Flossbach von Storch
RESEARCH INSTITUTE

MACROECONOMICS 02/10/2023

China's strategic foreign direct investment in Europe

AGNIESZKA GEHRINGER

Abstract

Until the early 2000s, there had only been a handful of foreign direct investment (FDI) in the EU from China, for a total volume of a few million USD per year. A few years later, in 2016 and 2017, over a hundred FDI transactions, with a volume of over 25 billion USD per year took place. China's grip on Western companies does not only serve the achievement of purely economic goals. It is an essential part of a comprehensive geopolitical and military strategy.

Zusammenfassung

Bis Anfang der 2000er Jahre gab es in der EU nur eine Handvoll ausländischer Direktinvestitionen aus China mit einem Gesamtvolumen von ein paar Millionen US Dollar pro Jahr. Wenige Jahre später, in den Jahren 2016 und 2017, fanden über hundert Transaktionen mit einem Volumen von über 25 Mrd. US Dollar pro Jahr statt. Der Zugriff Chinas auf westliche Unternehmen dient nicht nur der Erreichung rein wirtschaftlicher Ziele. Er ist ein wesentlicher Bestandteil einer umfassenden geopolitischen und militärischen Strategie.

The Chinese Challenge

At the end of the 1960s a book by the French author Jean-Jacques Servan-Schreiber entitled "The American Challenge" caused a stir. The book addressed the growing influence of American corporations and technology in Europe and was a wake-up call for many European policymakers and business leaders. However, Servan-Schreiber didn't view the American challenge solely as a threat. He also saw it as an opportunity for Europe to evolve, innovate, and compete at the global level. Today, China also poses a challenge for Europe. But in contrast to the earlier economic challenge from the US, the challenge from China has a strong political connotation. Hence, it also requires a political answer.

German machine builders were on the shopping list of Chinese buyers early on. Only in 2005, four of them – Heinkel AG, Kelch GmbH & Co Werkzeugmaschinenfabrik, Zimmermann AG and Werkzeugmaschinenfabrik Adolf Waldrich Coburg GmbH & Co KG – were swallowed up at once. However, it was the acquisitions of two German flagship companies in the years 2012 and 2015/6 that caused a real stir. The first transaction regarded the Württemberg-based concrete pump manufacturer Putzmeister which was bought by the Chinese Citic fund for nearly 700 million USD in January 2012. With the second transaction, the Augsburg-based industry robots producer Kuka was overtaken in two acts by Midea group: 3% of shares for 150 million USD in May 2015, followed by 82% for almost 4.7 billion USD in August 2016.

Machine manufacturers have long been of particular interest to Chinese industrial policy ambitions, although not the only ones. In December 2004, the Ministry of Commerce of People's Republic of China published a "Catalogue for the Guidance of Foreign Investment Industries" with a clear categorization of encouraged, restricted, and prohibited foreign investment industries.[1] The Catalogue suggests Chinese players to be active not only in mechanical engineering but also in many other leading and high-value sectors, e.g. in the chemical, pharmaceutical, and medicine industries.

The sectoral focus was subsequently updated and re-directed with the launch of the strategy "Made in China 2025" in 2015. It identifies ten key industries in which China aims to become the world market leader in the longer term.

[1] The full text of the Catalogue is available at: http://english.mofcom.gov.cn/article/policyrelease/aaa/200505/20050500093692.shtml

Remarkable, however, is the fact that in the same year 2015, "China's Military Strategy" was adopted and with it the "Civil-Military Integration" (CMI), according to which "China will work to establish uniform military and civilian standards for infrastructure, key technological areas and major industries."[2] This double-launch makes clear that China's grip on Western companies should not only pursue purely economic, but also military and broader geopolitical goals.

Whereas the EU and its member states have already taken action to counteract this new industry-military nexus, the underlying measures – with the FDI screening mechanism at the central stage – still seem to lack the required uniformity, depth and effectiveness.

With these strategic objectives of the Chinese industrial and defense policy in mind, the aim of this note is to document – over time, across space and with a particular focus on strategic sectors – the development of China's outbound FDI (OFDI) in the European Union. In so doing, it sheds some light on the remaining weak spots.

Exponential OFDI growth in 2008-2016 triggers response

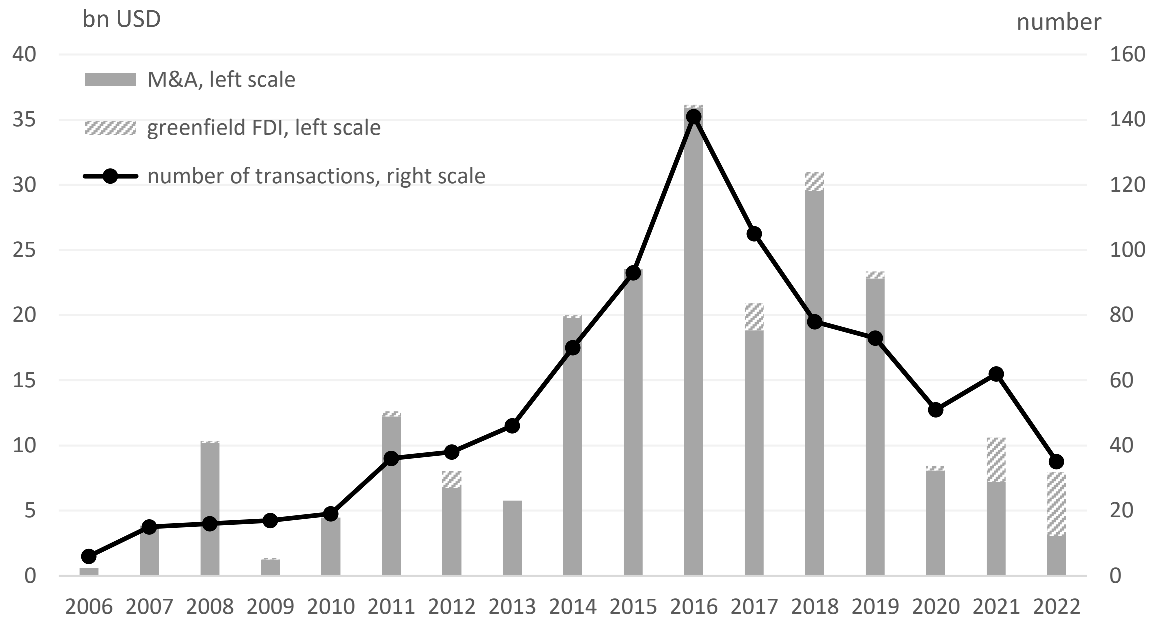
Prior to 2008, Chinese OFDI in Europe did not play any significant role. This changed afterwards, with a very fast growth both in terms of the number of transactions and in terms of total transaction volume per year. This trend continued until 2016/2017 but reversed thereafter (**Fig. 1**).

One of the explanations of this reversal lies in the growing regulatory scrutiny in the EU. Between 2017 and 2018, several governments across the EU have updated or established brand-new FDI screening regimes.

With the regulatory framework becoming challenging for acquisitions of the existing establishments, Chinese investors shifted their attention increasingly towards greenfield FDI. This became evident in 2022, when Chinese greenfield investment in the EU has overtaken M&A activity for the first time over the observation period (**Fig. 1**).

[2] The full text of the strategy is available at: http://eng.mod.gov.cn/xb/Publications/WhitePapers/4887928.html

Figure 1. Number and volume per year of Chinese outbound foreign direct investment (OFDI) – greenfield and M&A – in the EU



Source: Own elaboration Flossbach von Storch Research Institute based on China Global Investment Tracker & Refinitiv

Across the EU, the largest volume of Chinese OFDI were directed towards Germany, France, Italy and Spain (**Tab. 1**). Germany alone accounted for over 30% of the EU-wide volume in 2016 and 2018, the two years with remarkable M&A deals: Kuka's takeover by Midea and investment in Daimler by Zhejiang Geely.

Table 1. Yearly volume of Chinese OFDI in the four largest EU member states, in million USD

year	**Germany**	**France**	**Italy**	**Spain**	**Total (DE+FR+IT+ES)**	**Share of the EU total**
2006	--	480	--	--	480	83%
2007	130	700	--	--	830	22%
2008	140	2,800	250	--	3,190	31%
2009	--	--	--	1,000	1,000	74%
2010	--	--	1,170	--	1,170	26%
2011	2,040	3,750	130	500	6,420	51%
2012	2,700	610	700	--	4,010	50%
2013	800	890	1,300	550	3,540	61%
2014	1,620	3,090	7,860	540	13,110	66%
2015	1,690	2,820	10,580	850	15,940	68%
2016	12,580	2,430	1,710	2,040	18,760	52%
2017	7,560	1,350	890	390	10,190	49%
2018	12,650	4,870	910	1,260	19,690	64%
2019	6,510	4,420	1,250	280	12,460	53%
2020	420	4,440	580	610	6,050	72%
2021	2,430	1,080	--	350	3,860	36%

Source: Own elaboration Flossbach von Storch Research Institute based on China Global Investment Tracker

Sectoral patterns of Chinese OFDI – anything but random

There is widespread evidence that the FDI activity by Chinese investors follows a centrally pre-established sectoral pattern. The current sectoral focus can be traced back to the launch of the strategy "Made in China 2025" in 2015. It identifies ten key industries in which China aims to become the world market leader.[3] Besides the crucial role of *aerospace technology*, these include the latest generation of *information and communication technology*, *automation and robotics*, *high-tech shipbuilding and marine technology, advanced rail transport*, *energy efficiency and electromobility*, *environmentally friendly power generation*, *high-end agricultural machinery*, *new materials*, *biomedicine and high-performance medicine*.

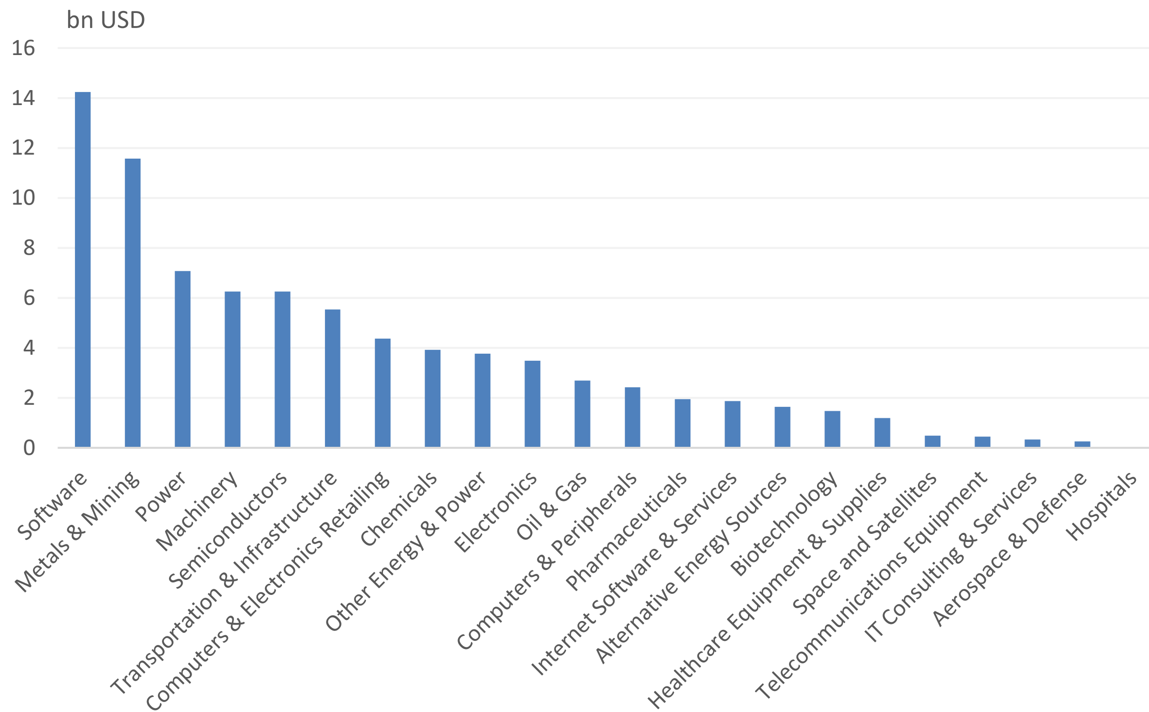
Figures 2 and **3** summarize the FDI activity – in form of M&A – by Chinese investors across the EU in sectors that can be claimed as being strategically important for the achievement of China's policy goals. Although the underlying sectoral classification – available via the Refinitiv M&A database – does not perfectly reflect the sectoral focus set in "Made in China 2025", some univocal patterns can be recognized. Over the observation period since 1980, software (in terms of volume, **Fig. 2**) and machinery (in terms of transaction number, **Fig. 3**) clearly dominate the classification. With a cumulative investment worth over 20 bn USD since 1980, the two sectors account for over 11% of the total M&A activity of Chinese investors in the EU. But intensive buying activity involved most of the other strategic sectors, especially in technologically advanced domains, including semiconductors, computers & electronic retailing, electronics, computer & peripherals, as well as chemicals, pharmaceuticals, biotechnology and healthcare equipment & supplies.

The remaining sectors are worth mentioning as well. Metals & mining is not only a sector sourcing important and new materials, but it also constitutes a crucial upstream supplier in several other strategic sectors, including machinery, computer & peripherals, space & satellites and aerospace & defense. Similarly remarkable is the interest of the Chinese investors in critical infrastructure sectors, like power, transportation & infrastructure, oil & gas, alternative energy sources, as well as in sectors directly referring to health protection, i.e. pharmaceuticals and healthcare equipment & supplies. As is well known, this interest goes beyond Europe and concerns infrastructure networks both underground, underwater and in the air. Since (global) networks

[3] The 14th Five-Year Plan adopted by the Communist Party of China in March 2021 has modernised the Made-in-China strategy with the "Vision 2035". Accordingly, the vision is for China to become "a strong, technologically advanced country that is a global leader in innovation and new forms of industrialisation". This means that the old "Made-in-China" wine should be poured into new bottles, but in a shortened time: the new end date is in 2035, instead of 2050.

share a physical basis, their expansion opens up opportunities for the accumulation and exercise of power well beyond national borders. As a consequence, China is moving closer to defining global standards in the next waves of technology and networks on its own. Those who set global standards will have their products marketed.[4]

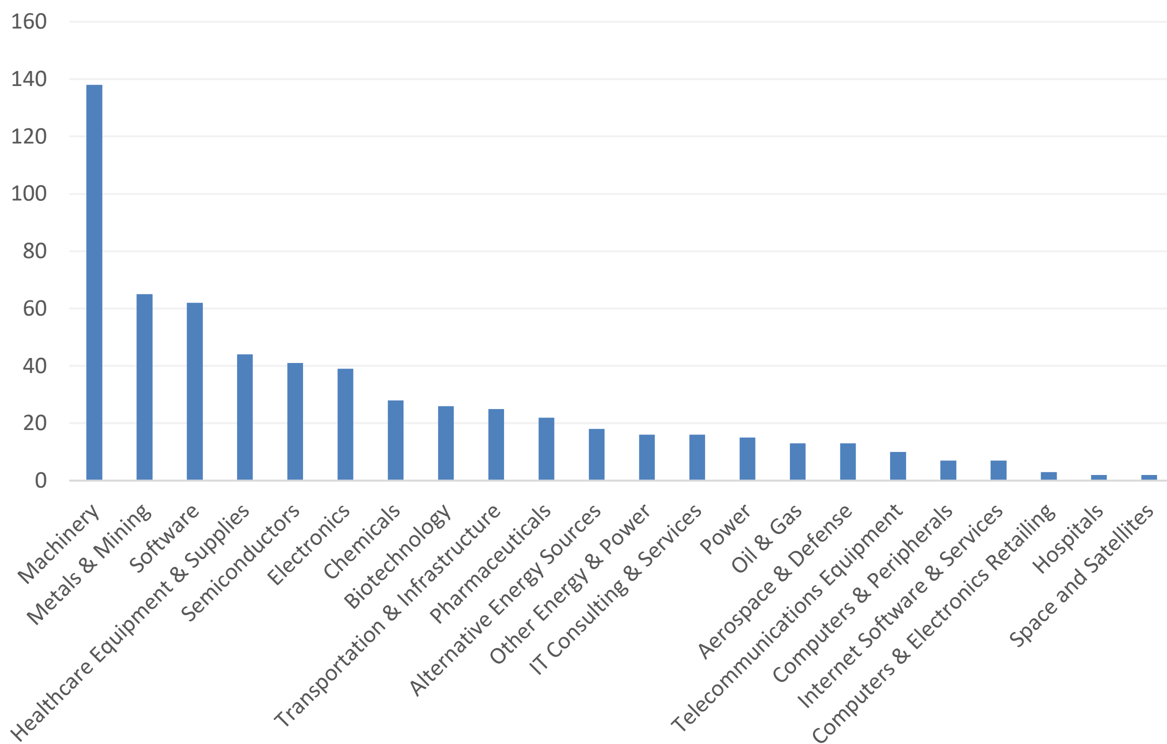
Figure 2. Volume of M&A by Chinese investors in the EU by sectors



Source: Own elaboration Flossbach von Storch Research Institute based on Refinitiv

[4] In a previous paper, we provided a thorough discussion on de-risking of critical infrastructure in the context of geopolitical tensions. The full text of the paper is available at: https://www.flossbachvonstorch-researchinstitute.com/en/studies/de-risking-critical-infrastructures/ .

Figure 3. Number of M&A by Chinese investors in the EU by sectors



Source: Own elaboration Flossbach von Storch Research Institute based on Refinitiv

Table 2 shows the largest M&A transactions in the underlying sample of strategic sectors. This overview is insofar insightful that it reveals the strong involvement – direct or indirect – of the Communist Party of China (CCP) behind these transactions. For some of the acquirers this is clear-cut since it is the government itself via its state authorities to sit at the negotiating table. An example in question is the M&A activity of the State Administration of Foreign Exchanges (SAFE). Since 2008 it invested for a total of 16 billion USD in Europe and concentrates especially on acquisitions in the energy and other infrastructure sectors. Among the biggest steps, in 2014, it acquired a stake in the Italian Eni/Enel group for 2.8 billion USD.

Some other acquirers belong to sizable state-owned enterprises (SOE). China Ocean Shipping, better known as COSCO, is a state-owned ocean shipping giant in China. Back in 2008 COSCO sealed the final terms of an estimated 5.8 billion USD deal with Greece's Piraeus Port (OLP) that sees Cosco operate OLP cargo facilities for up to 35 years. China Investment Corporation – the buyer of GDF Suez in 2011 and of NXP Semiconductors in 2016 – is a sovereign wealth fund responsible for managing part of China's foreign exchange reserves. State-owned hydropower giant Three Gorges is leading the charge to fulfil China's green energy transformation ambitions. In 2011, at the peak

of the European debt crisis, it targeted Energias de Portugal in a 3.5 billion USD deal. Between 2020 and 2021, it was, moreover, involved in other European green transactions, among which a 20% stake in the solar power system of the Madrid-based photovoltaic company X-Elio. But Three Gorges was not the only Chinese SOE to take advantage of the crisis situation in Portugal. In February 2011, the state-owned electricity grid operator (State Grid) acquired 0.5 bn USD worth stakes at the Portuguese transmission system operator, Redes Energéticas Nacionais, followed by the acquisition of a 35% stake for a total of 2.1 billion USD at Italy's Cdp Reti SpA.

That the state-owned enterprises are closely entangled with the communist leadership is rather undisputed. However, it is striking that also managers of allegedly private companies obey to the party of their own accord. The Chinese machinery group Sany Heavy Industry, which acquired the concrete pump manufacturer Putzmeister in 2012, is listed on the stock exchange and – in this sense – privately owned. However, the founder and largest single shareholder of Sany, Linag Wendgen, has undisputed connections to the CCP. Throughout his career, he has sought party affiliation, which was eventually crowned with a double whammy: the admission to the CCP in 2004 and the election as delegate to the Party Congress in Beijing in 2007 and 2012.

But even free spirits without proven party history on their necks are only allowed to do business as long as they do not get in the way of the party's interests. For instance, behind the Investor Group that purchased the mobile game maker Supercell for 8.6 billion USD back in 2016 stays – among others – Tencent. Although it is formally a private company - the largest Chinese conglomerate for software and social media - the CCP recently cleaned it up in an attempt to consolidate its power base and eliminate its opponents. It is thus likely to assume that most of foreign transactions of Chinese investors do not pursue purely economic goals, but are subordinated to the achievement of CCP-set objectives in line with the leading military-civil doctrine.

Table 2. The largest acquisitions by Chinese investors in the EU (and UK)

Year	Target name	Sector	Target nation	Acquirer	Transaction volume *in mln USD*
2016	Supercell Oy	Software	Finland	Investor Group	8,598
2008	Piraeus Port Authority	Transportation & Infrastructure	Greece	China Ocean Shipping (COSCO)	5,790
2015	Avolon	Aviation	Ireland	HNA	5,170
2016	KUKA AG	Machinery	Germany	Midea Group Co Ltd	4,680
2011	Energias de Portugal	Energy	Portugal	Three Gorges	3,510
2011	GDF Suez SA-Exploration and Production Business Operations	Power	France	China Investment Corp	3,260
2011	GDF Suez	Power	France	China Investment Corp	3,240
2016	Global Switch Holdings Ltd	Software	United Kingdom	Elegant Jubilee Ltd	2,968
2014	Eni, Enel	Power	Italy	State Administration of Foreign Exchange (SAFE)	2,760
2016	NXP Semiconductors	Semiconductors	Netherlands	China Investment Corp	2,750
2018	Linxens SA	Electronics	France	Tsinghua Unigroup Ltd	2,623
2018	Linxens	Technology	France	Tsinghua Holdings	2,570
2015	Avolon Holdings Ltd	Transportation & Infrastructure	Ireland	Bohai Leasing Co Ltd	2,532
2019	Global Switch Holdings Ltd	Computers & Peripherals	United Kingdom	Jiangsu Shagang Group Co Ltd	2,199
2018	JW Capital Investment Fund LP	Semiconductors	Netherlands	Shanghai Xiaomei Technology Co Ltd	2,168
2014	Cdp Reti SpA	Power	Italy	State Grid	2,101
2022	Ampleon Netherlands BV	Other Energy & Power	Netherlands	Wuxi Xichan Microchip Semiconductor Co Ltd	1,945
2015	NXP Semiconductors NV-RF Power Business	Semiconductors	Netherlands	Beijing Jianguang Asset Management Co Ltd	1,796
2016	Skyscanner Holdings Ltd	Internet Software & Services	United Kingdom	Ctrip.com International Ltd	1,739
2010	BorsodChem Zrt	Chemicals	Hungary	Yantai Wanhua Polyurethanes Co Ltd	1,700
2011	BorsodChem	Chemicals	Hungary	Wanhua Industrial	1,660
2017	Copelouzos	Alternative energy sources	Greece	China Energy Investment	1,640
2016	EQT	Alternative energy sources	Germany	Beijing Enterprises (BEHL)	1,590
2012	VimpelCom	Telecommunication	Italy	Huawei Technologies	1,300

Source: Own elaboration Flossbach von Storch Research Institute based on Refinitiv and China Global Investment Tracker

Make China Great Again!

The dual ambition under the Chinese President and CCP leader Xi Jinping to become independent of foreign technology and at the same time to dominate world markets is undeniably reflected in the China's OFDI strategy of the past decades.

The realization of such a dual ambition is, however, not the goal itself, but rather an instrument to maintain the legitimacy of China's political leadership. Since numerous official documents in China emphasize that a strong army is indispensable to the protection of the CCP and of China's prosperity, the fusion of economic and military objectives is an integral feature of the CCP's national strategy. Given the strong ties between the CCP and the economy, the military-civil fusion is thus determinant not only of China's foreign policy stance but also of business strategies of the private sector.

To be clear, putting foreign producers under competitive pressure or introducing mandatory requirements for domestic production may remain unobjectionable as long as the approach and methods used are in line with internationally agreed WTO rules and based on reciprocity in market access conditions. However, in relations with China the opposite is more often and increasingly true. The CCP's leadership systematically intervenes in domestic markets to ensure the rise of its own companies abroad, promoting their dominance while putting foreign players at a disadvantage.

This makes clear that international openness strategies in the EU and other market-oriented economies – in terms of both trade and capital flows – cannot take place unconditionally. They need to be adapted to an environment, in which Western companies do not only compete on economic merit but are increasingly exposed to state-dominated companies from countries where state interventionism, protectionism and – most importantly – (geo)politically motivated industrial policy goals prevail.

This change in the environment has already been recognized across Western capitals. In Germany, the Foreign Trade and Payments Ordinance (FTPO, *Außenwirtschaftsverordnung*), which rules the implementation of the German Foreign Trade and Payments Act (FTPA, *Außenwirtschaftsgesetz*), has been tightened several times. At the end of 2018, the audit threshold for critical infrastructure transactions was lowered from 25% to 10% of voting shares. With the EU FDI screening regulation from 2019, both the FTPA and FTPO were subsequently updated to incorporate the new EU rules. The core features of the amendment are new reporting obligations for investments from an extended list of strategic sectors as well as the definition of new

threshold values.[5] Finally, the new Anti-Subsidy Regulation – published in May 2021 but still awaiting adoption – sets new mandatory notification and approval requirements triggered by certain acquisitions, mergers and joint ventures. These rules will apply alongside the existing EU and national merger control and foreign direct investment screening regimes and address concerns that non-EU SOEs could use subsidies to destabilize the competitive framework and provoke harm to the EU internal market.

However, there remain blind spots in the current framework. Regarding the EU screening approach, two years of practice has revealed a number of shortcomings in the functioning of the framework. Most importantly, it lacks uniformity, so that EU-wide coordination of FDI screening is undermined. Still some member states do not have any screening mechanism or exclude important sectoral areas from the application of their screening mechanisms. Moreover, there are no explicit rules that apply to greenfield FDI or to R&D cooperations, which keeps the backdoors open for undesirable consolidation of influence from untrusted partners. The recent raise in greenfield FDI from China shows that Chinese leadership is well aware of this potential. Finally, too little attention has been offered so far to the need of a comprehensive inter-ministerial approach towards economic and political relations with non-like-minded countries. This should include an extensive monitoring of ongoing strategic changes in multiple areas, i.e. economic, political, scientific, social and military sphere.

With the recent decline of FDI flows from China the alarm that triggered the adoption of the EU screening mechanism has abated. But the current narrowness and incompleteness of the framework may still become a problem unless an exhaustive and forward-looking approach to manage the underlying risk is promptly adopted.

[5] Specifically, the catalogue of reportable sectors in the context of the cross-sectoral review is expanded from 11 to 27 listed sectors. Beyond critical infrastructures, the listed sectors include high-tech and future technology sectors, dubbed in the FTPO as “emerging technologies”. These sectors comprise artificial intelligence, autonomous driving and flying, robotics, semiconductors, security-related software, IT-, data-, networking- & communication-applications, aerospace and quantum & nuclear technology. Regarding the thresholds of the reporting obligations, depending on the listed sector, the new values amount to 10% or 20%. The threshold of 25% previously applicable to non-listed sectors remains unchanged.

LEGAL NOTICE

The information contained and opinions expressed in this document reflect the views of the author at the time of publication and are subject to change without prior notice. Forward-looking statements reflect the judgement and future expectations of the author. The opinions and expectations found in this document may differ from estimations found in other documents of Flossbach von Storch AG. The above information is provided for informational purposes only and without any obligation, whether contractual or otherwise. This document does not constitute an offer to sell, purchase or subscribe to securities or other assets. The information and estimates contained herein do not constitute investment advice or any other form of recommendation. All information has been compiled with care. However, no guarantee is given as to the accuracy and completeness of information and no liability is accepted. Past performance is not a reliable indicator of future performance. All authorial rights and other rights, titles and claims (including copyrights, brands, patents, intellectual property rights and other rights) to, for and from all the information in this publication are subject, without restriction, to the applicable provisions and property rights of the registered owners. You do not acquire any rights to the contents. Copy-right for contents created and published by Flossbach von Storch AG remains solely with Flossbach von Storch AG. Such content may not be reproduced or used in full or in part without the written approval of Flossbach von Storch AG.

Reprinting or making the content publicly available – in particular by including it in third-party websites – together with reproduction on data storage devices of any kind requires the prior written consent of Flossbach von Storch AG.

© 2023 Flossbach von Storch. All rights reserved.

SITE INFORMATION

Publisher: Flossbach von Storch AG, Research Institute, Ottoplatz 1, 50679 Cologne, Germany; Phone +49 221 33 88-291, research@fvsag.com Directors: Dr. Bert Flossbach, Kurt von Storch, Dirk von Velsen; *Registration*: No. 30 768 in the Commercial and Companies Register held at Cologne District Court; *VAT-No.* DE200075205; **Supervisory authority**: German Federal Financial Services Supervisory Authority, Marie-Curie-Straße 24 – 28, 60439 Frankfurt / Graurheindorfer Straße 108, 53117 Bonn, www.bafin.de; *Author*: Prof. Dr. Agnieszka Gehringer; *Editorial deadline:* 2 October 2023