and profited tremendously from the construction boom in China. The company invests heavily into its Research and Development and recently opened a 100 million Euro R&D facility in Bedburg, Germany. With the acquisition of Putzmeister, Sany not only expects access to technology and markets, but also hopes to increase profitability.

Putzmeister is not only a target of investment, but has itself agreed to the takeover for strategic reasons. Given the fact that China has become the largest market for cementation pumps, the cooperation with a large Chinese partner ensures future survival and profitability. Therefore, Putzmeister is among the first companies to use their own takeover for a long-term perspective and with a strategic aim.[22]
The same is true for Chinese companies like Sany though. Sany is well aware, that German products evoke a sense of reliability and quality in the eyes of consumers- thus marketing under an established German brand name may well provide long-term access to the fast growing developing markets and catch further market share. As Sany CEO Liang Wengen said: *"With this merger, Putzmeister and Sany will create a new and global market leader for concrete pumps." (Bryant 2010)*

According to the Financial Times, Putzmeister's headquarters will become Sany's global non-Chinese center for concrete equipment. Sany will continue to keep its focus on the Chinese market and provide autonomy for day-to-day business of Putzmeister. It remains questionable however, how far this autonomy will expand. Sany CEO Liang has already stated a 2 billion Euro turnover goal for Putzmeister until 2016- essentially this is more than the value of the global market for cementation pumps to date. It remains to be seen, how far lax attitudes will extend if these goals are not achieved.

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[21] Refer to: Sany Company Homepage 2012
[22] Refer to: Frankfurter Allgemeine Zeitung (2012). China kauft ein. FAZ 05.06.2012

# 7. Governmental Stakeholders

## 7.1 Institutions matter

In Foreign Direct Investment many stakeholders are involved in shaping an investment decision. As mentioned above, the government sets incentives, the investing company selects its target based on strategic interests and regulations govern the procedural aspects in the host country. However, little is known about the ability (and political willingness) of the host country to regulate the flow of investment. While much attention has been paid to Chinese investments in Germany, little is known about the capacity of local actors to influence and regulate investment flows today and in the future.

With an investment abroad, a Chinese company is becoming subject to local laws to which it has to adhere. This is especially the case in a highly regulated investment environment like Germany. Thus it can be argued, that investment decisions are highly susceptible to the regulatory system of the respective investment destination. This view is further supported in academic literature. As Oliver (1997) notes, the external institutional environment in which a firm operates, regulates and restricts its leeway. Institutions, like the state administration or social agents, are able to regulate based on their respective ability to exert pressure on a company:

> *„Institutions impinge on firms through the creation of market imperfections and through regulatory and social pressure. (...) Such market imperfections can be created through government actions and intervention.“ (Voss et al 2009, 137)*

For the case of Germany, we find a multitude of actors with capacity to intervene in an investment decision. Government is strong on all levels, ranging between supranational down to communal government. Furthermore, social institutions are by law guaranteed their participation and representation within the regulatory process, be it in through the governmental or public realm.

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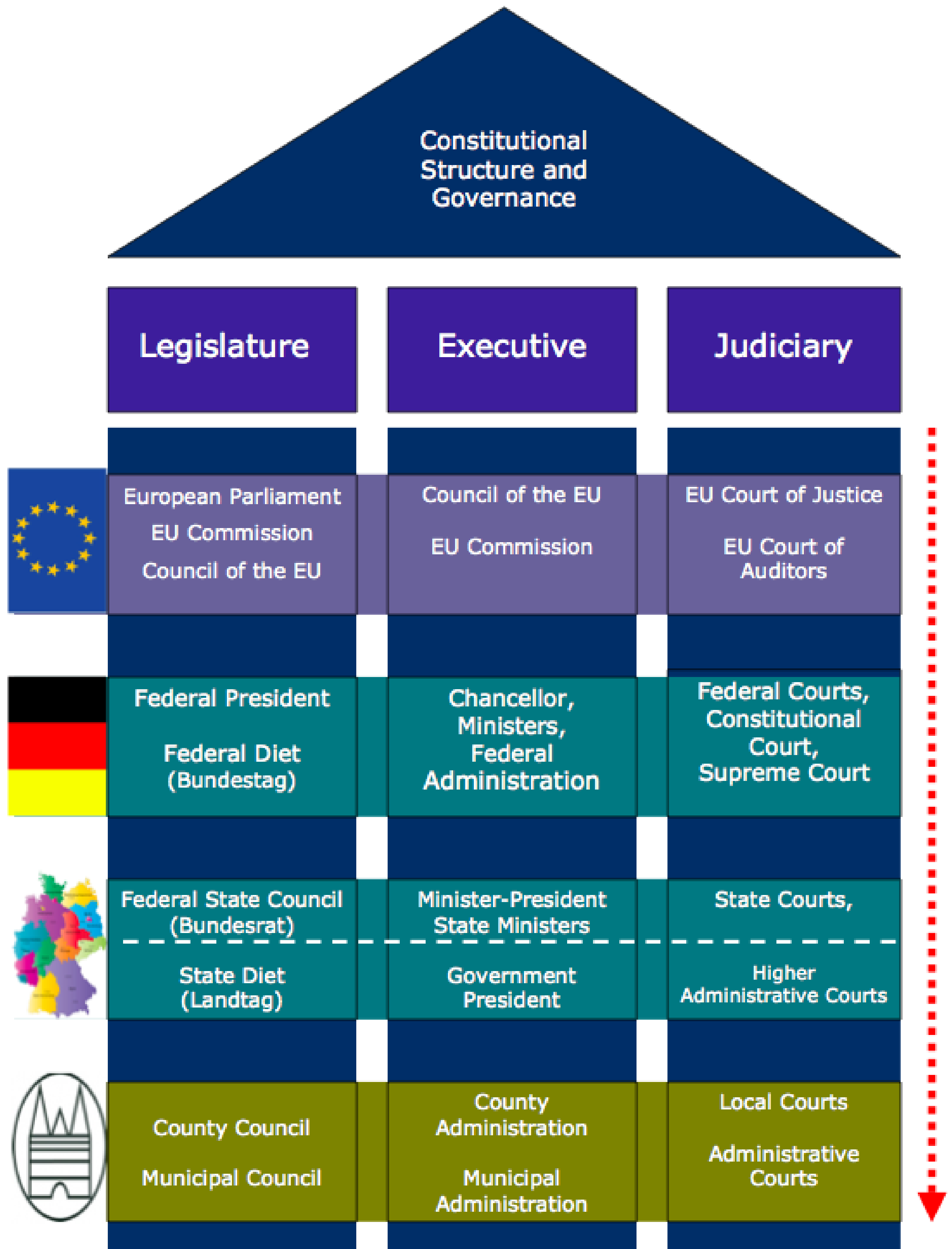
**Figure 15: Hierarchical Structure of German governance and its relation to the European Union**




Source: based on Gerlach 2010.

As a federal republic, German governance has 5 different layers. Starting from supranational European level institutions, to federal government, state governments and distinct forms of local administration- governance has developed a strong regulatory framework with democratic representation on all levels. Some of these levels are interconnected as state level administrations have their own legislative body at federal level (the "*Bundesrat*"). Their legislative powers are thus relevant beyond the regional scope and substantially influence federal politics. (Gerlach 2010)

Each sphere of governance has the capacity to regulate investment flows from China to Germany. This flow regulation has two main strands. Regulation by **positive promotion and regulation by negative confinement**.
Positive promotion can entail such aspects as financial incentives, tax incentives, legal support, cooperation within administration and unions for Chinese investors. However these aspects may be particularly pronounced in areas with strong inflow of investment, rather than areas of low Chinese investment.
Negative confinement entails the prohibition of Chinese investment into certain industries and the restriction of inflows into areas that may infringe national security. This entails the active regulatory process as well as regulations, such as embargos for certain types of industries. Apart from such legally binding restrictions, unions for example may be powerful enough to force the investor to agree to concessions, such as an agreement to job security, wage levels and restructuring of the takeover company. They may use different means of coercion to either hinder the investor to conclude the takeover or to restrain his managing capabilities.

In the course of the investment process, the investor faces stakeholders on an all levels of the spectrum depicted in Figure 15. Given their respective vested interests in the process, conflicts may also arise with regards to promotion or confinement. This is particularly the case between social and governmental stakeholders, as both may have different perspectives on Chinese investors.

## 7.2 Government Intervention in FDI

### 7.2.1 European Capacity in Foreign Investment

The European Union represents the supranational sphere of governance and can thus not only override most national decisions, but also guides national decisions through its supremacy in legislature, executive and judiciary. While certain states (like Germany) have been required through their Supreme Court to vote on transfer of powers to the EU institutions[23], the EU still largely dictates directives for politics in the 27 member states. As such *"(...) primary and secondary acts of the EU are part of the 'law of the land' in the member states, and supranational EU law is supreme over national law."* (Hix/ Høyland 2011, 13)

The supreme power of the supranational union is vested in the institutions of the European Union. As can be seen from the depiction in Figure 15, these institutions do not clearly categorize according to the partition into legislature, executive and judiciary, but may each fulfill functions in multiple realms:

First is the **European Commission**, which fulfills a variety of functions in policy formation and administration. This includes policy initiation, policy implementation, policy management and external relations. The Commission does however not unite all executive functions in the EU, but shares them with the EU Council. Under the Directorates-General, the Commission comprises a variety of sector- and functional departments to fulfill its administrative tasks. (Egeberg 2003)

Second is the **Council of the European Union**, which acts as the main decision-making body of the EU. It works as a collective system of governance, in which heads of state and national ministers come together in 16 specialized formations organized by policy area. The Council is designed to represent the member states and is both executive and legislative in nature. It is a key institution, as all Commission proposals necessitate approval by the Council before becoming EU law. (Lewis 2003)

[23] Refer to: Die Welt (2009). Urteil zum Reformvertrag. Karlsruhe hat der EU deutliche Grenzen gesetzt. Welt Online 06.30.2009

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Third is the **European Parliament**, the only directly elected institution of the EU. It has significant powers in developing policies and laws. Most of its workload is handled by standing committees, which also preside over economic and monetary affairs. Together with the council it represents the most important legislative institution in the EU, however the EP lacks legislative initiative rights. The EU Commission is directly accountable to the EP, thus the EP has considerable influence over the executive branch. (Scully 2003)

European institutions have a set of competences, of which some are exclusive, while others are shared with the member states. (Braams 2008, 121) Many of these areas are highly relevant with regards to foreign trade and economics. The competences of the European Union are laid out in the Treaty on the Functioning of the European Union (TFEU Title I), and include:

a. *Exclusive competences,* such as the regulation of the single market, the customs union and external trade policies, monetary policy for the Euro-zone, as well as subsidies and price setting of production. (TFEU Art. 3)
b. *Shared EU and member state competences* enlarge this spectrum: Economic-, social- and territorial cohesion, free movement of persons (including third-country nationals), as well as social regulation regarding workplace conditions and environmental standards. (TFEU Art. 2, Sec. 2)
c. *EU functions in support, coordination, enhancement of member states*. Here, the EU helps member states to coordinate their competences on European level. (TFEU Art. 6) Such functions of support include tourism, administrative cooperation and vocational training policies. (Hix et al 2011, 6)

While many of these competences touch on issues related to foreign investment, none of them clearly refers to any explicit involvement of the European Union into FDI related policy. The EU in fact lacked a direct mandate that would allow the interference into national FDI policies. This has changed since 2009, with the ratification of the Lisbon Treaty. Now the European Union also holds powers with regards to foreign trade and FDI. This includes the ability of Union institutions to reach decisions in relation to FDI, which are relevant for all European countries:

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*„The Lisbon Treaty amends (…) the Treaty on the Functioning of the European Union (TFEU). Article 207(1) of the TFEU explicitly mentions foreign direct investment as forming part of the common commercial policy, As such, the Treaty establishes the EU's exclusive competence on foreign direct investment.“ (EC 2010a)*

Given this amendment of the TFEU through the Lisbon Treaty, the European Union is now in a position to provide legislation on issues of Foreign Direct Investment to the EU27, as part of the common commercial policy (Art.207 (1); Art.3 (1) TFEU). The amendment not only allows the EU to involve in FDI, but makes it the key stakeholder. The Union now holds an exclusive competence and only the Union may legislate and adopt legally binding acts in an area where exclusive competence is conferred upon it. (Art.2 (1) TFEU)

In order to clarify its position in FDI, in 2010 the EU Commission issued first a Communication to the other EU institutions. (EC 2010b) In the Communication, the Commission laid out its plans to use the new mandate to further a progressive abolition on restrictions on foreign direct investment- ultimately leading to an international investment policy for the EU. To this end, the EU Commission adopted a proposal for a Regulation that would establish arrangements relating to investment agreements between member states and third countries. (EC 2010c) This regulation lays out a gradual roadmap away from individual Bilateral Investment Treaties (BIT), towards a comprehensive EU investment policy. This policy is to serve all investors and investments equally and will be developed gradually through amending existing European legislation.

From this point on, European member states must find it necessary to amend and modify their individual investment agreements for the transition, in order to comply with the abolition of restrictions for foreign direct investment aimed for by the EU. The member states are not any longer in the position to legislate on an individual basis, making it technically impossible to regulate investment flows to their respective markets individually. Any legislation already in place



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for regulation of Foreign Direct Investment is thus not only ineffective, but also deemed unlawful.

The discussion on regulation of Foreign Direct Investment could simply end here with a simple conclusion: Regulation is only permitted on EU level, which strives to abolish regulation of FDI flows into Europe altogether.
However, the case is not that simple. Regardless of the EU's exclusive competence laid out in Art.207 TFEU, a constriction of foreign capital flows can still be undertaken by the individual member states due to a loophole provision: Article 65 TFEU allows member states to constrict FDI in areas that infringe upon public safety and order. (Beuttenmüller 2011, 289) The definition of the term thus marks the spectrum of regulatory capacity for the individual states. Regulation by all means still remains a member state capacity.

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### 7.2.2 Federal Capacity in Chinese Foreign Direct Investment

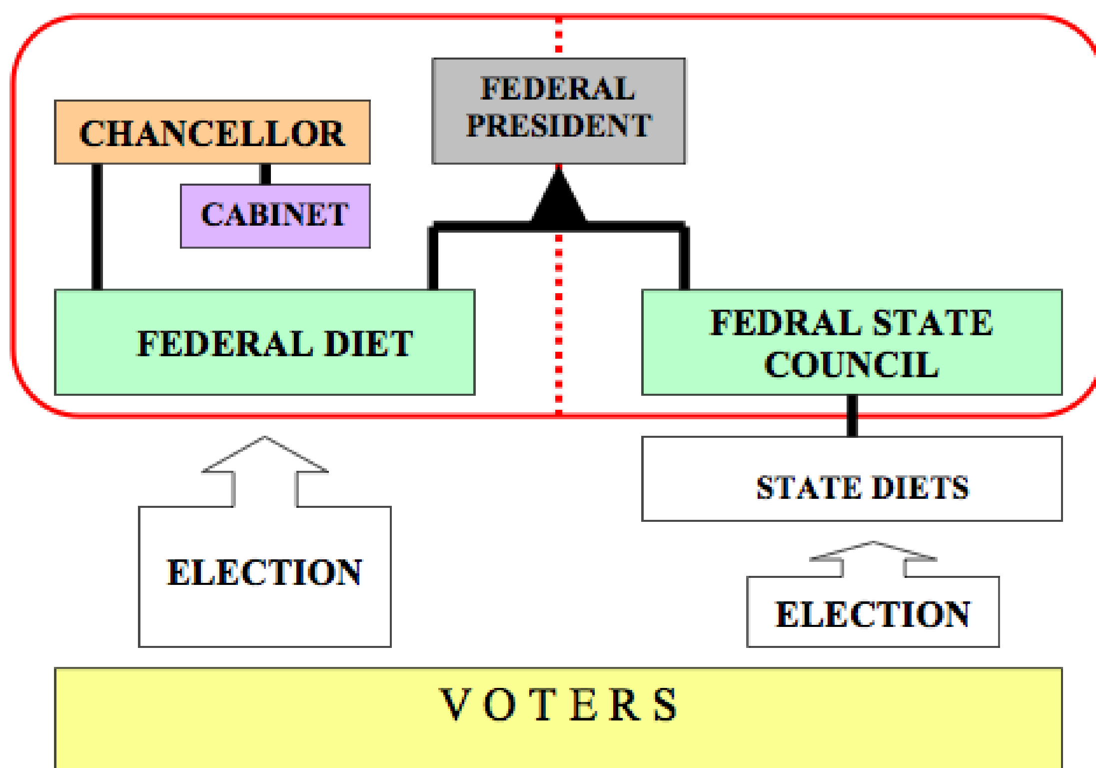
As can be seen from the above discussion, the negative confinement available to the federal government of Germany is clearly limited. While the European Union sets a general tone for a liberalized and free flow of FDI to the Union, it nevertheless leaves considerable leeway to national governments in restricting certain kinds of FDI.

The most important sphere for developing and executing legislation for the federation of the 16 German states is the federal (colloquially termed *national*) government. The federal government consists of a bicameral system of government, steered by the chancellor with her cabinet and the federal ministries. The state is formally headed by a Federal President (*Bundespräsident*), who mainly fulfills ceremonial and representative functions.

The **Federal Diet** (*Bundestag*) is the only directly elected parliamentary body at federal level. It is elected every four years and in turn elects the Chancellor. Its main task is to draft and pass legislation and approve the national budget. Usually the Federal Diet is not headed by a single party majority, but by coalition government, as elections are carried out under a system of proportional representation.

The **Federal State Council** (*Bundesrat*) is an indirectly elected parliamentary body, comparable to the second chamber in the UK. Its members are the heads of the state diets (state governors and ministers), which represent the federal states interests at national level. The Federal State Council fulfills a main function in creating and approving legislation.

**Figure 16: The federal governance of Germany**




Source: based on Gerlach 2010.

Most important for the executive functions are both the **Chancellor** (*Bundeskanzler*) and her **Cabinet** and the national level **Ministries**. The Chancellor is the head of government and thus of the executive. She heads the chief executive body, the cabinet with all ministers. The ministers and ministries play a key role, as they draft a large share of all laws passed in the federal council and federal diet. The ministers carry out their duties independently, but are bound by the Chancellor's political directives. Indeed, ministries play the key role when it comes to design and execution of federal policies. The Federal Ministry of Economics and Technology (BMWI) is the central stakeholder when it comes to Foreign Direct Investment Regulation. It is currently

headed by Vietnamese-born Dr. Philipp Roesler who is also Vice-Chancellor of Germany. The Ministry is the main body to formulate and execute the Foreign Trade Laws, which also govern flows of FDI from- and to Germany.

Germany has long regulated FDI flows through its Foreign Trade Law.[24] The law became obsolete for within the European Union through the treaty of Maastricht in 1992, but remained valid for movement of capital- and goods between Germany and a non-EU country.

In April 2009, only shortly after the exclusive competence for regulation of FDI was moved to European level, the German Foreign Trade Law was amended to fit the new circumstances. While the EU has granted itself exclusive competence, Germany had by no means lost its power to restrict FDI to the EU institutions- Germany has instead made use of the (temporary) loophole provision in EU Law to increase its leeway. (Menke 2010) While formerly only able to restrict investments in military industries, the Ministry now holds the power to restrict regardless of industrial sector. As long as a stake of at least 25 per cent is acquired by an investor from outside the EU, the ministry holds the power to restrict or forbid the investment. (Beuttenmüller 2011, 282) The rewritten version of the Foreign Trade Law of 2009 justifies these restrictions of Foreign Direct Investment flows to Germany, based on concerns for *public order* and *safety* in the Federal Republic of Germany. (Art.7 Sec. 1 No. 4 AWG) According to Art.7 Sec. 2 No.6 AWG such concerns may exist in **all** acquisitions of more than 25 per cent, which include foreign investors. The investor is deemed foreign if either directly or indirectly controlled from outside the EU.[25]

The new formulation of the German Foreign Trade Law is in itself rather problematic. The law states that the acquisition must lead to a **genuine** threat to public order and security in order to justify restrictions. This formulation is criticized extensively, as it does not establish clear criteria for the ministry on which to evaluate restriction of an investment, thus providing very little legal security to investors. (Lecheler/ Germelmann 2010, 176) The new Foreign Trade Law thus extensively relies on

[24] Refer to: AWG-Außenwirtschaftsgesetz, http://www.gesetze-im-internet.de/awg/index.html
[25] *Directly*: Investor from outside the EU; *Indirectly*: 25 per cent or more of the investing company are held by a foreigner from outside of EU.

discretionary decision-making on the side of the ministry. In order to ease the legal insecurity of possible prohibition, investors can apply for clearance at the ministry before they make their investment. There is however no obligation to inform the ministry of an investment and after three months the investment cannot be denied. (BMWI 2009a) This new German regulation is valid only so long as the EU does not pass further legislation overruling it. (Lecheler/ Germelmann 2010, 168)

Several sectors have already been outlined as generally closed for investments, including telecommunications, electricity or other services of strategic relevance (such as transportation and air travel). (BMWI 2009b) Another sector with definite legal investment prohibition with regard to security and public order lies in production of military goods and particularly dual use goods. Acquisitions of German companies in this sector are strictly prohibited, based on a European weapons embargo on China since 1989.

The second case study in chapter 6.4.2 is a good example for such an investment. Shenyang Machine Tool Group (SYMG) is a major producer of machinery, but also produces military tools and technology. If SYMG would have attempted to purchase a company in the military sector or had used its investment in the German target to enhance its production in the military goods production, the investment would likely have been prohibited by the Federal Ministry of Economics and Technology. If SYMG had already acquired the German target, the ministry could cancel voting rights and appoint a Public Trustee to reverse the transaction. For Chinese investors with an investment into dual goods, the situation is almost the same, as the weapons embargo for China still applies. A genuine threat of public order and security can be justified through the embargo, leading to a general ban of investments. However, to date no such ban has been reported and the EU is already softening its stance on the issue, with several member states selling non-lethal parts of military machinery and weapons to China.[26]

While it may seem the ministry has been issued a blank check, it has been modest in the application of its new powers, as to date no investment has been prohibited.

[26] Refer to: Deutsche Welle (n. d.). Waffenembargo gegen China ist löchrig. DW n.d.

(Menke 2010) The Federal Ministry of Economics and Technology is the sole body responsible for assessing investments with regards to possible infringements of security and order. Thus its power is comprehensive. Yet, as mentioned above, it only uses these powers in a very limited way. To date no bans on investments have been issued and no applications been rejected. Only a fraction of the investments are actually reported to the ministry, with a large share simply taking place without approval. This is not only due to the soft stance of ministry in the issue, but also due to basic questions of capacity. The ministry may simply not possess the necessary numbers of personnel to look into each and every transaction.

On the other hand, Germany also tries to win investors through investment promotion. On national level, the ministry of Economics has established a national investment promotion agency: GTAI- Germany Trade and Invest. The organization has come to exist from a merger of different investment promotion agencies at national level since 2003 and informs about investment opportunities in Germany. Its services are also provided in Chinese, which suggests the importance of this target group. The GTAI provides comprehensive services to investors and advises on all matters of investment. It does however *"(...) not provide target lists of companies that are looking for strategic business partners or financial investors*."[27] The GTAI thus fulfills mostly an informative function with little aim to regulate or influence investment flows. While the GTAI devotes particular attention to providing information on investment locations in East Germany, this does not constitute much of a pronounced influence on investment flows, as such information is equally available for all federal states alike.

### 7.2.3 State Capacity in Foreign Direct Investment

Germany is a federal republic, meaning that the country is subdivided into sixteen federal states (*Bundesländer*). The sixteen German states differ in size and include 13 territorial states and the three city-states of Hamburg, Berlin and Bremen. These city-states are both federal states and municipalities alike. The German federal states are partly sovereign and the constitution (*Grundgesetz*) provides them with far-reaching

[27] Refer to: GTAI (2012). FAQ Section. Germany Trade and Invest Website 2012

competencies in education, culture, police, public order and control of radio and media (GG Art.7) Furthermore they share a set of competences with the federal government, including economic legislation, immigration law, public housing, roads and waterways and various environmental regulations.

Each of the federal states has own legislative powers and administration, including **state ministries** of

- Employment and Social Welfare,
- Interior and Sports,
- Finance,
- Justice,
- Integration and Europe,
- Education, Academia and Arts,
- Economy and Transportation,
- Environment and Energy.

The state administration closely resembles that at federal level, while not including such ministries as foreign affairs or defense, which are federal competences only. The federal states nevertheless possess considerable influence in the realm of directing economic policy and finances, while lacking the right to confining FDI flows from China through issuing legislation. Their most efficient means of influence therefore focus on the issue of positive investment promotion. This is also due to their interest as federal states, which have a vital need for economic growth and investment.

For Germany as a whole, investment opportunities are marketed through the "GTAI-German Trade and Invest" Agency. On state level, we find a similar network of investment promotion agencies. The federal states have developed an expansive array of such agencies, in order to attract investors to- and inform about the investment opportunities in the respective state. These investment agencies operate in all German states and largely cooperate with regional- or municipal investment agencies on lower levels. Thus we can find an intricate web of investment promotion institutions on various levels, which are connected to each other more or less casually. The investment promotion agencies are organized as private companies, in which the only shareholder is usually the respective federal state. While de facto being a state

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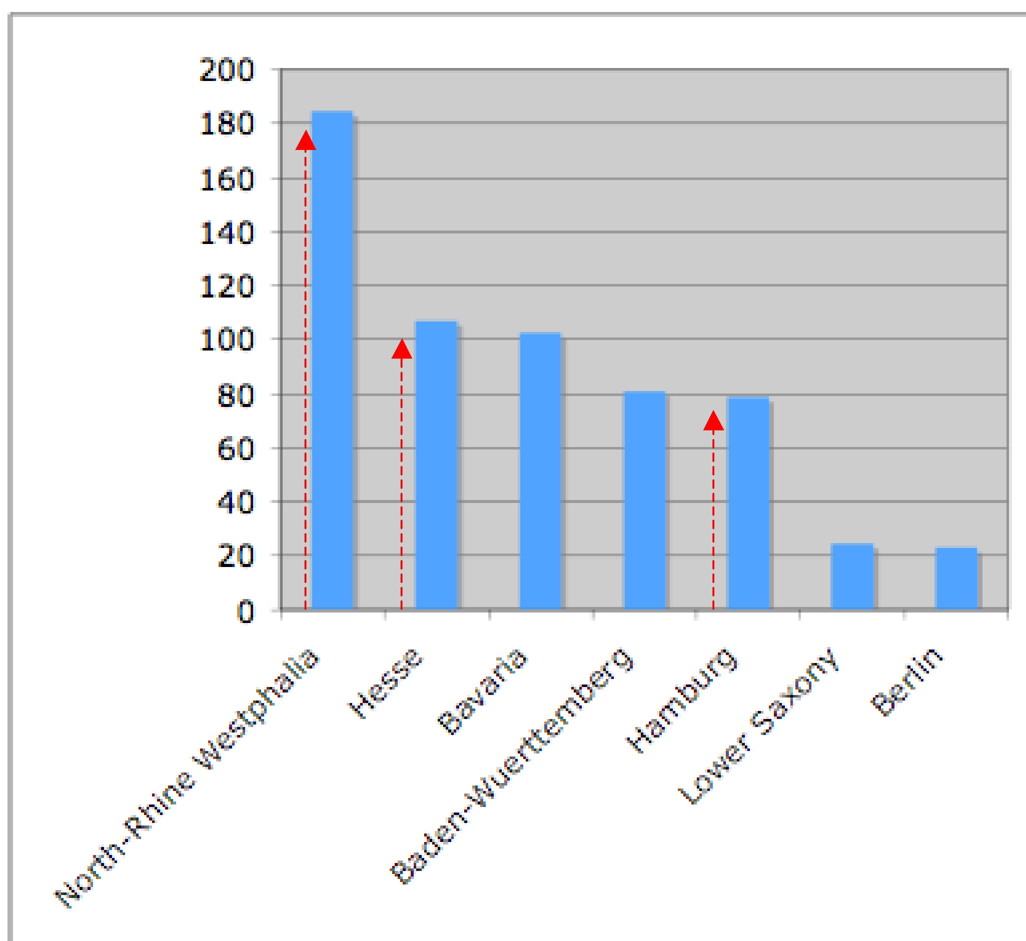
institution, the employees of such agencies are not state officials. To exemplify such arrangements, three examples for such investment promotion activities and respective networking with other agencies were selected based on overall inflow of investment and role as primary investment destination for Chinese investors. To guarantee a balanced representation, two territorial- and one city-state with the largest inflow of FDI respectively were selected: North-Rhine Westphalia, Hesse, and Hamburg.

**Figure 17: Investment Flows to German Federal States**, in billion Euro 2009

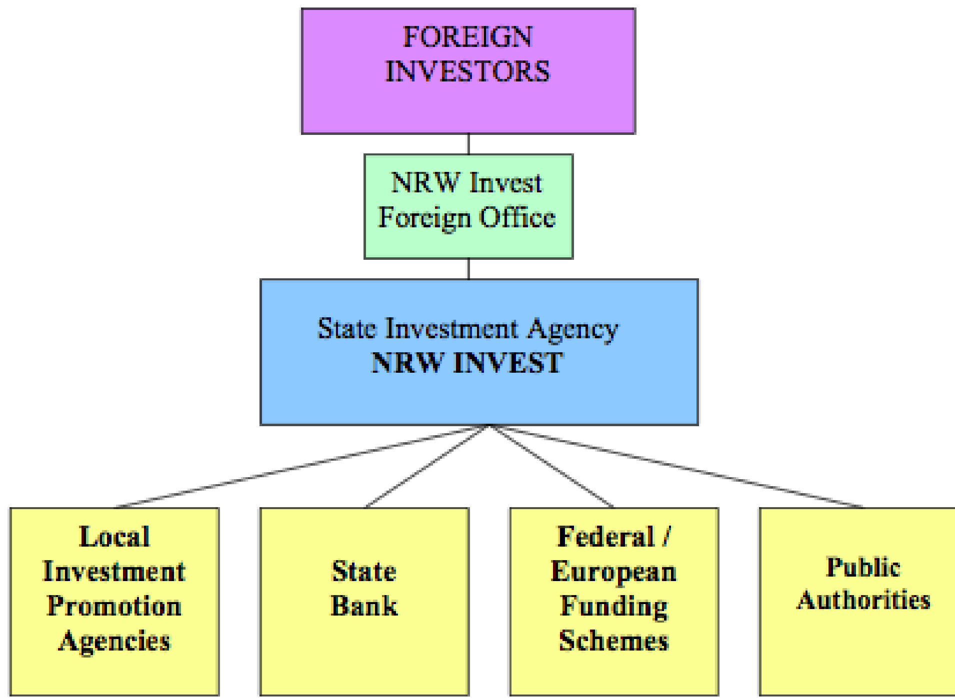



Source: German Central Bank 2011.

**NRW Invest**, the Investment Agency of North-Rhine Westphalia closely resembles the model described above. The Agency supports foreign investors throughout their entire investment and settlement process in the federal state of North-Rhine Westphalia. It has a particular focus on Chinese investors, maintaining a website in Chinese and offering services through its representative offices in Nanjing, Beijing and Shanghai. Again, the investment promotion agency is a private company, with the

main stakeholder being the federal state. It further represents all 200 local investment agencies on regional and municipal level.

**Figure 18: Structure of Investment Promotion North-Rhine Westphalia**




Source: NRW Invest 2012.

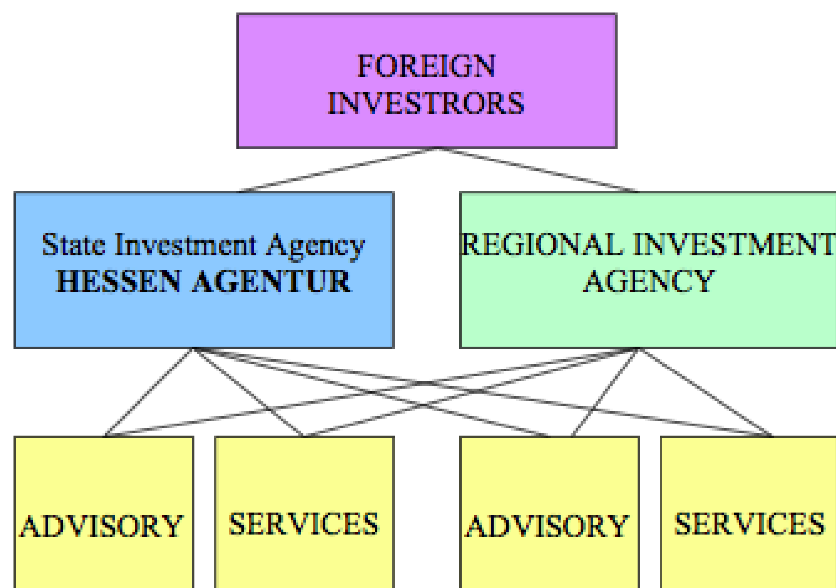
The agency provides advisory on tax and company regulations, while also offering an extensive array of services for the settlement process. For this end, NRW Invest offers a database with geo-information on available commercial sites and the respective contact persons. (Handwerksblatt 2007) During and after investment, the agency acts as intermediary between the investor and local institutions. NRW Invest particularly markets those areas of investment to foreign investors, where the federal state would like to upgrade its industry through new investment. Therefore, the services focus on high-end production and knowledge intensive sectors such as Healthcare, Innovative Materials, Microsystems Technology, Nanotechnology, Biotechnology, Environmental Technology, Chemicals and Energy. In its “Investment Guide to NRW”, the agency further offers information and services for obtaining financial subsidies on European, national and local level, with a particular focus on funding for R&D projects. (NRW Invest 2012)[28] Additionally, the state bank offers funding,

[28] Particularly refer to p.67 in NRW Invest (2012)

which can range to up to 5 million Euros. The state's investment agency is thus positively influencing investors by catering and marketing specifically to knowledge intensive industries and R&D investments. In its report it emphasizes several possible options of financing derived from either European, national or state level for such projects.

In Hesse, the structure of investment promotion is somewhat more fragmented between different actors. While there is a Webpage targeting foreign investors (particularly Chinese) on state level, and an investment Agency called "**Hessen Agentur**", there appears to be no centralized structure of investment promotion as is the case in North-Rhine Westphalia. While the state agency offers a variety of settlement services, the same services also are provided by the more regional and municipal investment promotion agencies. To underline this observation: The Rhine-Main metropolitan region is marketing itself through its very own investment agency and a second municipal investment promotion agency only for Frankfurt.

**Figure 19: Structure of Investment Promotion Hesse**



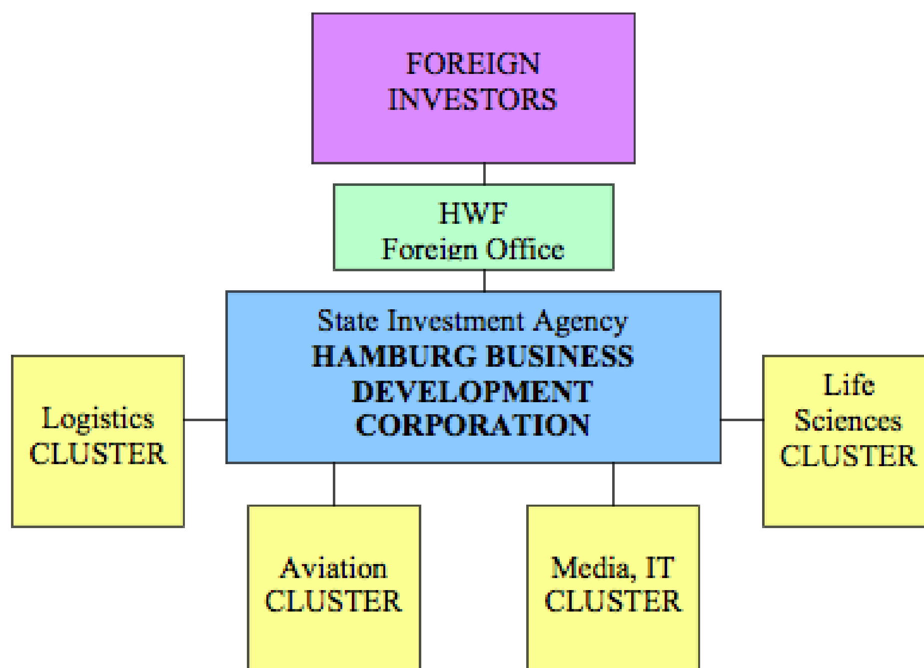

Source: Hessen Agentur 2012; FRM 2012.

Just as the state agency, this regional agency is funded indirectly by the state Ministry of Economics as well as other municipalities. One of its main stakeholders is the state investment promotion agency Hessen Agentur- creating a direct link between both

agencies. The regional agency is providing a similar range of services- covering advice on company foundation, information on tax and laws, settlement guidance, networking and integration and after-settlement services. The agency markets commercial sites within the respective Rhine-Main region, within the urban cluster described in chapter 6.2.2. (FRM 2012) It also markets primarily value added industries to investors, with the range including ICT, Automation, Creative Industries, Pharmaceuticals and Biotech, Greentech and Finance. The regional agency closely cooperates with the state bank through the Hessen Agentur, opening possibilities of financial subsidies in these fields. Nevertheless, the expert interview with the ministry of Economics in Hesse underlined the limited availability of such funds: "*There are no financial means to support Chinese investments to date. This is not expected to change in the near future.*"(Kern 2012, for transcript see appendix)

In Hamburg, investment promotion is organized through the **HWF- Hamburg Business Development Corporation**. As Hamburg is a city-state there are no other regional investment agencies. However, the HWF cooperates with a variety of stakeholder in providing its services.

**Figure 20: Structure of Investment Promotion Hamburg**




Source: HWF 2012.

Given that the city has largest harbor and hosts an Airbus development site, it aims to further investments into Logistics, Media, Creative Industries, Renewable Energy, Healthcare, Aviation, Technology, Maritime Industry and Life Science. (HWF 2012) Overall, the city cooperates with stakeholders from those eight different industry clusters. To help it structure its limited resources effectively it cooperates closely with the industry clusters to make use of their respective industry- and international know-how (Matz 2009). The industry clusters are represented through a host of organizations and companies, representing a cross-section of value-added sectors. Furthermore, Hamburg investment promotion is among the only to have a distinct regional focus in its investment promotion activities- particularly reaching out to Chinese investors from the Beihai Bay, Pearl River Delta, Jiangtze River Delta and the region around Chongqing. (Matz 2009) For this end, the HWF established foreign representative offices in Hong Kong, Guangzhou and Shanghai.

It appears, that all state-based investment promotion activities focus on value-added activities tailored to improve the productive structure locally. The system of investment promotion differs from state to state, as can be seen from the examples described above. The commonality between all examples is their focus on guiding Chinese investments into high-end, knowledge-intensive industries. While the national GTI agency provides services for all German investment locations and across all industries, the states use investment promotion activities to further industrial upgrading and direct investment into selected locations and commercial sectors. Their respective means of influence are however limited financially and by accessibility. It is interesting to note, that for some states (as is the case for Hamburg), the chambers of commerce serve as representative offices for their investment promotion activities. However this has not played a decisive role for investment promotion on state level in the promotion of Chinese investments.

### 7.2.4 Social Stakeholder Capacity in Chinese Foreign Direct Investment

Unions are voluntary associations of workers to represent their social and economic interests. As guaranteed under German constitutional law, unions together with the employers associations possess the right to collective bargaining regarding working conditions (including wages, working hours and vacation). Unions not only have

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come to play an important role in the individual enterprise, but also beyond. They remain key stakeholders in German politics, given their high number of members and influence over company policies. The most important tasks of the union include the improvement of working conditions, job security, the representation of workers interests at labor courts and the negotiation/ conclusion of collective labor agreements. Workers are also represented in elected work councils, often associated with the unions (but not necessarily). The largest unions of Germany are represented through the umbrella organization Confederation of German Trade Unions (*Deutscher Gewerkschaftsbund*).

The exchange between unions and employers plays a key role for the structure of the German economic model. The interest of the employers is represented through the employer's federations, chambers of commerce and chambers of crafts. Both parties are ultimately forced to cooperate, leading to a balance of interests and ultimately consensus. The work of unions is integrated into the daily working environment, but also spans up to the transnational European sphere. On the individual company level, employees elect a worker's council to represent their interest. In larger companies, these elected worker's council members are guaranteed a seat in the board of directors. (Page 2011)  Beyond the company level, unions have become a strong social force with networks on federal and European level. Unions cooperate across sectors to influence politicians through common initiatives, campaigns, and dialogs with key decision-makers. In Germany, unions are important for shaping a larger debate on values and policies, making them relevant for both micro- and macro levels. (Huke 2010, 7)

The case studies on Chinese investment in chapters 6.4.1 and 6.4.2 underline the key role unions play for success or failure of Chinese investors. Unions can either play a supportive role in the takeover process or else restrict the ability of the investor to act independently, given their capacity to organize the workforce and exert pressure on the management. Unions have various means at their disposal to coerce investors and make the smooth undertaking of a takeover virtually impossible. The influence of unions starts in the takeover negotiations, in which it is customary that an agreement be reached between the union and the investor over issues such as jobs cuts, extended

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working hours and salary. A positive example of this can be seen from the case of Schiess, in which union and investor cooperated smoothly, agreeing on labor security and concluding an agreement to guarantee no jobs to be outsourced in years to come. A negative example for conflict between union and investor can be seen from the example of Kelch & Links. The union used a rather aggressive strategy to hinder the investor evading his wage agreement with the workers of Kelch & Links. They not only made use of their right to go on strike, but also blocked the removal of machinery from the company headquarters. The right to strike is regulated by several conditions: Only associations allowed to conclude collective agreements (i.e. unions and employers' associations) are allowed to call a strike. The strike must have the aim to conclude such a collective agreement. (Klaß/ Rölz/ Rabe/ Reitemeyer 2012, 56) The union can thus make it virtually impossible for the investor to press through on job- or wage cuts, if not agreed upon with the union as representative of the workforce.
It appears, that means of public relations make among the strongest coercive instruments of unions vis-à-vis the investor. In the case of Kelch & Links, the union used a severe media campaign to destroy the public reputation of the Chinese investor. The union in question issued a leaflet denouncing the investor to employ "*Shanghai Methods*"- alluding to the notoriously bad image of Chinese labor standards.[29] The union was able to make media aware of the conflict, leading to the publication of several articles in local, regional and even national newspapers and magazines.[30] Given that Kelch & Links is an SME in a traditional, rural part of Germany, such a media campaign does not only tarnish the reputation of a company, but may well infringe further business activities. The bad reputation of a company will likely destroy business relations, customer loyalty and sales. As media on national level picked up on the story, this effect goes well beyond the local framework and is seriously hampering the takeover for the investor. While no case is known to date in which a union was able to preempt a takeover, a well planned media campaign could very well coerce an investor to agree to demands by the union or refrain from the M&A procedure. With the ongoing rise of M&A activity by Chinese investors, this seems all the more likely in the future.

[29] Refer to: IGM Metallnachrichten (2010). Shanghai-Methoden bei Kelch und Links? IG Metall Region Stuttgart. IGM News 03.16.2010
[30] The articles were published amongst other in the regional paper Stuttgarter Nachrichten; local newspapers Rems-Murr Rundschau and Waiblinger Kreiszeitung; several online industry papers; and the one article in national magazine Stern.

# 8. Conclusion

This research has followed the question what influence the German government (or the regional states/ or EU) and social agents (esp. workers unions) are able to exert on Chinese investment today and in the future. To conclude we can say that the EU and Germany's federal institutions alike possess strong potential regulatory powers. Due to its transnational status, the EU clearly is the most influential actor. Through the ratification of the Lisbon Treaty, the EU now holds exclusive powers to pass legislation with regards to FDI. The European policy process ultimately foresees a common policy for the entire EU. However, much of the necessary legislation is not yet in place. The European legislation process on FDI has thus to be understood as open-ended, making the current framework a mere status quo. In the foreseeable future, the EU aims to create free access for FDI in the EU member states and remove all barriers for investment. For now however, the European legislative process has not advanced to a point, where a comprehensive policy for all member states would be in sight. While the EU may hold exclusive legislative rights in the field of FDI, a loophole provision has opened a window of opportunity for the German federal administration to regulate FDI.

In light of the EU's exclusive competence in FDI related legislation, Germany should in fact have no possibility to predominantly regulate FDI flows into its market. However, quite the opposite has been the case. In fact, the current status quo has helped national administrations to even extend their powers with regard to FDI. The current European legislation contains a loophole provision, which allows the restriction of FDI flows, should they infringe on public order and state security. Based on the possibility to restrict FDI with this reasoning, the German government has augmented its old regulations to make use of the opportunity. While formerly only able to restrict investments into selected sectors, the new regulation allows Germany's federal government to monitor and prohibit investments by foreigners above a share of 25 per cent- as all of these are deemed potential threats to public order and security.

The federal Ministry of Economics and Technology can now restrict across all sectors and veto investments in any German company. Particularly the military and dual use goods sector remains sensitive, as a weapons embargo on China justifies restrictions based on heightened threat to public order and security created through Chinese investments. Overall, the capacity of the federal Ministry has increased across the board, making it the central stakeholder in the approval or refusal for Chinese investments. However, in practice these rights are rarely exercised. As there is no obligation to notify an investment to the Ministry and given the large number of transactions, (even if it wanted to) the Ministry would likely be unable to employ its rights to the full possible potential.

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This in turn may strengthen the position of social institutions, as they can raise awareness for particularly problematic investments. Thus their function as whistleblowers to the public and particularly to the ministry may likely become part and parcel of the approval process in the future. As the discussion proves, social stakeholders like unions employ media and public relations to pressurize and coerce investors. They are well connected and able to raise awareness, which not only directs public- but also media attention towards problematic takeovers. As can be seen from the case of Kelch & Links, the union was able to put the conflict with the investor into the press at local-, regional-, and national levels. Media attention in turn guarantees involvement by political stakeholders- ultimately leading to political intervention. To date, conflicts between unions and investors are still sparse, but may well increase with a further rise of investments from China. As unions are important stakeholders at company level and also play a crucial role in the political system of Germany, they are in a position to influence political awareness for particular investments- ultimately making them key stakeholders in Chinese investments to Germany. This will likely go hand in hand with conflicts between the governmental and social sphere, as the federal states have a pronounced interest in furthering investments in their respective areas. At state level, various types of investment promotion agencies are in place to attract investors into the respective federal state. These are situated below the federal agency GTAI, and are legally organized as private corporations, with the state as main

stakeholder. These agencies try to promote investment into a set of knowledge intensive sectors that help upgrade regional economy. To this end they provide various promotional activities, advisory and settlement support services and continuously act as intermediaries between the investor and the public administration (and third stakeholders). It remains questionable however, how effective such investment promotion activities ultimately are: The agencies have a different structure in each state, individually try to promote a single location to a wide variety of investors and investment promotion is fractured among different sub-regional actors. Furthermore, a lack of financial subsidies largely persists across all German states.

Overall this leads to a conclusion that the situation is one of constant change. The current stage of investment regulation is clearly only a status quo- necessitating an outlook for the likely future proceedings. Still, we can conclude: Depending on how long current regulations will be valid and to which amounts Chinese FDI will further grow, various conflicts of interest between all stakeholders are highly likely. As Chinese investments are still comparatively small, these conflicts are of limited prominence in public awareness to date.

However, Chinese investment to Germany is on the rise, with particularly staggering growth rates achieved through Mergers and Acquisitions. Chinese FDI bears certain risks for Germany. Most problematic remains the defining feature of OFDI from China, that a large share originates from State-Owned Enterprises. These enterprises use FDI to acquire key technologies and know-how to become globally competitive- while still able to produce at (often subsidized) discount prices. Secondly, these SOEs also have preferential access to funds and capital at a time when German companies are hampered by crisis, making them easy targets for takeover. The analysis has further shown how FDI from China is directed according to state policies, which aim at upgrading Chinese company's ability and create globally competitive firms- thus ultimately forging stiff competition for Germany. State influence is thus the key feature of Chinese OFDI. This leads to several problems for Germany as an investment destination. Firstly, Chinese investment is undertaken primarily in core

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sectors, which make for the competitive edge of German industry at home and abroad. The acquisition of companies with advanced know-how and technology by a Chinese investor may well result in the loss of competitive edge across an entire sector (as can currently be seen by example of the German solar panel industries described above). The effect of this loss results not only in a decrease of market shares for German companies (see the example of the German automotive supplies industry described above), but also has an immediate effect on the local job markets.

We should however not forget, that investment from China is still very limited and currently plays only a minor role for Germany. Chinese investors remain very much an exception, even if investors from Hong Kong are counted in. Upon entering the German market, Chinese investors often encounter additional barriers. As foreigners they not only face information asymmetry, but also more cultural barriers than is the case for Europeans or Americans. Nevertheless, Chinese companies, as this discussion shows, can have a very beneficial influence on German companies: takeovers tend to save jobs, even create new ones and ultimately improve competitiveness of German companies. A new perspective is also opened through the findings on the cases of Putzmeister and Schiess, which underline how German advanced technologic know-how and the Chinese capacity to produce large numbers at low cost may provide for a sustainable form of cooperation. While a large share of companies are acquisition targets due to financial troubles, in the future, many more may agree to a takeover based less on hardship but rather in light of future opportunities that emerge through such a step. The takeover by a Chinese investor not only holds the prospect of access to funds, but of enhanced competitiveness through division of labor: production of basic parts in China at low prices and upgrade and assembly in Germany. Ideally this results in speedy production, cheap prices and high quality, ultimately opening a path to a new form of global market dominance.

## 8.1 Outlook

The European legislation is clearly in flux and will require more time to reach the stage of a comprehensive investment legislation covering all member states. In the meantime, there are several alleys open to the EU to reach an improved investment framework with China. Several steps have been taken since 2010, which indicate such an aim. First, in the abovementioned Communication on the EU future investment policy, China has been clearly identified as potential partner for a standalone investment agreement. Second, an EU-China Investment Joint Task Force was established in 2010 under Trade Commissioner de Gucht and President Barroso. (Council of the European Union 2010) The EU has a vested interest in reaching an agreement, in order to gain better market access and to abolish barriers (such as protected strategic sectors, foreign ownership thresholds, Joint-Venture requirements, investment screening, discriminatory treatment of EU investors in licensing, subsidies, and authorization) in China. Overall, there is currently only limited comprehensive legal framework between China and the EU on these matters. Thus the EU and China may choose among three policy options to provide a solution:[31]

a. **Reach a comprehensive investment agreement**- which would include both regulation for better market access and investment protection.
b. **Conclude a stand-alone investment protection agreement**- which would replace all agreements held between individual member countries and China. This agreement would only cover investment protection but not market access.
c. **Conclude no separate agreement with China**- continuation of dialogue and broader agreements, yet no specific investment protection- or market access agreement.

Over the next couple of years, we will see a variety of consultations between China and the EU institutions, as well as between the EU stakeholders themselves. The first public consultation of such kind was launched in 2011- likely many more will follow until one of the above options has been chosen.[32] Ultimately a comprehensive agreement is most desirable for the EU, as it strengthens its positions with regards to

[31] As laid out a presentation held by Leopoldo Rubinacci (Head of Investment Unit at Directorate General for Trade, European Commission) at the DG Trade and Civil Society Dialogue on June 20th 2011.
[32] Refer to: European Commission Public Consultations Database. EC Directorate General for Trade 2012

the member states and given the economic importance of China for the European Union. However, such an agreement will take many more years to conclude, therefore a gradual process ultimately leading to such an agreement appears most likely.

While the EU has to choose between a comprehensive-, a partial- or no agreement- the federal German government and its federal states face a different spectrum of choices. So long as there is no comprehensive European regulation in place, they can temporarily either increase or decrease regulation within the legal spectrum created for themselves. The federal government continuously underlines that they wish for an increase in FDI from China, but not out of pure goodwill. While Germany has large shares of its FDI invested in China, Chinese investment to Germany is still small- leading to unfavorable imbalances. The federal Ministry of Economics therefore concludes, that for the long-term assurance of German investment opportunities in China, it is desirable that Chinese companies also invest more capital in Germany. (BMWI 2009, 13) An increasing regulation and active sanctioning can thus not be expected, given the aim of reaching a status of reciprocity and a balanced FDI flows. This leads to the following possible conclusion for the federal side: Chinese Investment will be allowed to operate- in order to ultimately reach a reciprocal abolition of barriers on the Chinese side.

The sixteen federal German states in turn concur with this notion. As stated by the senior official from the Ministry of Economics in Hesse interviewed for this research, reciprocity is also a key goal for state administrations. However, their understanding of reciprocity points to a very different direction. While welcoming the Chinese engagement in Germany, the official stated that Chinese investments should not end up as a one-way street: in which Chinese investments can flow unhindered into Germany, while German investors face a variety of barriers. Therefore the promotion and support of German investment in China is most significant to them. It appears that they will not become involved in any form of regulation or substantially increase promotion in the future, given their sole focus on supporting German companies and their lack of financial resources.

There is however a worrying development at municipal level, which may change these lenient attitudes in the state administrations: Several German municipalities were

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approached by Chinese investors, who appeared to plan large-scale investments there (the latest involving an alleged investment of 100 million Euros). (FR 2012) As it turns out, these investors either did not follow through with their investments, only invested a minor share of the promised funds, or simply, at some stage, disappeared back to China. They left behind their debt, redundant construction sites and outstanding accounts with local businesses. By now, many municipalities struggle with such "hollow" investments, in which the state or the municipality transferred property rights to the investors and investors received substantial public funding (either directly or through guarantees). A particularly striking example is the German city of Parchim (in Mecklenburg West-Pomerania), which sold its airport to the Chinese logistics company Link Global. (Siegmund 2008) The city transferred property rights to the Chinese investor, yet never received the purchasing price of 30 million Euros and none of the promised 100 million Euro investment was carried out.[33] The transfer of property rights in turn has made it impossible for the city to agree to the lucrative offer to merge its regional airport *Parchim* with the international airport of Hamburg- leading to substantial financial damages to the local community and the state.

Many such hollow investments have occurred and still do occur- ultimately leading to a change in attitudes towards Chinese investors. While regulation cannot hinder such problems to occur, states and municipalities may develop a negative attitude towards investments from China. This will make it impossible for any Chinese investor, trustworthy or not, to carry out investments in Germany in the future- ultimately proving to become a much larger barrier to Chinese investment flows than any sanction or regulation ever could.

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[33] Refer to: Abendblatt (2010). Chinesischer Käufer bleibt Rate schuldig. Abendblatt online 02.15.2010

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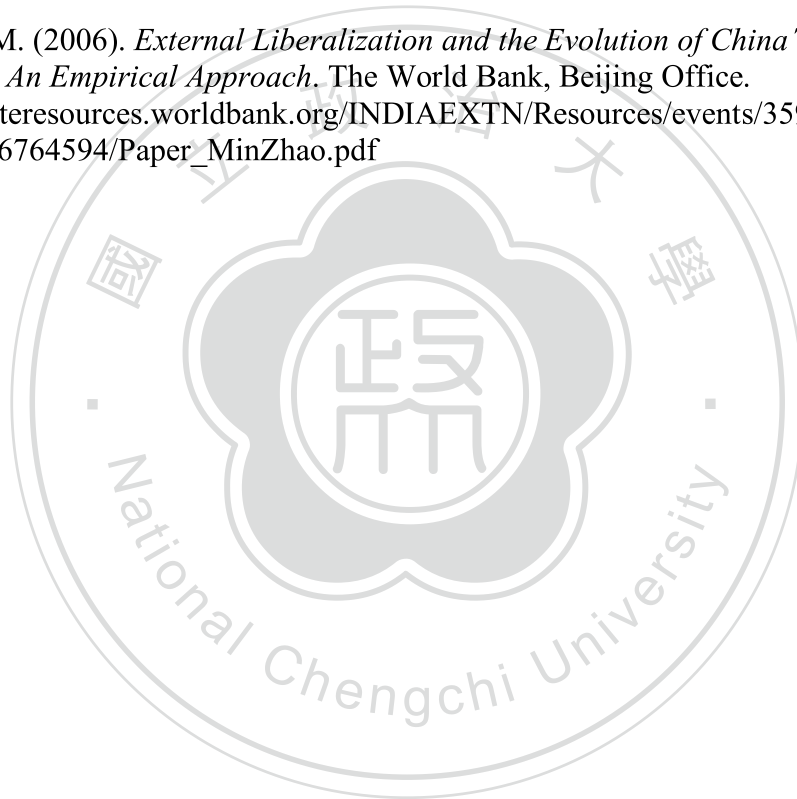

# Appendix

*(Interview Transcript Ministry of Economics, Hesse, March 19$^{th}$ 2012)*

NAME : Dr. Helmut Kern
JOB TITLE: Head of Division, Financial Center Frankfurt
DEPARTMENT: Hessian State Ministry of Economics
(BRIEF) DESCRIPTION OF DUTIES: Promotion and development of the financial center Frankfurt

**What is the attitude of your organization towards Chinese Investments in Germany?**

- How has it been in the past, what is it like today?
- Do you view your agencies role more in promotion or regulation of FDI activities from China?
- Would you say that Chinese investment is a key issue for your organization?

*Chinese engagements in Europe are certainly welcome in principle, given our interest in global exchange of goods and trade development. However this engagement should not end as a one-way street, which is why the promotion of German (Hessian in particular) investments in China plays a crucial role for us.*
*Chinese activities, which benefit and help to promote the financial center Frankfurt, are particularly welcome. This assessment has not changed.*
*Nonetheless, the promotion of the financial center Frankfurt as a subject area in this ministry is still only peripherally touching upon investment activity from the Chinese side.*

**Does your organization promote FDI flows from China to Germany?**

- Which means does your organization possess in doing so?
- Are they effective?
- Which means does it lack, from your point of view?
- Do you foresee any change that may extend capabilities of your organization to influence FDI from China in the future?

*There are no financial means to support Chinese investments to date. This is not expected to change in the near future. The foreign economic policy of the ministry is much more concerned with- and aimed at attending to German companies needs (especially Hessian that is) and supporting their activities in foreign markets.*

**Does your organization regulate FDI flows from China to Germany?**

- Which means does your organization possess in doing so?
- Are they effective?
- Which means does it lack, from your point of view?
- Do you foresee any change that may extend capabilities of your organization to regulate (restrict) FDI from China in the future?

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*In the foreign trade promotion of the ministry there is absolutely no distinction between promotion and regulation. Thus I would like to refer to my previous answer in question number two. In general however, our perception towards Chinese Foreign Direct Investment could be described as neutral- I would like to reference my answer for question one on this issue.*

**Which organization(s) do you think has the most influence on Chinese investment in Germany?**

- Do you feel governmental agents in general take on a more supportive/restrictive role?
- Do you feel social agents in general take on a more supportive/restrictive role?
- Any conflict between agencies in regards to Chinese Investment?

*This cannot be judged or estimated by the ministry.*

**German Union IGM- Industriegewerkschaft Metall (**Industrial Union of Metal Workers**) Leaflet: *"Shanghai Methods at Kelch & Links?"***

# Metallnachrichten

Kelch und Links GmbH
Kelch und Links Produktion GmbH

## SHANGHAI-METHODEN?
### bei Kelch und Links

**BETRIEBSRÄTE SOLLEN FRISTLOS GEKÜNDIGT WERDEN.**

Demokratie und Mitbestimmung hatten im Gemeinschaftsbetrieb der Kelch und Links in den letzten Monaten keinen Platz. Dies gipfelte beim Versuch Produktionsmittel in einer Nacht- und Nebelaktion wegzuschaffen.

**Mit Herz und Verstand habt ihr dies verhindert.**

Die Indizien, dass mit den abtransportierten Maschinen eine Produktion in der dafür gegründeten Kelch und Links GmbH mit Sitz in München gestartet werden soll, haben sich erhärtet.

Die Gesellschafter, die chinesische „Harbin Measuring & Cutting Tool Group Co" und die dafür verantwortlichen Geschäftsführer, Thomas Esswein und Jiyuan Li, versuchen durch diese Machenschaften sich der Verantwortung gegenüber den Beschäftigen des Gemeinschaftsbetriebes zu entledigen. Die Kelch und Links Production wurde in die Insolvenz geführt. Allerdings ist von einer Zusammenarbeit mit dem Insolvenzverwalter nichts zu spüren. Im Gegenteil, die Mauern zwischen der alten Kelch und Links und der insolventen Production werden errichtet. Mittlerweile haben die beiden Geschäftsführer Esswein und Li ihr Amt bei der Kelch & Links Production GmbH niedergelegt. Neuer Geschäftsführer ist Kurt Wolfgang Kottenberg.

Es deutet alles darauf hin, dass die Gesellschafter jegliches Mittel nutzen, dass die KLP liquidiert wird. Die Geschäfte sollen vermutlich in reduzierter Form und reduzierter Beschäftigung aus K&L (alt) und KLP in der neu gegründeten K&L mit Sitz in München fortgeführt werden. Eine insolvente KLP steht diesem Ansinnen im Wege.

Straftätig wurde inzwischen Eigentum der KLP entfernt. Hier gilt es die staatsanwaltlichen Ermittlungen abzuwarten.

Euer Betriebsrat hat dem vorläufigen Insolvenzverwalter eine konstruktive und vertrauensvolle Zusammenarbeit im Sinne einer möglichen Fortführung der KLP angeboten.

**Stören dabei die Betriebsräte?**

Eine der letzten Handlungen des ehemaligen Geschäftsführers Jiyuan Li, beraten durch die Anwaltskanzlei White&Case, war die Beantragung der fristlose Kündigung von 5 Betriebsratsmitgliedern.

Es wird damit versucht diejenigen einzuschüchtern, die den Machenschaften der Geschäftsleitung nicht widerspruchslos gegenüberstehen.

Der Betriebsrat hat in seiner Anhörung diesen außerordentlichen Kündigungen widersprochen. Dennoch rechnet jeder der Betroffenen mit weiteren Repressalien. *„Wer bislang keinen Anstand gezeigt hat, wird dies auch nicht zukünftig tun".*

Am **16. März 2010** findet im Gemeinschaftsbetrieb der Kelch und Links GmbH, sowie der Kelch&Links Production GmbH die **Betriebsratswahl** statt.

**Stärkt euren Betriebsräten den Rücke**

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