July 7th, 2016

Dr. Diana Kisro-Warnecke
Johannes Dahlke

An optimistic view on Chinese direct-investments in Germany

Only bronze for Germany: In the first quarter of 2016 Chinese investments into German companies accounted for over €3.3 billion – that ranks Germany third worldwide for target countries of Chinese outbound direct investments. In the country of World Champions, one usually isn't particularly satisfied with finishing third. Yet in this case, many people in Germany would have preferred a much lower ranking. The reason: In 2015, 35 German companies were acquired by Chinese investors.[1] In Germany Chinese investors mainly target *Hidden Champions* in the sector of technology and mechanical engineering. Therefore, concerns about reductions of jobs and production facilities as well as fears of the outflow of valuable know-how are rapidly growing. Recently, even the Federal government engaged in the process of searching a possible German investor to acquire the robot manufacturer *Kuka* – a prime example of German "Industry 4.0" – because the Chinese *Midea Group* had issued a €4.5 billion offer.[2] The activities remained unsuccessful. Since German investors weren't willing to signal interest, *Midea* has now closed a deal to acquire *Kuka* and has purchased the needed shares over the last couple of weeks – they are now holding 86 percent of the company.[3]

Impulses and financing for German Industry 4.0

With all the wide spread skepticism there also are two major positive effects of Chinese investments that can't be refuted: Gain of capital and better access to the Chinese market. The strategic relevance of these two points can be elucidated by taking a closer look at *Kuka'*s recent decision. Due to China's change of course with regards to high-quality innovation the Chinese market advanced to become the largest market for multifunctional industrial-robots. The market is predicted to account for 150,000 of 400,000 industrial-robots sold worldwide in 2018.[4] Especially for a relatively small global player, such as *Kuka*, broad access to this market can't be achieved without an experienced Chinese partner helping to overcome cultural and political hurdles and the infamous bureaucratic "red-tape". In addition, competitors like *Estun*, *Siasun* und *Efort*, are quickly gaining ground in China.[5] After the takeover by *Midea*, *Kuka* is now aiming for yearly sales turnovers of over one billion Euros in China alone. For most companies it is already only reasonable to keep an ear to Chinese ground for strategic reasons. And for companies in certain sectors, the Chinese market is simply too big to ignore. It begs to be entered, preferably earlier than later.

Against common assumptions, *Kuka's* profits would still flow back to Augsburg and would certainly also benefit Germany as a whole. Gain of capital and growing profits can be particularly attractive to companies focusing on the development of future-technologies since they'd provide much needed funding for research and developments in the context of "Industry 4.0" – which is supposed to be the saving grace of German competitiveness. Yet, in a time in which medium sized business find themselves in the position of not being able to finance the modernization of production facilities and global players refuse to open their purses due to concerns about the risks of Industry 4.0 as well as actual the value of returns on investments, the motor of German Industry 4.0 is beginning to stutter before it has ever actually started running. In comparison to German firms, US-based companies use more than double the shares of their budgets to finance the development of future-technologies.[6]

All the more incomprehensible is the fact that a company like *Siemens*, while displaying a big "Industry 4.0"-shaped hole right in the middle of their portfolio, didn't signal any interest to issue an offer for *Kuka*.[7] Even despite the fact that no one was expecting an offer in the heights of the inflated Chinese prices. After all, Chinese investors need to enhance the palatability of their offers monetarily to compensate for the missing transparency of financing structures and bad experiences with Chinese takeovers in the past years.[8]

Restoring good reputation

Although Chinese outbound direct investments quintupled in the first quarter this year in comparison to last year's,[9] Chinese executives find themselves more and more obliged to internally and externally justify their investments. The reason for this development can be found in serious missteps and enduring issues with acquisitions such as the Canadian company *Nexen* (sold for $15 billion). A clear sign of the new overall skepticism is quantified by the number of $47,5 billion, that describes the value of failed mergers & acquisitions (M&A) by Chinese investors in the year 2015.[10] In the early phases of Chinese foreign acquisitions, debacles like the *Nexen* takeover or the current fiasco related to the *Airport Frankfurt-Hahn* are systemic symptoms of inexperience, internal pressure to invest and carelessness. But a new trend is emerging. Consequences of the previous experiences are contributing to slower rapprochements on all sides of the table. An increasing number of exploratory talks and careful preparations can be observed. *PwC* classified this evolution of Chinese takeover strategies as the “maturing phase” following the “learning phase”.[11]

A recent study by the *International Institute for Sustainable Development* shows that the standards of working conditions in companies owned by Chinese investors are very similar to the standards set by companies from OECD-countries. It, for example, demonstrates that the worry of deteriorating working conditions after Chinese takeover scientifically doesn’t hold water – that is especially true for Germany.[12] After a protest march by the workforce of the Swabian pump-manufacturer *Putzmeister* (in the light of the planned takeover) the Chinese investor *Sany* offered guaranteed jobs until the year 2020. Furthermore, the acquisition wasn’t followed by forced structural changes of any kind. The managment of the international business remains in the hands of the German executives, while *Sany* largely only focusses to support the company in the Chinese market environment. Similar experiences have been made by the engineering-company *KraussMaffei* from Munich, *Kiekert*, an supplier for big automotive companies and the waste recycler *EEW* based in Lower Saxony.[13]

Also, it was a good sign that even an overseas-experienced Chinese investor like *ChemChina* sought help from the reputable investment managers of *AGIC Capital* in order to avoid structural shortcomings and contractual loopholes for their acquisition of *KraussMaffei*.[14] With regards to *Kuka*, the two involved parties agreed upon an agreement to preserve the independence of the current management: *Kuka* stays independent and listed on the stock market. Guaranteed jobs, guaranteed location in Germany.[15]

The misunderstanding of Chinese intention and German know-how

These kind of acquisition are also motivated by the equity of German brands and structures to access the German market, they don’t just aim at achieving transfers of technology and knowledge.[16] For the latter, as well, the motto’s changed: The objective is to learn and internalize, instead to copy or steal. To demonstrate China’s power of innovation the Chinese government recently presented their new supercomputer “Sunway TaihuLight“ at the *International Supercomputing Conference* in Frankfurt. This computer is the fastest computer worldwide and puts American computers into their places. Hardware and software: developed and made in China.[17] Meanwhile, the Chinese smartphone-manufacturer *Huawei* was ranked the 45th most innovative company in the world by *BCG*.[18]

German labor unions like *IG Metall* and members of the chambers of commerce are eager to clarify that accusing Chinese investors of exclusively being interested in patents is – in the light of recent evidence – simply unjustified.[19] Moreover, it is disclosing a deep misunderstanding of the process of innovation. Inventing innovative technologies is not solely based on one great idea, one genius moment. On a more fundamental level, innovation is the result of complex processes and sustainable structures of (human) resources, laying the groundwork for genius ideas and skilful engineering. There is not one blueprint for innovation, there are only organic processes. Company culture, production methods, workers and environment all constitute important factors of the success of German engineering.[20] *Kion*-

chairman Gordon Riske and Till Reuter, managing director of *Kuka*, both know: at the core of successful innovation stand the employees and their contributions to interacting processes.[21] So, instead of just buying the fruits, Chinese investors adapted to acquiring the whole tree. Even if the fruits of hard labor must then be shared with the owners from the Middle Kingdom, the tree still remains rooted in Germany.[22]

Sino-German Courage

German investors, on the other hand, can be accused of lacking farsightedness and the willingness to take risks. In addition, the following question seems justified: Can this supposedly new form of Sino-German economic relations really be described as a novelty? Considering that every German automotive company – the crown jewels of the German economy – already is maintaining joint-ventures with Chinese partners, Chinese investments in Germany seem to be a logical next step in the development of the symbiotic economic relations between China and Germany. This next step should, in turn, be followed by the freedom for German investors to unrestrictedly acquire companies in China. The Association for German Industry (BDI) also argues: "Mergers and acquisitions are part of the global economy, from which Germany, in particular, is benefitting immensely."[23] The recent takeovers should therefore be understood as two things: a tribute to the German quality and power of innovation, as well as a call to action for German investors to finally appreciate the mentioned valuable characteristics of their homeland's business environment and, more importantly, start supporting them financially. Next to their culturally inherited carefulness, German companies and investors must start to channel their inner Chinese courage. Like a World Champion would.

Dr. K&K ChinaConsulting
Postfach 3201
30032 Hannover

phone +49 (0) 511.807 24-20
fax +49 (0) 511.807 24-60

email:info@ChinaConsulting.org
net:www.ChinaConsulting.org

[1] cf. Armstrong, Ashley: „China's M&A boom is forcing the heavyweights to open up". In: The Telegraph (04/2016). Available: http://www.telegraph.co.uk/business/2016/04/01/chinas-ma-boom-is-forcing-the-heavyweights-to-open-up/ (retrieved July 27 2016).

[2] cf. Wirtschaftswoche: „Aktionär kritisiert Vorstand wegen Haltung zu Midea-Offerte". In: WiWo-Online (06/2016). Available: http://www.wiwo.de/unternehmen/it/kuka-uebernahme-aktionaer-kritisiert-vorstand-wegen-haltung-zu-midea-offerte/13762198.html (retrieved July 27 2016).;
cf. Börse-Online: „Politik sucht europäischen Retter für Kuka – Siemens nicht interessiert". In: Börse-Online (06/2016). Available: http://www.boerse-online.de/nachrichten/aktien/Presse-Politik-sucht-europaeischen-Retter-fuer-Kuka-Siemens-nicht-interessiert-1001232400 (retrieved July 27 2016).

[3] cf. Ard: „Kuka einigt sich mit Chinesen". In: Boerse ARD (06/2016). Available: http://boerse.ard.de/aktien/kuka-einigt-sich-mit-Chinesen100.html (retrieved July 27 2016).
cf. Höpner, Axel: „Wie geht es jetzt für Kuka weiter?". In: Handelsblatt (07/2016). Available: http://www.handelsblatt.com/unternehmen/industrie/midea-haelt-86-prozent-wie-geht-es-jetzt-fuer-kuka-weiter/13884462.html (retrieved July 27 2016).

[4] cf. Bryant, Chris: „The Danger of Robot M&A". In: Bloomberg Gadfly (04/2016). Available: http://www.bloomberg.com/gadfly/articles/2015-12-21/investors-betting-on-a-robot-deal-may-be-too-optimistic (retrieved July 27 2016).

[5] cf. Ard: „Kuka einigt sich mit Chinesen". In: Boerse ARD (06/2016). Available: http://boerse.ard.de/aktien/kuka-einigt-sich-mit-Chinesen100.html (retrieved July 27 2016).

[6] cf. McKinsey: „McKinsey Studie zu Industrie 4.0: Deutsche Unternehmen trotz wachsender Konkurrenz zuversichtlich". In: McKinsey. Available: https://www.mckinsey.de/mckinsey-studie-zu-industrie-40-deutsche-unternehmen-trotz-wachsender-konkurrenz-zuversichtlich (retrieved July 27 2016).

[7] cf. Bryant, Chris: „The Danger of Robot M&A". In: Bloomberg Gadfly (04/2016). Available: http://www.bloomberg.com/gadfly/articles/2015-12-21/investors-betting-on-a-robot-deal-may-be-too-optimistic (retrieved July 27 2016).
cf. Börse-Online: „Politik sucht europäischen Retter für Kuka – Siemens nicht interessiert". In: Börse-Online (06/2016). Available: http://www.boerse-online.de/nachrichten/aktien/Presse-Politik-sucht-europaeischen-Retter-fuer-Kuka-Siemens-nicht-interessiert-1001232400 (retrieved July 27 2016).

[8] cf. Armstrong, Ashley: „China's M&A boom is forcing the heavyweights to open up". In: The Telegraph (04/2016). Available: http://www.telegraph.co.uk/business/2016/04/01/chinas-ma-boom-is-forcing-the-heavyweights-to-open-up/ (retrieved July 27 2016).

[9] cf. J.P. Morgan: „China's Increasing Outbound M&A". In: J.P. Morgan. Available: https://www.jpmorgan.com/global/insights/chinas-key-drivers (retrieved July 27 2016).

[10] cf. Armstrong, Ashley: „China's M&A boom is forcing the heavyweights to open up". In: The Telegraph (04/2016). Available: http://www.telegraph.co.uk/business/2016/04/01/chinas-ma-boom-is-forcing-the-heavyweights-to-open-up/ (retrieved July 27 2016).

[11] cf. PwC (2016): Chinesische M&A Aktivitäten in Deutschland. In: PwC. Available: http://www.pwc.de/de/deals/assets/chinesische-m-und-a-investitionen-in-deutschland-juni-2016.pdf (retrieved July 27 2016).

[12] cf. International Institute for Sustainable Development (2016): „Sustainability Impacts of Chinese Outward Direct Investment: A review of the literature". In: IISD. Available: http://www.iisd.org/sites/default/files/publications/sustainability-impacts-chinese-outward-direct-investment-literature-review.pdf (retrieved July 27 2016).;
cf. Hans Böckler Stiftung / NRW.Invest (2015): Chinesische Übernahmen in Europa und Deutschland. S.6-11. Available: https://www.nrwinvest.com/fileadmin/user_upload/downloads/DE-Broschueren/NI_MA-Brosch_DE_20150825_RZ_web.pdf

[13] cf. Wirtschaftswoche (2016): China: Die Übernahmewelle im deutschen Mittelstand. In: Wirtschaftswoche (23/2016).

[14] cf. Szepan, Marc: „A New Model for China's Outbound M&A" In: The Diplomat (01/2016). Available: http://thediplomat.com/2016/01/a-new-model-for-chinas-outbound-ma-deals/ (retrieved July 27 2016).

[15] cf. Höpner, Axel: „Wie geht es jetzt für Kuka weiter?". In: Handelsblatt (07.2016). Available: http://www.handelsblatt.com/unternehmen/industrie/midea-haelt-86-prozent-wie-geht-es-jetzt-fuer-kuka-weiter/13884462.html (retrieved July 27 2016).;
cf. Ard: „Kuka einigt sich mit Chinesen". In: Boerse ARD (06/2016). Available: http://boerse.ard.de/aktien/kuka-einigt-sich-mit-Chinesen100.html (retrieved July 27 2016).

[16] cf. PwC (2016): Chinesische M&A Aktivitäten in Deutschland. In: PwC. Available: http://www.pwc.de/de/deals/assets/chinesische-m-und-a-investitionen-in-deutschland-juni-2016.pdf (retrieved July 27 2016).

[17] cf. Martin-Jung, Helmut: „China schockt die Konkurrenz mit extrem schnellen Supercomputern". In: Süddeutsche Zeitung (06/2016). Available: http://www.sueddeutsche.de/digital/computer-china-schockt-die-konkurrenz-mit-extrem-schnellen-supercomputern-1.3042331 (retrieved July 27 2016).

[18] cf. Bosting Consulting Group (BCG): „The Most Innovative Companies". In: Bcg.Perspectives (12.2015). Available: https://www.bcgperspectives.com/content/interactive/innovation_growth_most_innovative_companies_interactive_guide/ (retrieved July 27 2016).

[19] cf. Wirtschaftswoche (2016): China: Die Übernahmewelle im deutschen Mittelstand. In: Wirtschaftswoche (23/2016).;
cf. Szepan, Marc: „A New Model for China's Outbound M&A" In: The Diplomat (01.2016). Available: http://thediplomat.com/2016/01/a-new-model-for-chinas-outbound-ma-deals/ (retrieved July 27 2016).

[20] cf. Bläske, G. (2012): Auf der Jagd nach schwäbischen Mittelständlern. In: Börsen-Zeitung, 08.08.2012.

[21] cf. Dworak, Matthias: "Jetzt schlagen die Chinesen zu – und kaufen den deutschen Mittelstand auf". In: Focus-Online-Money (05.2016). Available: http://www.focus.de/finanzen/news/uebernahmen-aus-fernost-jetzt-schlagen-die-chinesen-zu-und-kaufen-den-deutschen-mittelstand-auf_id_5565557.html (retrieved July 27 2016).

[22] cf. Emons, Dr., Oliver (2015): Übernahmen: Erfahrungen mit chinesischen Investoren in Deutschland. In: NRWInvest: Chinesische Übernahmen in Europa und Deutschland.

[23] cf. Börse-Online: „Politik sucht europäischen Retter für Kuka – Siemens nicht interessiert". In: Börse-Online (06/2016). Available: http://www.boerse-online.de/nachrichten/aktien/Presse-Politik-sucht-europaeischen-Retter-fuer-Kuka-Siemens-nicht-interessiert-1001232400 (retrieved July 27 2016).