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Chinese OFDI: Historic Development & Activities in Germany

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Abstract*: In China´s heavily regulated economy, government policies and strategies have always been the underlying determinants to explain the development of Chinese OFDI. In 2000, the Chinese government officially started the "go global" strategy with the goal of promoting OFDI. This change of strategy from tightly restricted capital outflows towards encouraging Chinese companies to invest abroad was significant for stimulating the growth of Chinese OFDI. In support of the "go global" policy, the Chinese government has further streamlined the OFDI regulatory regime and relaxed control of outward capital flows. Even after the latest reform of the Approval and Filing policies for OFDI by the NDRC in 2014 the regulatory system is still relatively restrictive and complex compared to western regulations, requiring approvals from often various government bodies. Alongside the steady relaxation of regulatory regimes, China´s OFDI´s are more and more directed by commercial motivations rather than governmental ones. The extent of governmental interventions thereby varies and heavily depends on the motivations for the OFDI projects, personal connections and importance of the involved companies.*

Keywords: *OFDI; FDI; China; M&A; Germany*

1. Introduction

As result of its success in opening and reforming its economy and attracting significant FDI, China has quickly developed into a major source of global outward foreign direct investments (OFDI) in the recent past. From almost no OFDI in 1979 as initial year of Chinas opening process, China has reached very significant 116 billion USD in 2014. China, being not as strongly affected by the global financial crisis of 2007-2009, as economies of developed countries, was able to almost triple M&A volumes between 2007 and 2009 and OFDI flows were 3rd largest worldwide in 2014 [5].

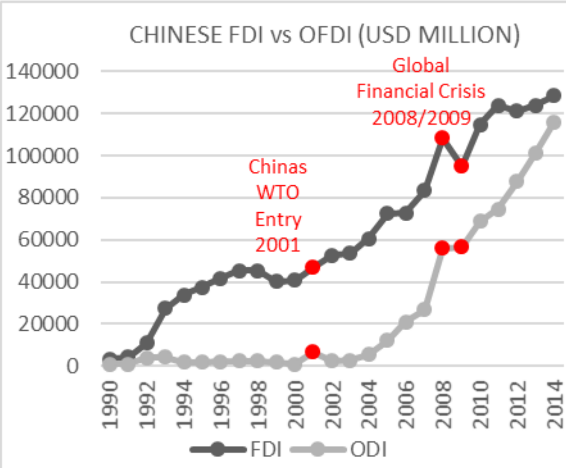

Figure 1. Development of Chinas FDI vs OFDI [5]

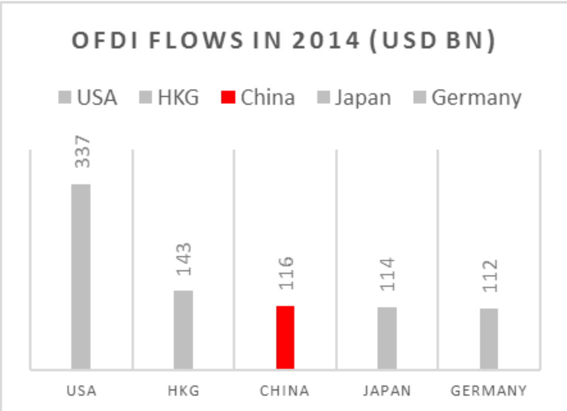

Figure 2. OFDI Flows in 2014 [5]

2. Development of Chinese OFDI

In China´s heavily regulated economy, government policies and strategies have always been the underlying determinants to explain the development of Chinese OFDI. In 2000, the Chinese government officially started the "go global" strategy with the goal of promoting OFDI. This change of strategy from tightly restricted capital outflows towards encouraging Chinese companies to invest abroad was significant for stimulating the growth of Chinese OFDI. In support of the "go global" policy, the Chinese government has further streamlined the OFDI regulatory regime and relaxed control of outward capital flows. Even after the latest reform of the Approval and Filing policies for OFDI by the NDRC in 2014 the regulatory system is still relatively restrictive and complex compared to western regulations, requiring approvals from often various government bodies. Alongside the steady relaxation of regulatory regimes, China´s OFDI´s are more and more directed by commercial motivations rather than governmental ones. The extent of governmental interventions thereby varies and heavily depends on the motivations for the OFDI projects, personal connections and importance of the involved companies.

2.1. Phase I 1978 - 1983: Restrictive early internationalization

As a direct result of and accompanying the economic reforms and the opening policy of 1978, first outward investments have been conducted. Activities were strictly limited to SOE´s (mostly logistics, trading, mining and hospitality) and given a complete lack of a regulatory framework, each investment had to be individually reviewed and approved by the State Committee [7]. Generally, there was a strong tendency to favor FDI over OFDI to avoid the outflow of US$ which reflected in the low volume of OFDI during that phase. In terms of OFDI motivations, only investments in the field of natural resources, technology transfer, production technology / export or expanding management knowledge could have been approved by the State Committee.

2.2. Phase II 1984 - 1991: Standardization and Encouragement

Based on confidence from more experience in the global economy, Phase II introduced a gradual standardization and the regulatory system evolved from individual case by case decisions to a more standardized system including other government agencies (MOFCOM, PBC, SAFE and SACAC) besides the State Committee. Even though this phase saw a first encouragement by the government for OFDI´s, the investments were still strongly dominated by SOE´s and the government tightly controlled the OFDI´s in terms of volumes, numbers, industries and target markets. The motivations and players (SOE´s) mentioned in Phase I stayed the same and OFDI´s mostly targeted developed economies with required natural resources such as Australia. It is noteworthy that similar to FDI in China the preferred market entry method of Chinese SOE into these markets were Joint Ventures rather than M&A´s. Phase II ended 1991 with the introduction of "Opinion of the State Planning Commission on the Strengthening of the Administration of Overseas Investment Projects" by the NDRC which took a critical standpoint towards the capability of Chinese companies to conduct and manage large outbound investments.

2.3. Phase III 1992 - 1998: Tightening Approvals / Private ODI´s

As Figure 1: Historic development of Chinese FDI vs. OFDI [5] shows the absolute dominance of FDI over OFDI continued in Phase III and the cautious attitude towards OFDI was further strengthened by the Asian Financial Crisis and a significant streak of loss of state assets in Hong Kong through real estate and stock speculations [6]. The approval process was further refined and became stricter and longer with investments above 1 million USD having to run a pre-approval by SAFE before being forwarded to MOFCOM for final approval. While little changed regarding target industries, countries, general motivations as well as SOE´s as main protagonists for most OFDI´s, Phase III saw first significant investments from private enterprises such as IT manufacturers and in particular home appliance manufacturers. It is noteworthy at this point that these early entrepreneurs have been quite successful in building reputable international brands. Another phenomenon was the growing importance of green field investments as alternative method of market entry compared to JV´s [2].

2.4. Phase IV 1999 - 2005: "Go Global"

Phase IV marks the official start of the "Go Global" policy which saw a strong promotion for OFDI in key industries and was manifested in the 10th five-year plan in 2001. Chinas entry in the WTO in 2001 further accelerated the encouragement of OFDI´s and slowly moved the focus away from a very restrictive approval system towards mere supervision without losing its ambitions for guidance. Chinese companies were actively encouraged by the government to conduct investments in overseas manufacturing capabilities. The liberalization policy culminated in a key document released in 2004 by the State Committee in which the approval system was further diminished to a mere record keeping about OFDI´s with the government along with access to international capital markets for Chinese companies with the purpose of financing their OFDI´s. Phase IV also saw a strong support of M&A endeavors by the NDRC which officially made it a preferred investment method. M&A therefore became increasingly important as market entry mode next to green field investments and JV´s and accounted for half of all OFDI in 2005 [2]. Besides the rise of M&A´s there was another shift regarding the target markets. The previously preferred developed economies only received 10% of OFDI from China in 2005 whereas 52,6% went to South America and 35,6% were invested within Asia

[2]. SOE´s remained the main investors but there was also a strong continuation of private investments, particularly in the manufacturing industries.

2.5. Phase V 2006 - present

The final Phase is a continuation of the regulatory liberalization for China outward investments as a logical result of the maturity of both government agencies and Chinese investors. In general, the approach to OFDI moves from a policy driven strategy to a firm centered strategy in which the Chinese government trusted a more mature and experienced Chinese economy to make their own decisions regarding OFDI. SAFE lifted the restrictions on the availability of foreign exchange for OFDI from Chinese enterprises and MOFCOM further lowered regulatory restrictions. Even more for the first time the Chinese Government gave OFDI a priority over FDI by providing serious service and support for OFDI. This dramatic shift form attracting FDI into China to engaging in OFDI from China was a direct result of the large foreign exchange deposits China has built up in the past decades. Because of these policies, we see a significant increase in OFDI from 21 billion USD in 2006 to 116 billion USD in 2014 [5]. With a dramatic jump between 2007 and 2008 because of the global financial crisis which did not hit the Chinese economy has hard as it did most other economies which was greatly used by Chinese investors given ample investment opportunities.

While SOE´s are still the main investors of OFDI, private companies continue to gain importance. A tendency towards market entry through M&A has become of the distinguished characteristics of Chinese OFDI, in particular for larger investments, yet green field investments and JV´s still play a role. There are prominent examples for Chinese enterprises successful entered markets and built brands with greenfield investments like Huawei or CITIC or through M&A such as Sany or Lenovo.

2.6. Summary

In the past 35 years, Chinese OFDI gradually developed from almost insignificance in comparison to FDI inflow to preferred economic strategy for China. The growth of OFDI is closely connected to the regulatory policy of the Chinese government which, with increasing confidence and experience of both the Chinese government and Chinese companies, switched from a regulatory centered policy to a firm centered policy. The introduction of the "Go-Global" policy in 1999 and Chinas WTO entry in 2001 had significant influence on the growth of Chinese OFDI as did the financial crisis of 2007 and 2008. At this stage, the government still guides OFDI directly through regulations particularly for large investments and indirectly through investments of SOE´s but significantly focuses on providing support and service rather than tight regulations. One of the success stories of Chinese OFDI is the successful creation of several Chinese MNE´s such as Huawei, Lenovo, Haier etc.

1978 – 1983	Restrictive early internationalization	• First steps accompanying general economic reforms; • FDI and OFDI had similar strategic goals • Only SOE´s can invest abroad • No overall framework but decisions on a case by case basis • Limitation of OFDI to strict goals
1984 – 1991	Standardization & Encouragement	• First liberalization of policies to stimulate Chinese OFDI´s • Continued domination of OFDI originating from SOE´s • Continued limitation of OFDI to strategic national goals
1992 – 1998	Tightening approval & first non SOE investments	• Further encouragement for international Investments (Focus on large SOE) but • Tightening of the approval process for OFDI´s because of a streak of state asset losses
1999 – 2005	"GO Global" Policy	• Control of illicit capital transfer • Active promotion of OFDI´s in key industries • Introduction of "GO OUT" policy in 1999 • China WTO entry
2006 – present	Post WTO	• In 10th five-year plan (2001-2005), "Go Out" was formalized; in 11th five-year guideline (2006-2010), "Go Out" was stressed; in 12th five-year guideline (2011- 2015), a combination of "FDI" and "OFDI" is being promoted. • Shift from a policy driven policy to a firm centered policy • Further simplifications in 2014 for projects below $300 million US$ • Simplified Approval in 2014 based on increasing number of non SOE M&A´s

Table 1. China´s OFDI policies [3] [1]

3. Chinese M&A in Germany

Chinese Investments in Europe have grown substantially in the past 5 years. Germany´s share of these EU bound M&A deals has consequently increased in these 5 years. In 2014 Germany achieved the top position regarding deal volumes of Chinese M&A activities and is second place in terms of overall deal values behind the United Kingdom. Germany´s high attractiveness for Chinese investors thereby can be explained by its strong industrial technologies, high-tech knowledge, well developed production and management skills and consumer related business brands. Further reasons for Chinese companies to expand into Germany can be found in their search for market entry into new markets, increasing demand of Chinese consumers for sophisticated and high quality products as well as cost pressure from increasing production costs in China forcing Chinese companies to improve their products and processes to stay competitive.

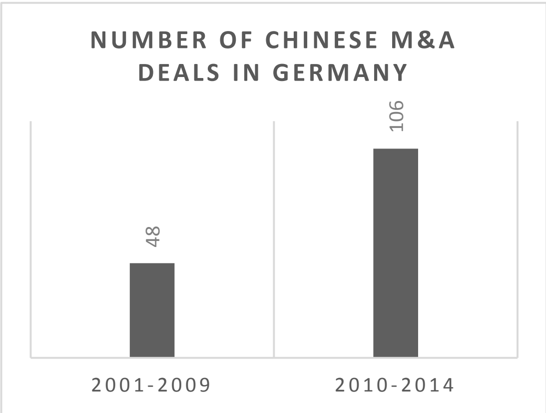

Figure 3. Chinese M&A Deals in Germany [4]

Further reasons for the attractiveness of Germany for Chinese investors is the positive and stable economic development in Germany in comparison to other European economies which still struggle with the aftermath of the international financial crisis and the EU financial crisis. The German industry is particularly strong in automotive, industrial manufacturing, chemicals and renewable energy etc. Many of these strongpoints of the Germany industrial landscape are an excellent match with the strategic goals of Chinese companies such as acquiring technology, transfer know how and intellectual property, enter the European market and improving the competitiveness of their product portfolio. Market access of course is not a one-way street and synergy effects in form of access to the Asian / Chinese market through the M&A can be a very interesting incentive for the German target company as well.

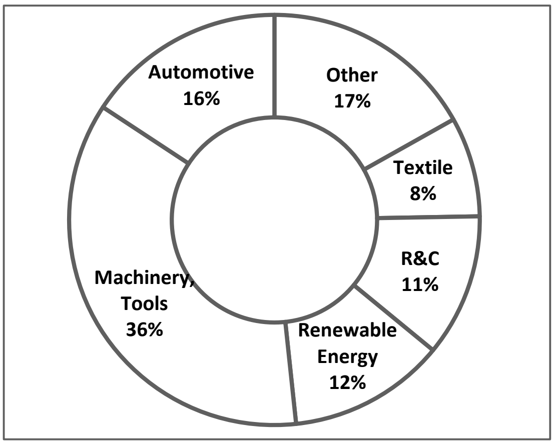

Figure 4. German Industry Sectors targeted by Chinese M&A 2014 [4]

4. Conclusion

Building on the success of the Chinese economic development with significant trade surpluses and high reserves in foreign exchange the Chinese economy is increasingly turning its focus on OFDI. As part of their internationalization strategies many Chinese companies (private and state owned) are investing abroad to become global players. As a result, cross border M&A form China into developed countries increased dramatically in the past years and reached new heights regarding volume and number of deals on a yearly basis. Germany with its unique industrial landscape and favorable external factors is of particular interest for Chinese companies seeking to improve their competitive advantage on the global and local market, transfer of technology and management know-how and gain EU market access.

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