A Sudden Turn of Events: Increased Opposition to Chinese Acquisitions in Germany

Only a few months ago, Chinese bidders seemed to be announcing the purchases of venerable German firms almost on a weekly basis. By mid-November 2016, Chinese companies announced or completed German acquisitions worth a record €11.3 billion (US$12 billion), almost eight times the level of 2015, according to Bloomberg data. Until recently, none of them faced any opposition from the public, politicians or regulators. Deals included the sale of the incinerator specialist EEW to Beijing Enterprises for €1.8 billion and the takeover by China National Chemical of the time-honoured machinery maker KraussMaffei for just under €1 billion. And finally, with the purchase of a €4.6 billion stake in the robot manufacturer KUKA, Chinese buyer Midea gained access to one of Germany's high-tech jewels. For a long time it appeared that Chinese investors were welcomed in Germany with open arms — a mistaken view, as it is now emerging.

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A prime example of what might be understood as a sudden policy shift is the case of Aixtron, a struggling semiconductor equipment manufacturer based in Herzogenrath in the state of North Rhine-Westphalia. Until recently, the company attracted little notice except among industry experts and specialists in German equity markets. That changed overnight. In a surprise move at the end of October 2016, the German government revoked its approval for the planned takeover of Aixtron by the Chinese firm Fujian Grand Chip Investment (FGCI). It is now considered a near-certainty that U.S. intelligence services were behind the deal being blocked.

According to media reports, chips manufactured with Aixtron equipment could be used in Chinese weapon systems. This was the cause of grave national security concern with major U.S. authorities. Ultimately, U.S. President Barack Obama prohibited the deal at the beginning of December. As a consequence, the Chinese investor withdrew its offer and admitted that the transaction had failed.

Although the Aixtron case is unique, to dismiss it as an outlier would be wrong. The planned sale of the Osram lighting business Ledvance has also hit political roadblocks in the homestretch. The prospective buyer: a consortium headed by the Chinese LED specialist MLS. The German Ministry of Economic Affairs is now reviewing a security clearance certificate, a process that will at least delay the transaction. Until recently such a deal would have been waved through routinely by the Berlin authorities.

But amid growing unease sparked by the rash of Chinese takeovers, culminating in the KUKA deal, the German Minister for Economic Affairs, Sigmar Gabriel, who is also Head of Germany's Social Democratic Party (SPD), saw the need to take action. The bidders' very deep pockets and the clout this gives them is not the only worrying factor. Many observers are equally or even more concerned that most of them are under the influence of the Chinese state, at least to some extent. Increasingly, they are targeting the key strategic technologies that form the bedrock of Germany's competitiveness in global markets.

This is no coincidence. Many German companies are a perfect match and answer to China's strategy of achieving rapid gains in high-tech sectors with the most promising future. The leadership in Beijing is particularly keen to forge ahead in such fields as mechanical engineering, automation, aerospace, IT and pharmaceuticals. In disciplines where Chinese challengers cannot close the gap in the foreseeable future, it is only logical simply to purchase the reigning German champions.

Nor is the increasing nervousness limited to Gabriel's political home, Germany's SPD. Warnings are also being heard in conservative circles, and also increasingly among industry representatives. Already with the KUKA takeover, efforts continued for weeks to put together a competing German offer to outbid Midea. In particular, the German auto makers — actually a perfect fit as long-standing KUKA customers — ultimately passed on the opportunity. That was not only because Midea's bid valued KUKA at 17.7 times EBITDA, and was thus going to be very hard to beat. China is also a vital market for German premium cars. And who wants to upset a favourite customer?

So far there are no signs that it is in fact detrimental to German interests when a technology leader falls into Chinese hands instead of being purchased by a Japanese or American buyer. Chinese investors have kept their promises in the past and — as seen with firms like Putzmeister and Kion — have continued to develop their German acquisitions in ways that have also benefited the German economy.

But from a German standpoint there is an enormous imbalance. While Chinese investors can buy vital technologies in Germany practically at will, the opportunities in China are strictly limited. In many industries, investments are permitted only as part of joint ventures or partnerships — including technology transfers. Visible and invisible barriers make it next to impossible for foreign investors to purchase domestic champions. For years the Asia Pacific Committee of German Business (APA) has been chanting the mantra of "reciprocity." Until recently, however, this appeal for equal rules for everyone fell on deaf ears. With the call by EU Commissioner Günther Oettinger for European ownership of KUKA, at least one political ally of Chancellor Angela Merkel (CDU) raised his voice. But the Chancellor herself kept quiet. Commenting on KUKA, Economic Affairs Minister Gabriel merely stated that he would warmly welcome a German counteroffer. And no wonder as the aversion to all forms of protectionism is deeply ingrained in the export nation Germany. For decades, Germany's economic success has been anchored by its very clear regulatory framework.

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Has the dam burst? After all, in the future, watching from the sidelines may no longer be an option. In mid-October 2016, news emerged of a position paper drawn up by Gabriel's ministry that sets out much more extensive possibilities for fending off foreign investors. That would bring Germany into line with the approaches of other industrial countries such as the U.S. The proposal calls for the state to be empowered to prohibit the acquisition of shares in companies. Official sources in Berlin say that this would be justified especially when a foreign state is involved. Gabriel's plans do not mention any particular country. But it's obvious to all concerned: the goal is to prevent the sale of German technology to China. An anonymous government source recently stated emphatically: "When countries like China deliberately hand over tax money to their companies in order to buy up our high-tech companies, we can't just watch." Gabriel has also become less shy about more or less openly voicing these reservations — for example during his visit to China in early November. This unprecedented open criticism from Germany has met with considerable annoyance on the part of the Chinese.

What will this all mean for Chinese corporate buyers of German assets?

It is still entirely unknown whether and, above all, when Gabriel's plans for broader veto scenarios will become a reality. There is no legislation in the pipeline. Moreover, the minister would surely prefer a Europe-wide regulation, as Germany would then not face accusations of protectionism.

However, it is now clear that tailor-made, timely and credible communication with all relevant stakeholders will be *the* decisive factor in the future for Chinese acquisitions in Germany. Already in the past, Chinese bidders met with suspicions — sometimes quite intense and even irrational. There were fears of a sell-off of innovation, job losses and plant relocations, weak corporate governance and cultural conflicts. These are only a few aspects of some prejudices directed towards Chinese investors more than others from other jurisdictions. The policy shift in recent weeks not only further incites these attitudes — it lends them an air of legitimacy. This adds a structural element to the resistance against Chinese investments in Germany. And it makes it all the more important for Chinese buyers to approach deals carefully and communicate well and openly through the process.

To ensure that the unavoidable lack of knowledge about Chinese bidders does not kill deals from the outset or create obstacles to successful integration, investors should redouble their efforts in the future to build trust among all stakeholders. Essential ingredients are credibility, transparency, and the willingness and ability to engage in dialogue. Personal meetings of the top management with key stakeholders and a sufficient supply of facts and information about the buyer can go a long way to foster acceptance on the ground in Germany. Experience has shown that, in the past, those aspects could not always be taken for granted with Chinese investors. There is no doubt, however, in today's environment. For Chinese buyers, a watertight explanation of why its investment will create sustainable value for all concerned is more important now than ever before.

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