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Reaching New Heights

An update on Chinese investment into Europe

Rhodium Group

EXECUTIVE SUMMARY

Chinese companies have expanded in the European market at a record pace in recent years. This report provides a comprehensive snapshot of Chinese investments in the EU-28 countries from 2000 to 2014, with a focus on developments in the past three years. In the absence of accurate and timely official statistics, data on acquisitions and new greenfield establishments are used to describe recent trends and developments. The key findings are:

Chinese investment is surging and here to stay:
Annual investment by Chinese companies in Europe continues to climb and reached a new all-time high of $18 billion in 2014. Annual inflows averaging $10 billion over the past four years confirm that Chinese investment is not a one-time event triggered by crisis buying, but a long-term structural trend that marks a new era for EU-China economic relations.

Food, real estate, technology and advanced services are the new frontiers:
The accelerated shift to a new growth model and the liberalization of outbound investment rules have shaped the mix of assets that Chinese investors target. While the number of large-scale acquisitions in energy and materials has declined, activity in other sectors – most importantly food, commercial real estate, technology, and financial services – soared and drove the total investment value to a new record high.

The mix of investors is more diverse:
The mix of Chinese investors in Europe has evolved from past patterns. In addition to the growing importance of private sector investors over the past five years, a notable trend is the rise of globally-oriented financial investors, including private equity funds, sovereign entities and insurance companies.

Market entry strategies and deal structures are changing:
While acquisitions remain the preferred Chinese entry mode, the scope of greenfield projects is expanding as companies switch from office operations to warehouses, manufacturing facilities, research and development centers, and real estate developments. In M&A, the most prominent trends are a greater share for small and medium-sized transactions and more readiness to pick up minority stakes instead of acquiring full control.

Challenges from regulatory incongruence:
As one of the most open markets in the world, Europe is welcoming to Chinese investment and politicization of deals is rare. However, the differences in regulatory regimes and business cultures pose significant hurdles for Chinese companies entering and operating in Europe.

The outlook is positive if Europe avoids a "lost decade":
While Chinese investment reached a new record in 2014, it has plenty of room to grow further. Recent steps to abolish most approvals for outbound investment and an aggressive economic reform agenda will sustain Chinese companies' interest in advanced economies. Whether Europe remains the top destination will depend on EU leaders' ability to re-start economic growth. Successful structural reforms will be critical to ensure that Chinese capital will flow into productive assets that enhance Europe's long-term competitiveness and prosperity.

TABLE OF CONTENTS

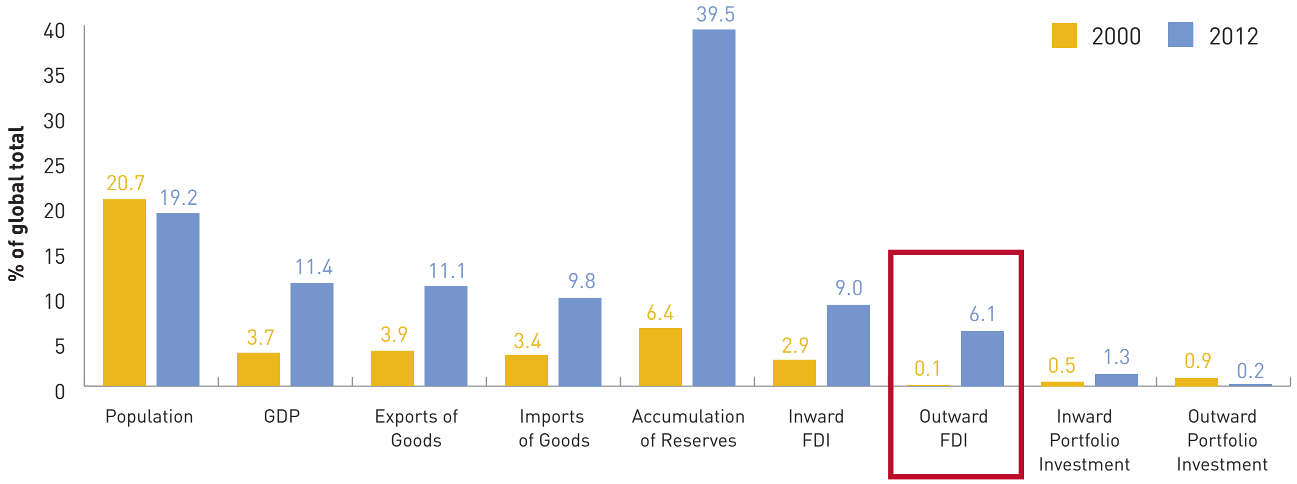
INTRODUCTION

China is in the midst of transitioning from a developing to an advanced economy, with an ambitious reform agenda that will transform its footprint in the global economy. Under the old economic model, China's interaction with the world was mostly through trade and inward FDI flows. The next stage of economic growth will foster a more complex integration with the rest of the world through greater two-way movement of goods, capital, and people.

The most important developments are a bigger role for China in financial globalization, driven by growing capital flows across China's borders. China's role in global finance is still tiny compared to the size of its economy, and the gradual liberalization of restrictions on outward and inward investment flows will trigger a "catch up" process with other major economies. The first wave of these new investment flows has already been felt around the globe: the rapid growth of outbound FDI by Chinese companies over the past decade. China's outward FDI has ballooned from virtually nothing to more than $100 billion per year in less than a decade, catapulting China's share of global OFDI flows from zero in 2000 to six percent in 2012 (Figure 1).

FIGURE 1: CHINA IN THE GLOBAL ECONOMY, 2000 VS. 2012

Percent of global total



Source: World Bank, World Economic Outlook, United Nations Conference on Trade and Development (UNCTAD), Rhodium Group estimates. For more information on the various types of capital flows shown in this chart, please see Data Appendix.

Initially focused on extractive industries in developing economies, Chinese outbound FDI has shifted toward advanced economies in recent years, including the countries of the European Union.[1] This report provides an update on Chinese investment in Europe with a particular focus on the period of 2012-2014, explores recent changes in the composition of investment by location and sector, describes the evolution of the investor mix, and discusses the major challenges Chinese investors face when entering the EU market. In the absence of comprehensive and timely official statistics, the analysis is based on a proprietary dataset that tracks Chinese acquisitions, greenfield projects, and expansions in Europe.

1. For an early assessment of Chinese investment in Europe, see Hanemann and Rosen (2012).

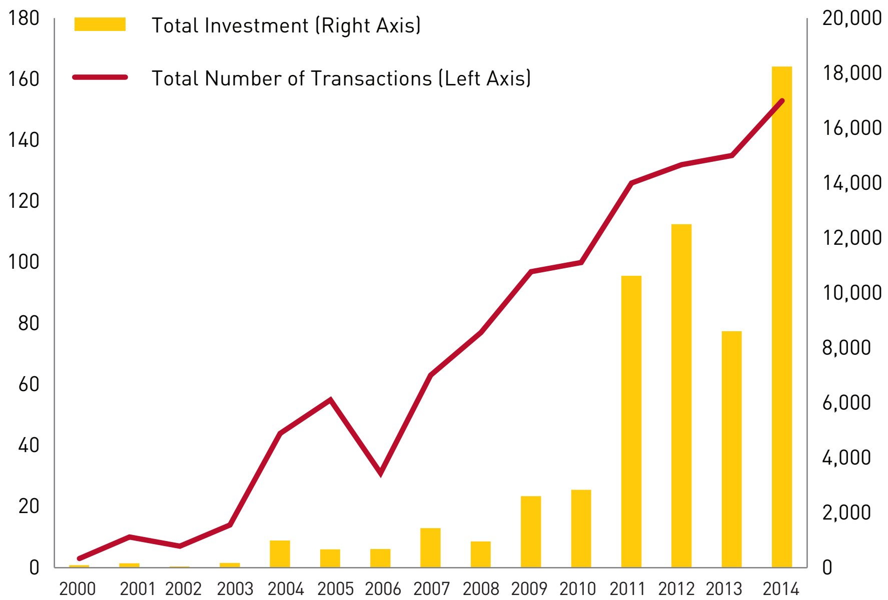
ANNUAL INVESTMENT PATTERNS

An accurate description of growing Chinese outbound investment is complicated by the limitations of official FDI data and specific Chinese characteristics compounding those problems. Tracking acquisitions, new greenfield establishments, and expansions has proven to be a useful and timely alternative approach for describing new trends in Chinese outbound FDI activity.[2]

A snapshot of Chinese FDI transactions in the 28 member states of the European Union shows an extraordinary growth story since the mid-2000s (Figure 2). Before 2004, direct investment from China into Europe barely existed, with only a few transactions at low value. From 2004 to 2008, the number of investments ticked up, but the average combined value remained below $1 billion annually. The first significant jump occurred in 2009 and 2010, when annual investment tripled to about $3 billion. In 2011 and 2012, the EU became one of the biggest recipients of Chinese capital globally, with annual investment surpassing the $10 billion mark. In 2013, investment levels dipped somewhat as deals in energy and materials dropped sharply, and growth in other sectors could not balance out the multi-billion dollar plunge in the extractive sector. In 2014, investments soared to a new all-time high of $18 billion, driven by growing Chinese interest in real estate, food, and financial services sectors.

FIGURE 2: CHINESE FDI TRANSACTIONS IN THE EU-28 ECONOMIES, 2000-2014

Number of transactions and investment value in USD mn



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

These patterns reinforce the notion that growing Chinese FDI in Europe must be seen as a structural trend, not a cyclical phenomenon. China's emergence as an investor in the EU market coincided with the worst financial crisis in decades, which lead some Europeans to conclude that the influx of Chinese inbound FDI was a one-off cyclical spike and Chinese companies were bottom fishing for cheap assets. While cheap valuations and privatization of government assets have certainly contributed to the growth of Chinese activity, Chinese companies continue to deploy capital in Europe despite a significant recovery in asset prices. Annual inflows averaging $10 billion over the past four years represent the beginning of a long-term structural trend that marks a new era for EU-China investment relations.

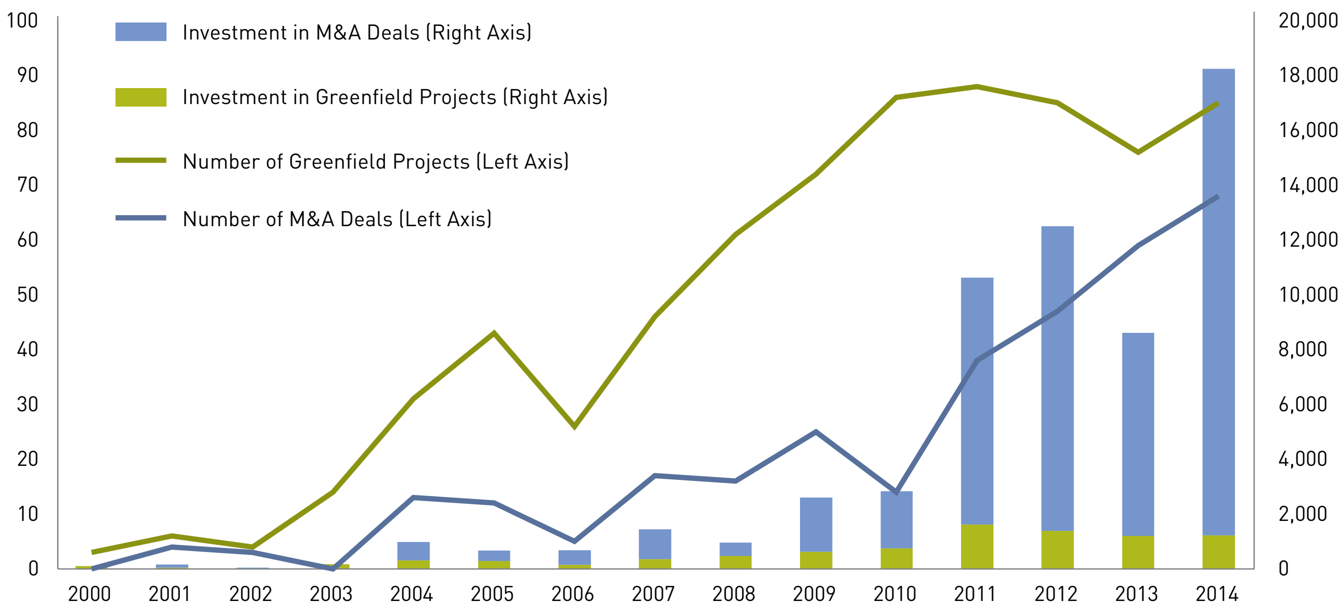
2. More information on methodology and important caveats for this approach can be found in the Data Appendix.

MARKET ENTRY AND DEAL STRUCTURES

Companies have two ways of entering foreign markets: through the acquisition of existing companies or assets (mergers and acquisitions, or M&A), and by setting up new facilities (greenfield projects).[3] Over the past decade and a half, the majority of Chinese companies have grown their EU market presence through greenfield projects and the expansion of existing facilities (70% of all transactions). In terms of investment size, however, the bulk of investment can be attributed to acquisitions (86% of total value), as M&A deals are generally more capital-intensive than greenfield projects and expansions (Figure 3).

FIGURE 3: CHINESE FDI TRANSACTIONS IN THE EU-28 BY ENTRY MODE, 2000-2014

Number of transactions and investment value in USD mn



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

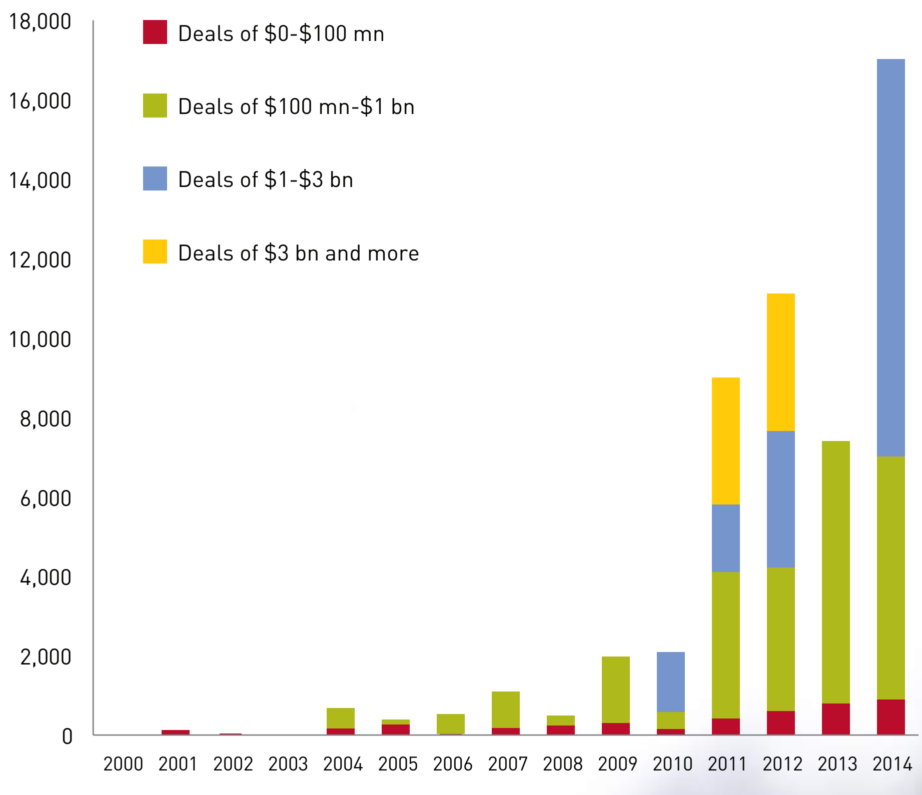
3. In addition to new establishments, our greenfield FDI data also includes the expansion of existing facilities. See Data Appendix for details.

One important trend in the last four years is the growing average value of greenfield projects. Previously consisting mostly of offices and smaller administrative operations, Chinese companies have begun to invest in greenfield projects with significant capital expenditures, including research and development (R&D) centers in Scandinavia, food processing facilities in France, real estate developments in Britain, and machinery production in Germany. Companies have also ramped up spending on the expansion of existing facilities in Europe including chemical plants, warehouses, and other transportation infrastructure.

The composition of M&A activity has also changed substantially since 2011. One important trend is the growing importance of small and medium-sized M&A deals (Figure 4). While megadeals north of $1 billion still account for a big share of total inbound Chinese investment, small deals (below $100 million) and middle-market transactions (between $100 million and $1 billion) have grown particularly strongly since 2011. More importantly, they are less prone to annual fluctuations than large-scale transactions and provide another confirmation of the structural expansion of China's private sector in Europe.

FIGURE 4: NUMBER OF CHINESE M&A TRANSACTIONS IN THE EU-28 BY SIZE, 2000-2014

USD mn

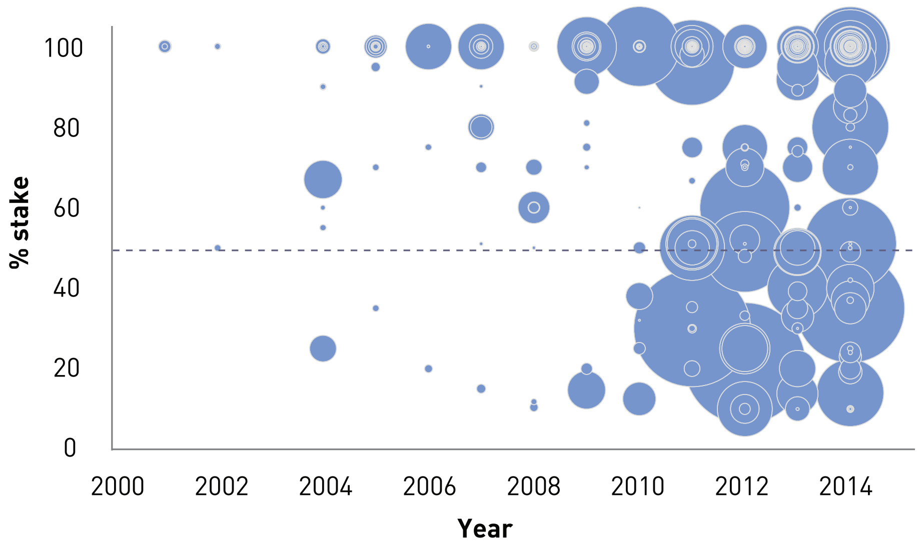


Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

A second related observation in the M&A landscape is that Chinese investors are increasingly willing to buy smaller stakes in European companies instead of taking full control of their target (Figure 5). Prior to 2008, investors were mostly eyeing full ownership control. Since 2009, a greater number of transactions have resulted in non-controlling stakes. The majority of large-scale deals since 2011 were transactions that resulted in stakes of the 20-50% range. This change reflects the rise of private equity funds and other financial investors in the Chinese outward investment space, but also the realization by Chinese companies that a partnership with existing shareholders can help to mitigate risks and maximize commercial success.

FIGURE 5: CHINESE M&A TRANSACTIONS IN THE EU-28, STAKE IN TARGET COMPANY, 2000-2014

Percent stake, bubble size indicates investment value



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

GEOGRAPHIC DISTRIBUTION

For most of the past decade, Chinese capital largely followed the overall geographic distribution of foreign investment in Europe, with the biggest and most advanced economies attracting the bulk of inflows. Before 2011, nine countries (Austria, Belgium, Denmark, France, Germany, Luxembourg, the Netherlands, Sweden, and the UK) attracted 77% of Chinese investment. But these patterns have changed in recent years due to shifting Chinese interests and emerging opportunities on the European side (Figure 6).[4]

One important trend is that Chinese investors increasingly deployed capital in economies that were severely affected by the financial crisis. The share of the PIIGSC group (Portugal, Ireland, Italy, Greece, Spain, and Cyprus) in total Chinese inbound EU investment grew from 8% in 2009-2011 to 33% in 2012-2014.[5] Chinese investors particularly seized opportunities arising from the privatization of state-related industries such as utilities and transportation infrastructure.

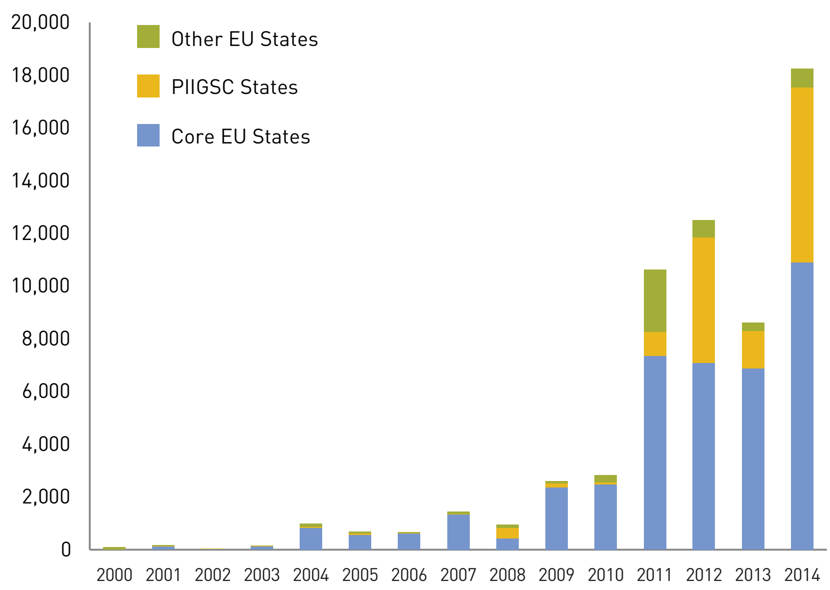
The new member states in Eastern Europe also somewhat increased their share of total inbound FDI from China in recent years, driven by significant investments in manufacturing, energy, and other areas. At the same time, the headline-grabbing announcements of particular megadeals have blurred the reality. In the big picture, Eastern European economies still play a comparably small role, accounting for just 8% of total investment value from 2000-2014.

In short, Chinese investment in Europe has become much more diverse in recent years and is now extending into all parts of Europe. Despite this greater diversity it is important to emphasize that the EU-15 countries remain the most important recipients of Chinese investment, accounting for more than 90% of total investment from 2000-2014. This very much indicates a structural and healthy growth story, and the desire of Chinese investors to make a long-term bet on the European economy.

Taking a national perspective, Chinese capital had reached every single one of the 28 EU economies by the end of 2014, but there are clear differences within the EU. The top recipient of Chinese investment from 2000-2014 was the United Kingdom, with more than $16 billion worth of deals. The UK takes the number one spot due to a mix of factors, including the unique role of London as a financial center (which hosts companies operating globally in mining and other extractive sectors), its attractiveness to commercial real estate investments (which have boomed in the past two years), and the growth in appetite

FIGURE 6:
CHINESE FDI TRANSACTIONS IN THE EU-28 BY COUNTRY GROUP, 2000-2014

Investment value in USD mn



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix. "Core EU States" refers to Austria, Belgium, Denmark, France, Germany, Luxembourg, Netherlands, Sweden, and the UK. "PIIGSC States" refers to Portugal, Ireland, Italy, Greece, Spain, and Cyprus. "Other EU States" refers to Bulgaria, Croatia, Czech Republic, Estonia, Finland, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, and Slovenia.

4. Investments are attributed to the country of headquarters or principal operation. Please see Data Appendix for details.
5. EU-15 refers to EU member states before 2004: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom.

by financial investors for UK-based companies with valuable consumer assets (such as Weetabix and Pizza Express).

Europe's biggest economy Germany comes in second place ($8.4 billion), recording high levels of investment in a broad range of industries for several years. Industrial equipment (Putzmeister and KION), auto components (KSM Castings), telecommunications, and renewable energy all attracted significant levels of investment from China, reflecting Germany's attractiveness for advanced manufacturing activities. Another relevant factor that sets Germany apart is the high number of privately-owned small and medium-sized businesses, which are attractive targets for Chinese companies seeking technology leadership in exchange for assistance with market access in China.

Third place is held by France ($8 billion), with a diverse set of investments across different industries, such as its mature chemicals (Rhodia Silicones SAS) and telecommunications industries (Alcatel-Lucent). Another factor that contributes to its leading role is the recent readiness of the French government to sell strategic stakes to Chinese state companies and sovereign entities, such as China Investment Corporation's (CIC) stake in GDF Suez or Dongfeng's $1.1 billion injection into ailing automaker Peugeot.

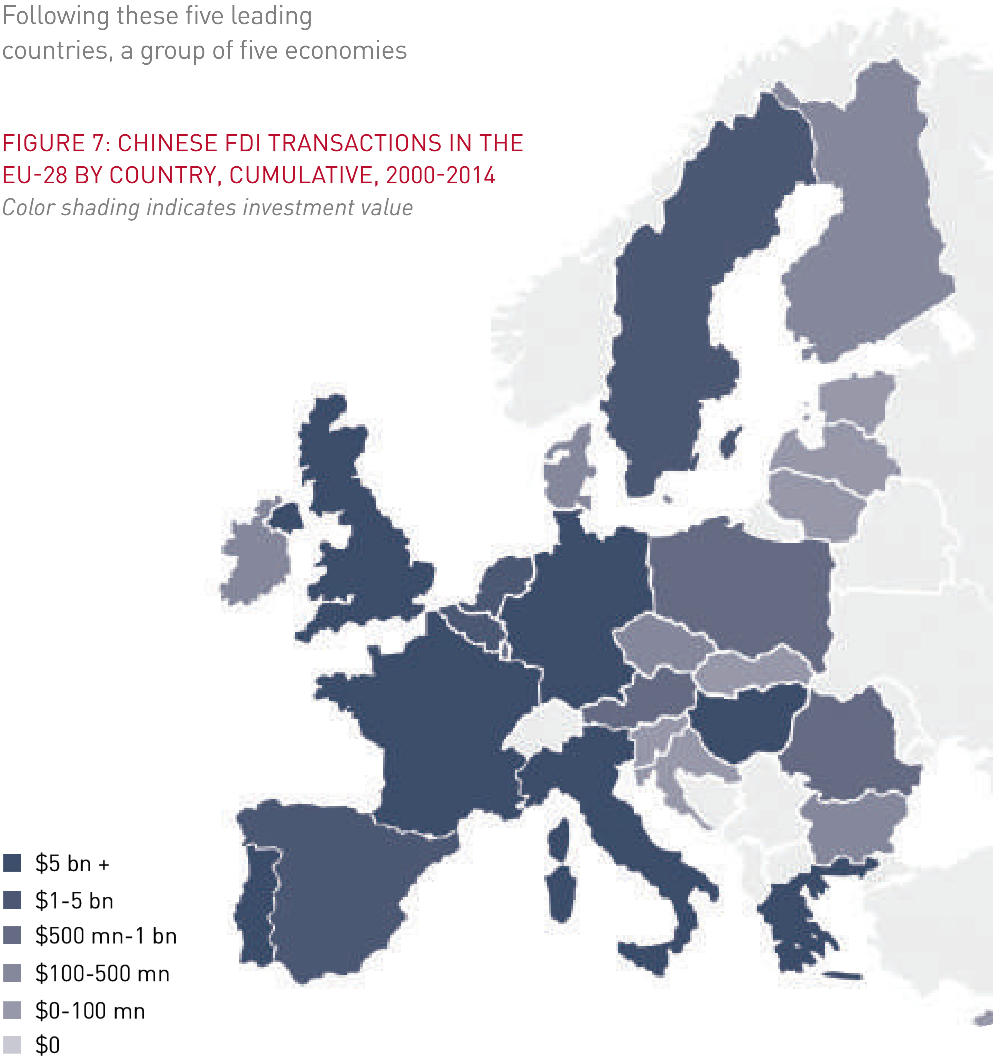
Portugal's role as the fourth largest recipient of Chinese investment ($6.7 billion) is largely due to successful Chinese participation in the privatization of state assets in the financial sector (three insurance companies under Caixa Seguros e Saude) and utilities (Energias de Portugal and Redes Energéticas Nacionais SGPS). Private sector investment exists (Fosun, Huawei), but remains small compared to other top recipient countries.

Italy is the fifth largest recipient of Chinese direct investment ($5.6 billion). In addition to the $2.8 billion stake of China's State Grid in CDP Reti in 2014, Chinese investors have targeted Italian assets in industrial equipment and machinery (CIFA, Ansaldo Energia), transportation equipment (Ferretti), food (Salov) and luxury goods (Raffaele Caruso).

Following these five leading countries, a group of five economies have attracted between $1-5 billion of investment each for the period of 2000-2014: the Netherlands, Hungary, Sweden, Spain, and Belgium. A third group including Romania, Austria, Luxembourg, Poland, and Greece attracted deals worth $500 to $1 billion. Lower levels of Chinese investment can be found in Bulgaria, Czech Republic, Denmark, Finland, and Ireland, with between between $100 and 500 million each. The rest of the EU-28 attracted less than $100 million of investment each, including Malta, Slovakia, Lithuania, Cyprus, Estonia, Slovenia, Croatia, and Latvia.

FIGURE 7: CHINESE FDI TRANSACTIONS IN THE EU-28 BY COUNTRY, CUMULATIVE, 2000-2014

Color shading indicates investment value



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

INDUSTRIES AND CLUSTERS

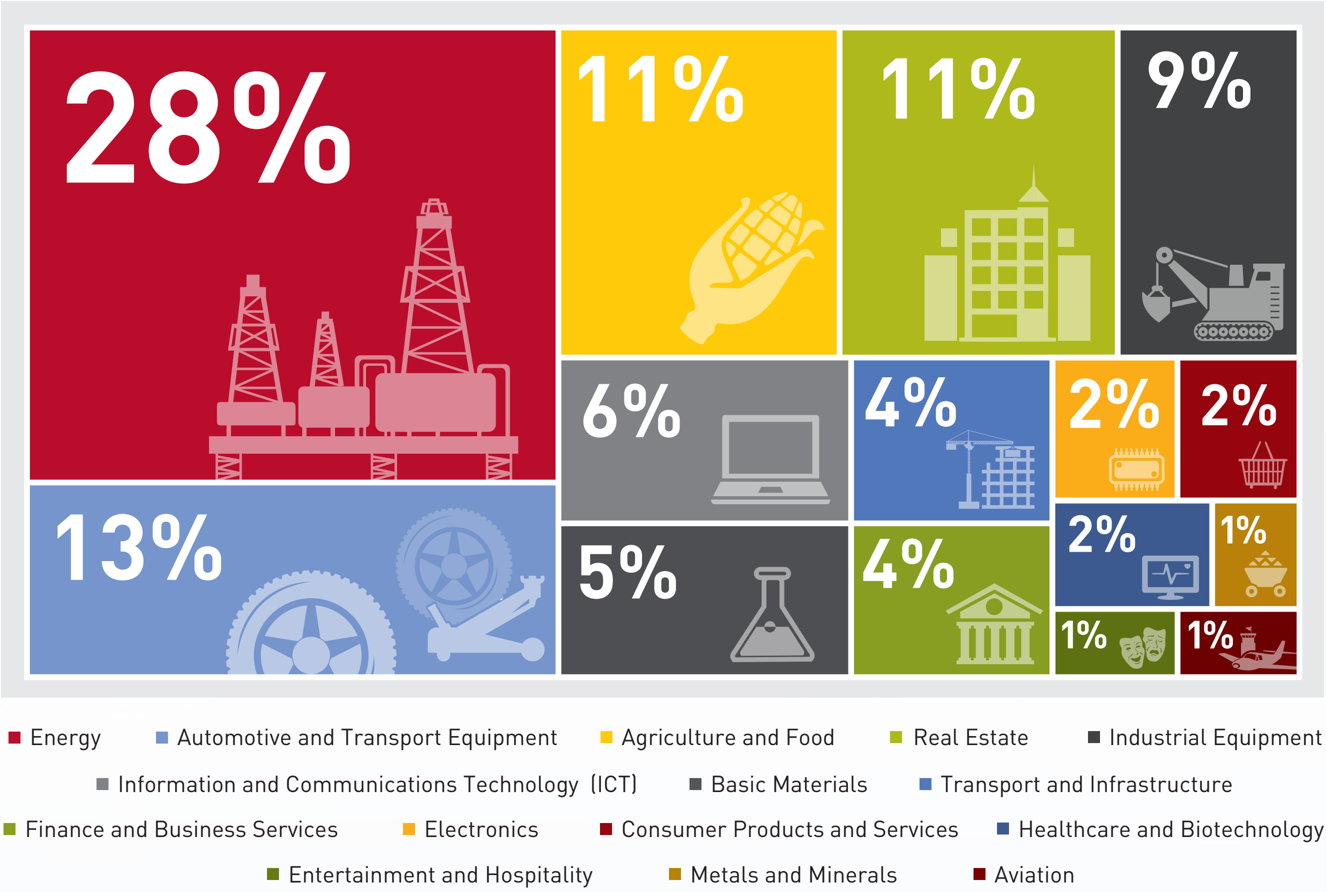
The $61 billion of cumulative Chinese EU investment in the period of 2000-2014 are spread across a wide range of industries (Figure 8). The top recipient of Chinese capital was Europe's energy sector ($17 billion), split between fossil fuel extraction ($7 billion), utilities ($7 billion) and renewable energy ($3 billion). Automotive is the second largest recipient with $8 billion, followed by agriculture and food ($7 billion), real estate ($6 billion), industrial equipment ($5 billion), information and communications technology ($3.5 billion), basic materials ($3.1 billion), transport and infrastructure ($2.4 billion) and finance and business services ($2.4 billion).

The evolution of the industry mix over time, as summarized in Figure 9, reflects the changing position of Chinese companies in global value chains and the evolution of China's policy framework for outbound FDI.[6] Prior to 2011, EU market entry was primarily motivated by trade facilitation considerations and the desire to access technology in a few sectors with catch-up ambitions such as automotive and industrial equipment. In 2011-2012, the appetite for technology and other competitiveness-enhancing assets spread to other sectors including information and communications technology. However, the main driver of ballooning investment in those two years was a buying spree by China's state-owned companies, spending a combined $11 billion

6. For a detailed perspective on the commercial drivers and outbound FDI policy framework from 2000-2011, see Hanemann and Rosen (2012).

FIGURE 8: CHINESE FDI TRANSACTIONS IN THE EU-28 BY INDUSTRY, CUMULATIVE, 2000-2014

Percent of total cumulative investment from 2000-2014 ($61 bn)



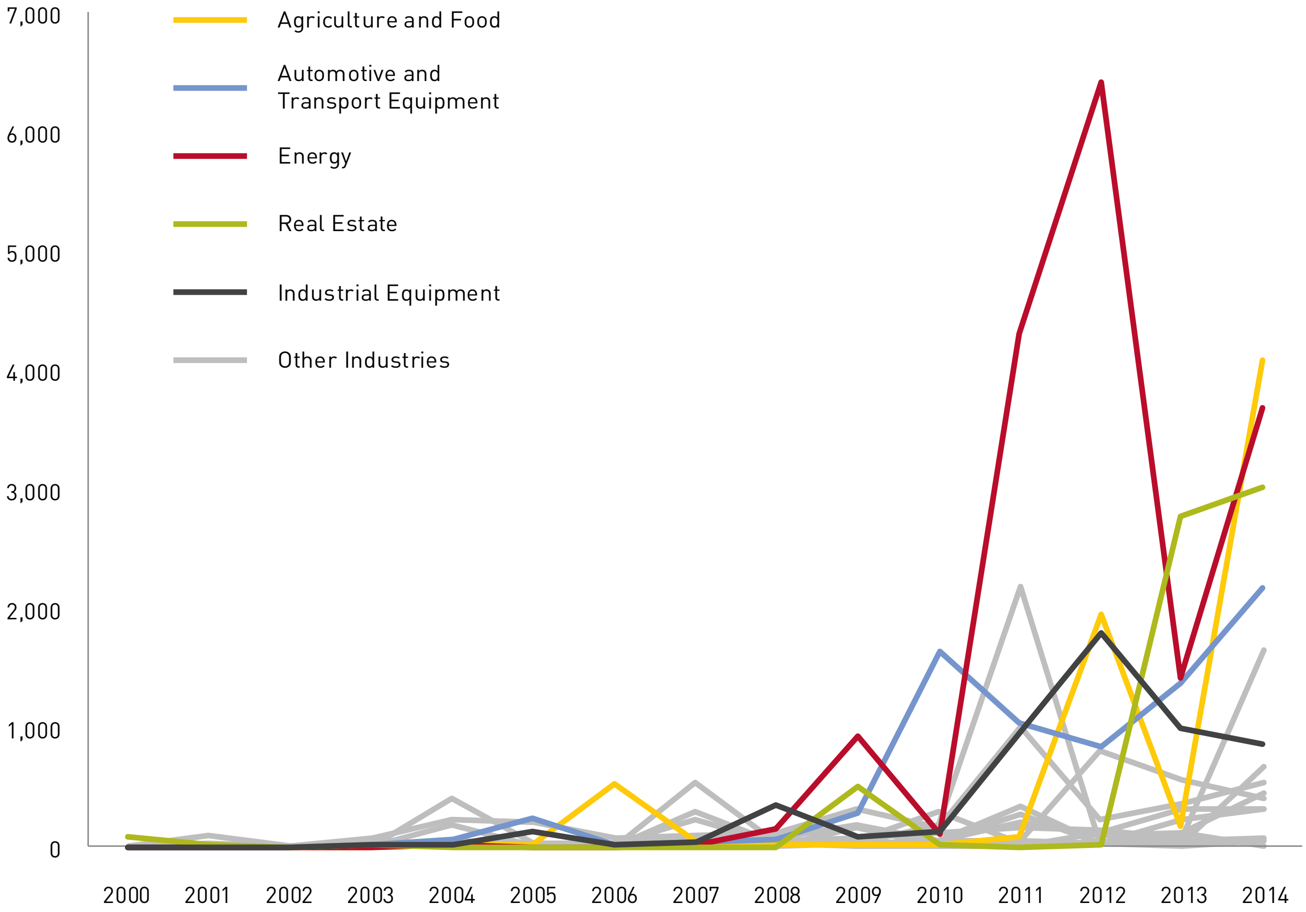
Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

on European mining companies, energy assets, and utilities.

This trajectory changed radically in 2013 and 2014, with Chinese spending on energy and materials shrinking to $5 billion for both years combined as companies' appetite was shaken by sweeping changes to the resource-intensive growth model, a fierce anti-corruption campaign (which led to the detention of several executives at major SOEs responsible for overseas expansion) and changes in the European energy markets (such as the deep cuts in feed-in tariffs for renewable energy). Falling investment in resources was balanced by new interest in other sectors, as commercial motivation to invest abroad increased and continued efforts to liberalize outbound FDI rules have broadened the base of overseas investors and given private companies as well as institutional investors a greater weight in China's overseas investment.

FIGURE 9: CHINESE FDI TRANSACTIONS IN THE EU-28 BY INDUSTRY, 2000-2014

Investment value in USD mn

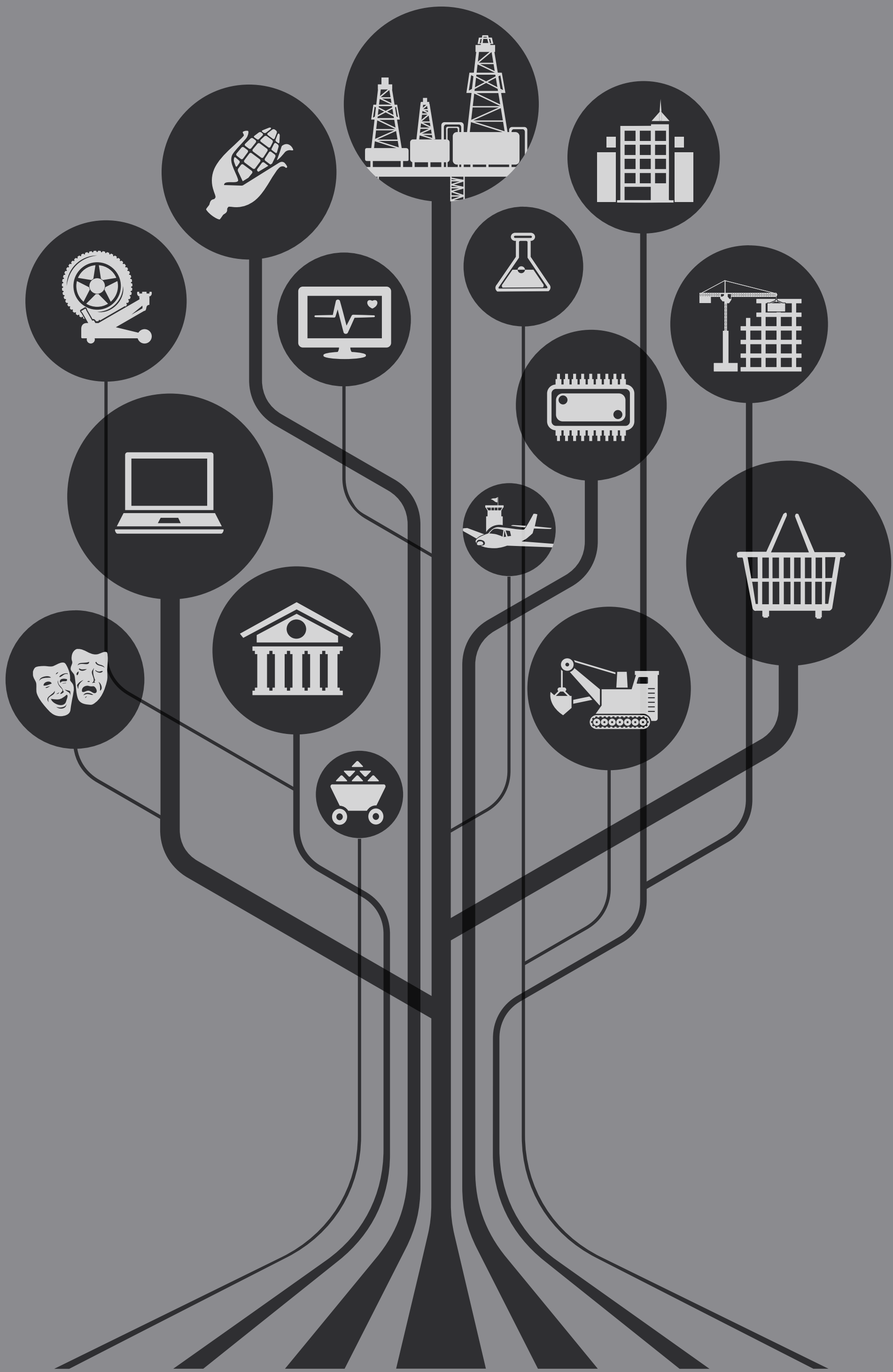


In-depth information is available on the individual industry pages.

Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

One newly emerging target of Chinese capital is commercial real estate. From virtually zero before 2013, investment in European real estate surged to $2.8 billion in 2013 and 3$ billion in 2014.[7] Pressure on developers to diversify away from a slowing domestic market, the desire of institutional investors to deploy capital in low-risk assets globally, and the takeoff in the overseas Chinese population and travelers contributed to this property investment boom. Another high-growth sector is agriculture and food, with several large acquisitions motivated by access to supply chains, European know-how, quality control, technology, and brands to double down on the fast growing domestic demand and Chinese consumer market. Investments in transportation and infrastructure also reached more than $2.4 billion in 2014. Growth in Chinese outbound tourism also fueled investments in commercial airlines and other transportation services, along with the continued expansion of bilateral trade. Finally, the past two years indicate that Chinese financial institutions are gearing up for overseas expansion as domestic financial liberalization and growing two-way capital flows increasingly require an international presence.

7. Real estate developments and other multi-year greenfield projects reflect actual spending on acquisitions and construction in the respective year. Projects with significant capital expenditures are not counted at announced value but split up over the length of the project. See Data Appendix for more details.



THE FOLLOWING PAGES PRESENT SNAPSHOTS OF CHINESE PRESENCE IN **15 INDUSTRIES** ACROSS EUROPE, DERIVED FROM TRANSACTIONS DATA FOR THE YEARS 2000-2014.[8]

8. The data presented here show industrial clusters based on the headquarters or principal location of business for the local European entity, not a comprehensive analysis of intra-European operations and subsidiaries.

AGRICULTURE AND FOOD

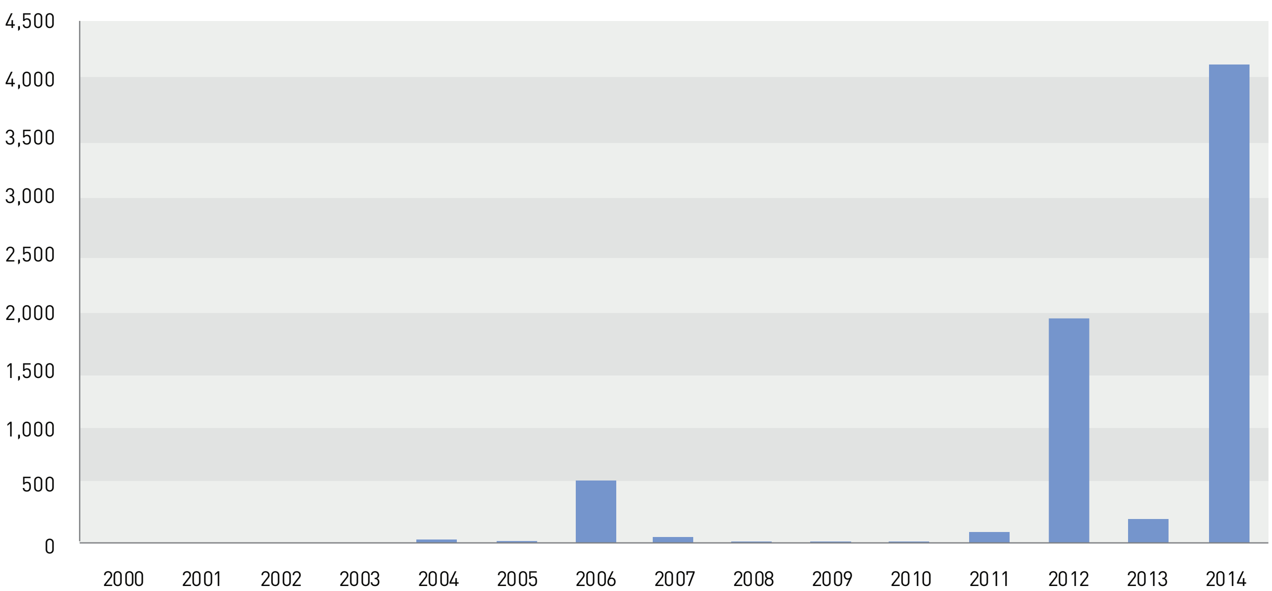
Though not historically at the top of the menu, agriculture and food has recently emerged as an important sector for Chinese companies in Europe. By the end of 2014, investors from China had spent 7$ billion in this sector, up from less than $1 billion at the end of 2011. The United Kingdom, the Netherlands, Belgium, Spain, and France were the major recipients.

Key drivers of food investments are the desire for access to know-how and technology, acquisition of consumer brands, and, more recently, the utilization of European facilities to export food products to the Chinese market and secure global supply. Most investors are strategic buyers from the same sector, but over the past 12-18 months financial investors have emerged as important players in the market.

The biggest transactions are China National Cereals, Oils and Foodstuffs Corporation's (COFCO) investment in Nidera, Bright Food's investment in Weetabix, Hony's stake in Pizza Express, and Shuanghui's stake in Campofrio Food Group. The most prominent greenfield project is Synutra's milk drying facility in France.

FIGURE 9.1: CHINESE FDI TRANSACTIONS IN THE AGRICULTURE AND FOOD INDUSTRY OF THE EU-28, 2000-2014

Investment value in USD mn



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

AUTOMOTIVE AND TRANSPORT EQUIPMENT

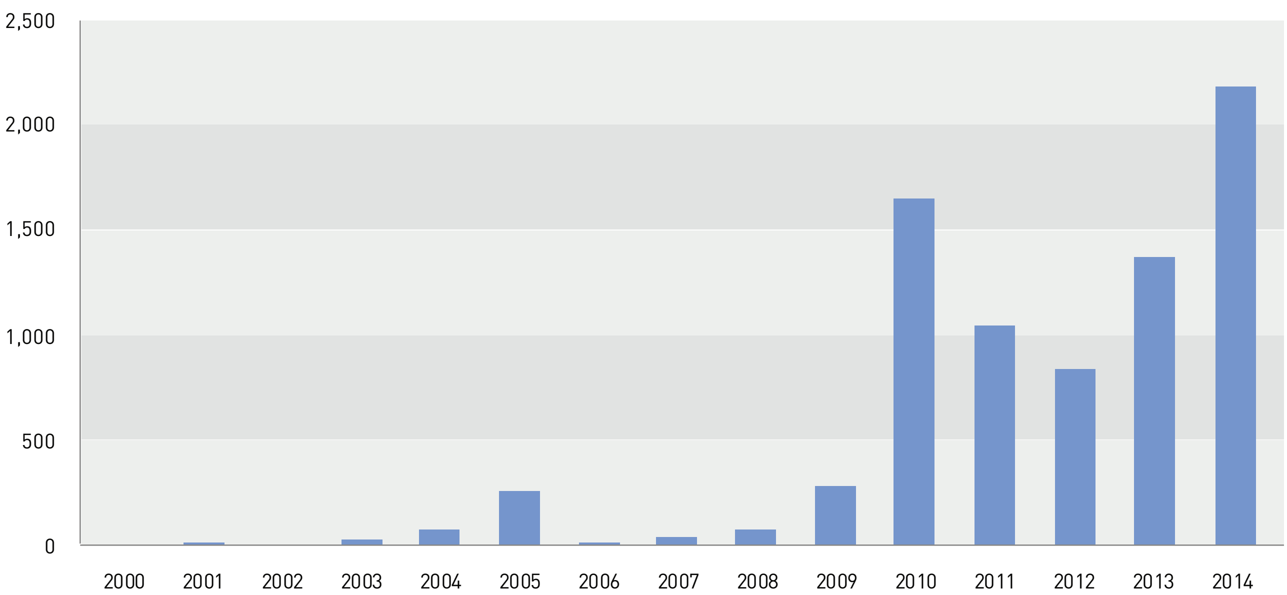
Automotive and transport equipment was one of the first sectors to receive interest from Chinese companies and remains one of the top recipients, with more than $7 billion worth of deals through the end of 2014. Investments are spread across the European core, with Germany, Sweden, France, the United Kingdom, and Italy as the major recipients.

Chinese companies have invested in all segments of the value chain: manufacturers with their own platform and consumer branding (Volvo, Peugeot, and Rover), auto parts and component suppliers (Hilite, BOGE's rubber and plastic business, KSM, SaarGummi), and specific activities such as research and development centers (Shanghai Automotive Industry Corporation [SAIC] in Birmingham and Changan in Turin). A recent trend is the growth of transactions in non-auto transport equipment, included in this category, most notably European yacht manufacturers (Sunseeker and Ferretti).

Most investors in this space are strategic investors, with financial investors playing only a small role. State-owned companies account for a significant share of investment because of the industrial policy legacy in China's auto market. Another characteristic is the exceptionally high number of medium-sized M&A transactions, reflecting the attractiveness of small, but globally-oriented EU companies.

FIGURE 9.2: CHINESE FDI TRANSACTIONS IN THE AUTOMOTIVE AND TRANSPORT EQUIPMENT INDUSTRY OF THE EU-28, 2000-2014

Investment value in USD mn



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

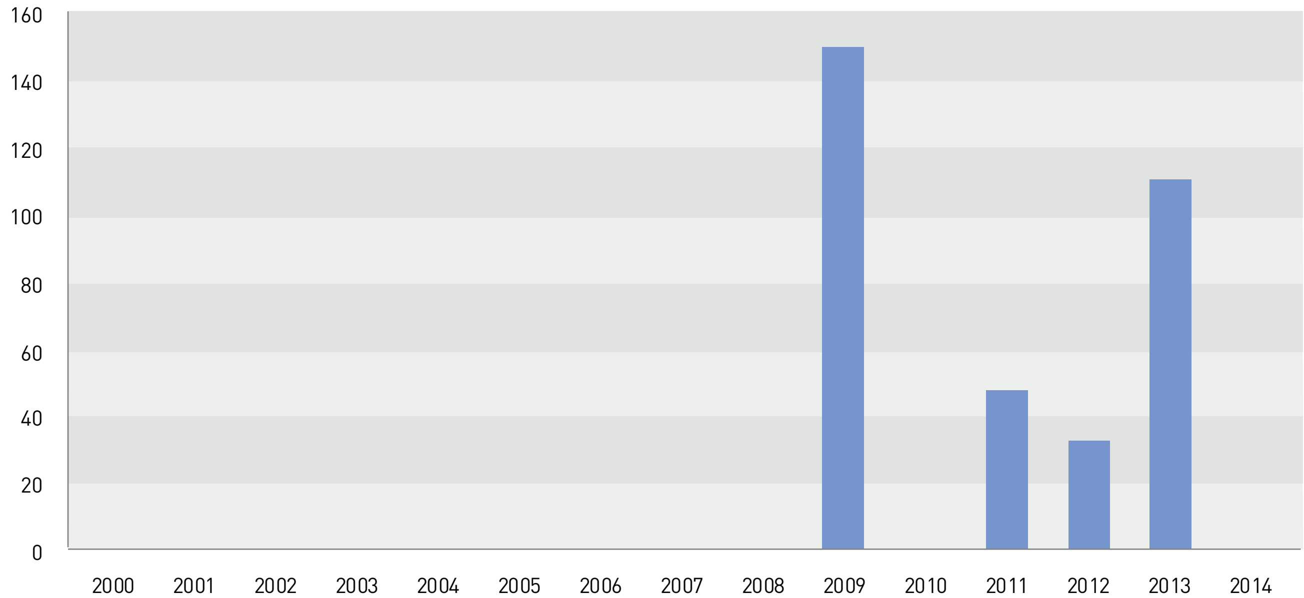
AVIATION

Riding a strong state mandate to develop a competitive domestic industry, Chinese companies have begun to invest in the European commercial aviation industry since 2009. Investments are largely driven by the desire of leading state-owned players such as the Aviation Industry Corporation of China (AVIC) and the Commercial Aircraft Corporation of China (COMAC) to access technology and know-how through acquisitions (Fischer Advanced Composite Components [FACC] and engine maker Thielert Aircraft), and establishing offices to promote R&D cooperation and recruit local talent (COMAC's office in France).

However, compared to other industries, total investment in the aviation sector remains small, with about $340 million cumulative investment as of the end of 2014. The major recipients were Austria, Germany, and France. The future trajectory will depend on the feasibility of integrating foreign technology and mitigating existing national security concerns in EU countries over the applicability of aviation technology for defense purposes.

FIGURE 9.3: CHINESE FDI TRANSACTIONS IN THE AVIATION INDUSTRY OF THE EU-28, 2000-2014

Investment value in USD mn



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

BASIC MATERIALS

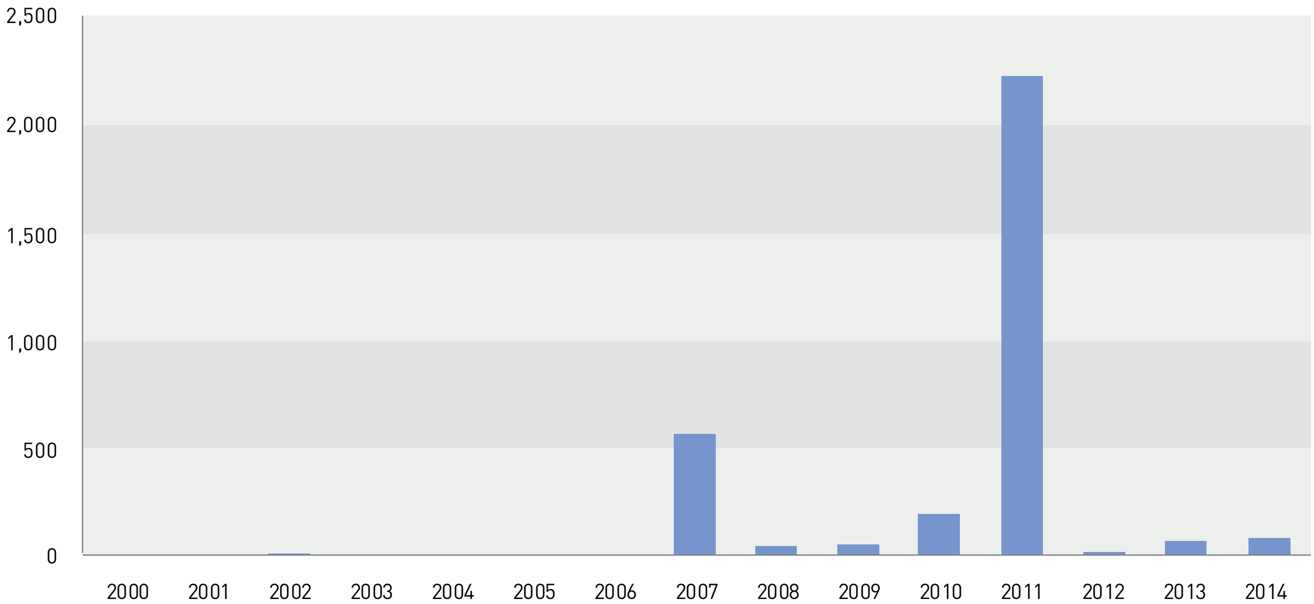
The basic materials sector has received a steady share of Chinese investments since 2002, amounting to about $3.1 billion through 2014. Prior to 2010, Chinese companies mostly built sales offices and warehouse facilities in Europe to import cheaper chemicals and materials from China. Since 2011, companies have started to establish manufacturing plants in Europe to be closer to their customer base, and R&D facilities to acquire new technology and move up the value chain. The geographic presence of Chinese investors mostly reflects existing industry clustering within Europe, with the major recipients being Hungary, France, and Germany.

State-owned enterprises are significant investors in basic materials and the decline in global M&A activity by SOEs has impacted overall investment in the sector in the past two years. Almost all investments into basic materials are strategic. The biggest M&A transactions are Wanhua Group' acquisition of BorsodChem and China National Chemical Corporation (ChemChina)'s investment in Rhodia's Silicones business. The biggest greenfield projects were expansions of those operations.

Several investors have announced bigger scale greenfield projects in Eastern Europe in recent years (for example China International Investment Stock's joint venture for building a paper mill in Croatia) but progress has been slow to date.

FIGURE 9.4: CHINESE FDI TRANSACTIONS IN THE BASIC MATERIALS INDUSTRY OF THE EU-28, 2000-2014

Investment value in USD mn



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

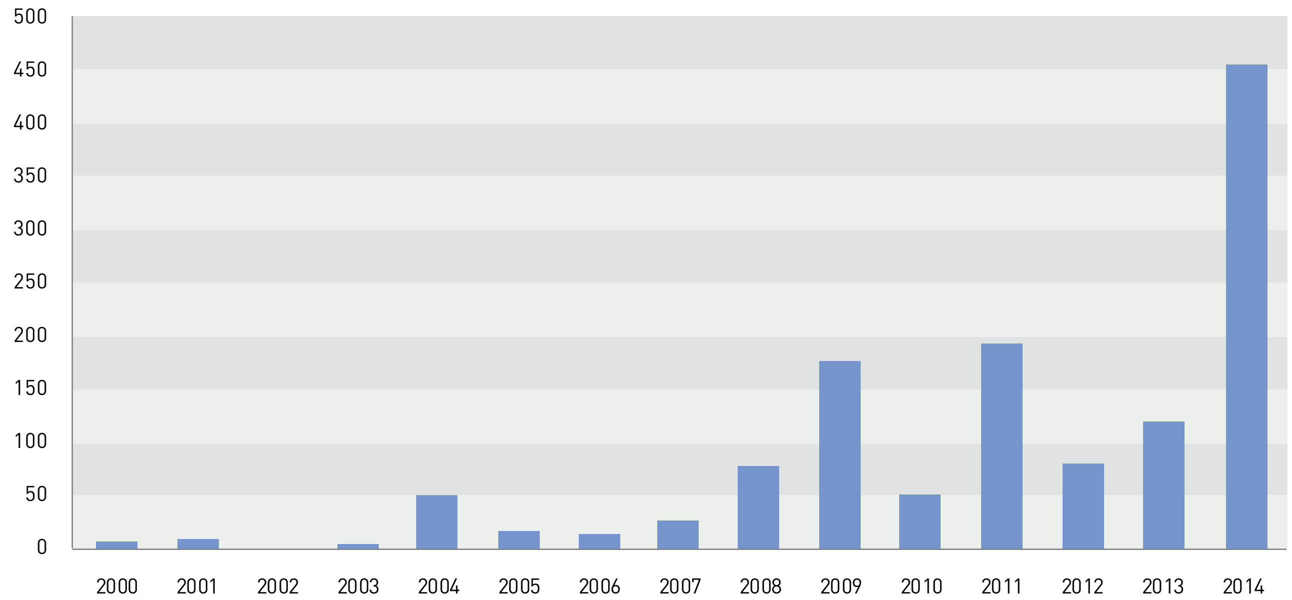
CONSUMER RODUCTS AND SERVICES

Chinese investment in consumer-related assets is relatively small but quickly growing. Total cumulative investment reached $1.3 billion in 2014, with the United Kingdom, Germany, and Italy as top destinations. Investment is driven by two major motivations: to promote the sale of Chinese products and services in the EU market; and to ramp up companies' ability to serve China's burgeoning middle class with high quality and brand-name products.

The former motivation has driven globally minded players, such as appliance producers Haier and Midea, to enter the EU market at an early stage, and localize their branding and sales networks in Europe. The motive of tapping into Chinese consumer spending by acquiring EU assets is particularly visible in the acquisition of brand name assets in recent years. That includes Nanjing Xinjiekou's investment in Highland Group, which owns the UK department store House of Fraser, and Fosun's financial investments in Raffaele Caruso and Tom Tailor.

FIGURE 9.5: CHINESE FDI TRANSACTIONS IN THE CONSUMER PRODUCTS AND SERVICES INDUSTRY OF THE EU-28, 2000-2014

Investment value in USD mn



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

Chinese presence in
15 industries across Europe

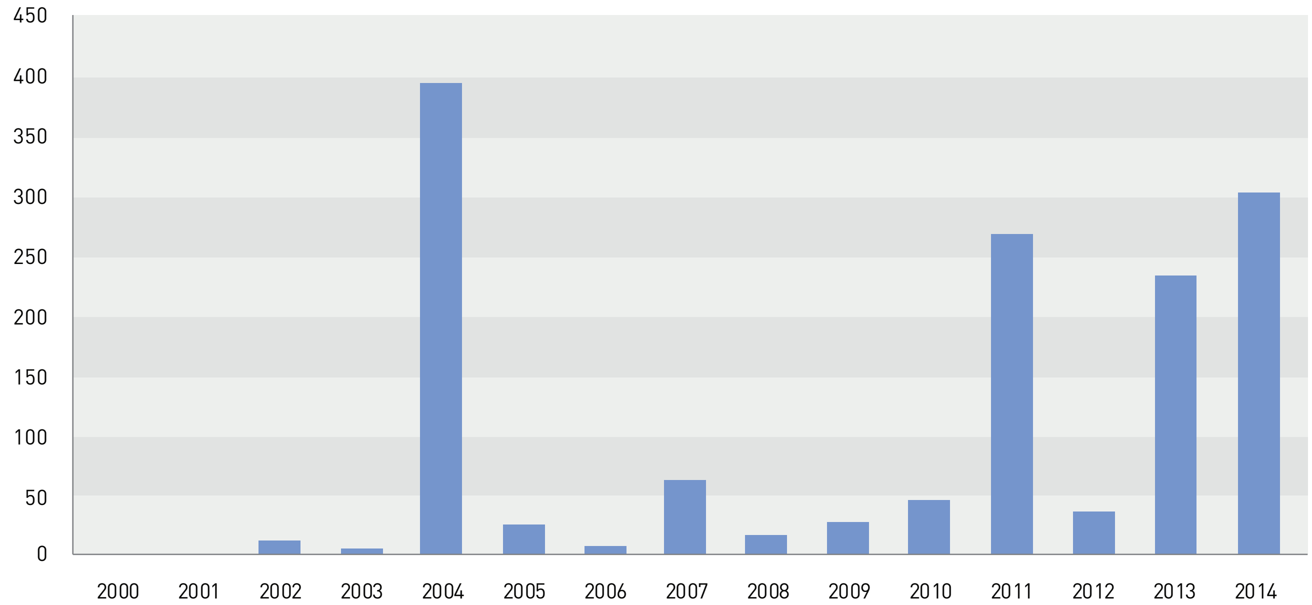
ELECTRONICS

After China's World Trade Organization (WTO) accession, Chinese electronics companies started to invest in Europe in the early 2000s to facilitate exports. With a significant labor and production cost advantage back home, prominent Chinese companies including Hisense, Lenovo, and TCL, entered the market to build supplier relationships and establish their own sales operations across the EU.

In the past few years, Chinese electronics companies put a greater emphasis on brand building, talent, and R&D capabilities. Some companies have also acquired or built manufacturing assets in the EU to move closer to their customer base. The total value of investments remains relatively low due to the small average size of transactions. As of year-end 2014, total cumulative investment reached more than $1.4 billion, the majority of which are strategic investments by private companies. France, the Netherlands, and Luxembourg are the biggest recipients.

FIGURE 9.6: CHINESE FDI TRANSACTIONS IN THE ELECTRONICS INDUSTRY OF THE EU-28, 2000-2014

Investment value in USD mn



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

ENERGY

The energy sector is the number one recipient of Chinese capital, totaling $17 billion through 2014 (28% of total investment value from 2000-2014). Portugal, France, the United Kingdom, and Italy are the major recipients.

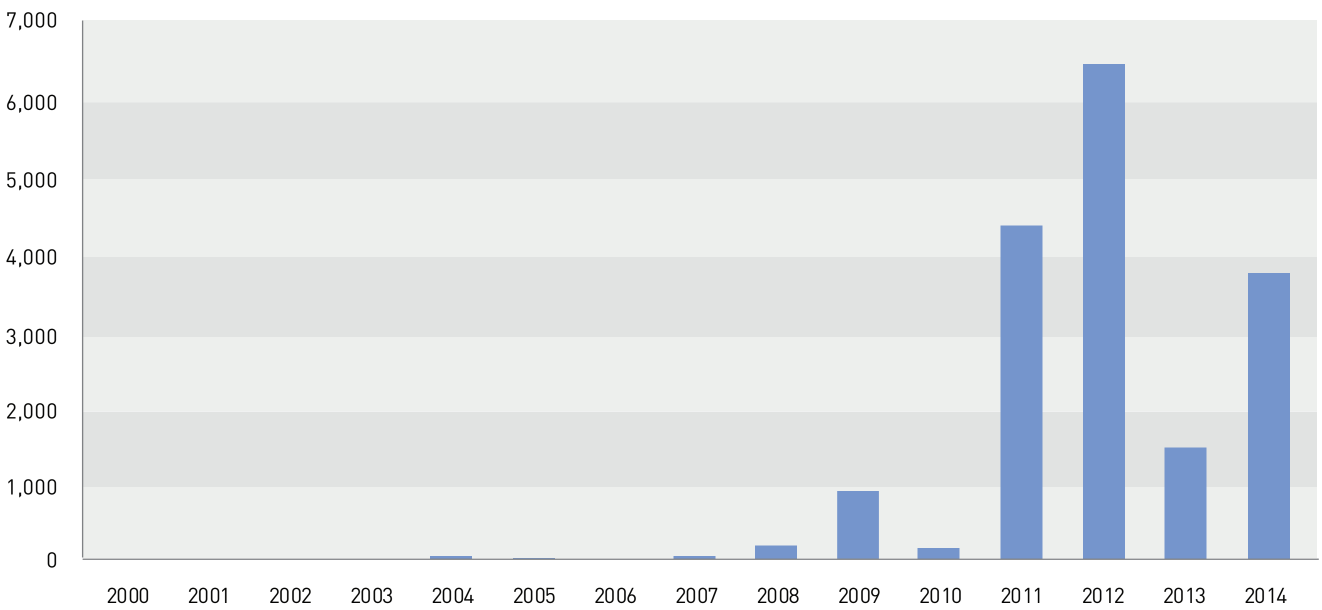
Chinese investment into the European energy sector was mostly driven by acquisitions of global oil and gas companies with headquarters in Europe and stakes in public utilities companies. Since the mid-2000s, state-owned oil giants were seizing opportunities to buy into European oil and gas assets (China Petroleum & Chemical Corporation [Sinopec] in Talisman and PetroChina in INEOS' refining business, but these deals slowed down significantly in 2013/2014 as the aggressive anti-corruption campaign targeted many state-owned energy firms and domestic market reforms began to move China towards a less resource-intensive growth model.

The privatization of government assets in countries affected most by the crisis was the second important driver of Chinese capital flows in the energy sector, as state-owned enterprises snapped up assets in the utilities sector (such as State Grid Corporation of China [SGCC] in CDP Reti or China Three Gorges International [CTG] in Energias de Portugal [EDP]).

The third key driver is investment in the renewable energy sector, where Chinese investors have financed numerous solar and wind power projects, to increase the utilization of their equipment or to tap the attractive subsidy schemes in certain countries (UK, Germany, Romania, and Portugal).

FIGURE 9.7: CHINESE FDI TRANSACTIONS IN THE ENERGY INDUSTRY OF THE EU-28, 2000-2014

Investment value in USD mn



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

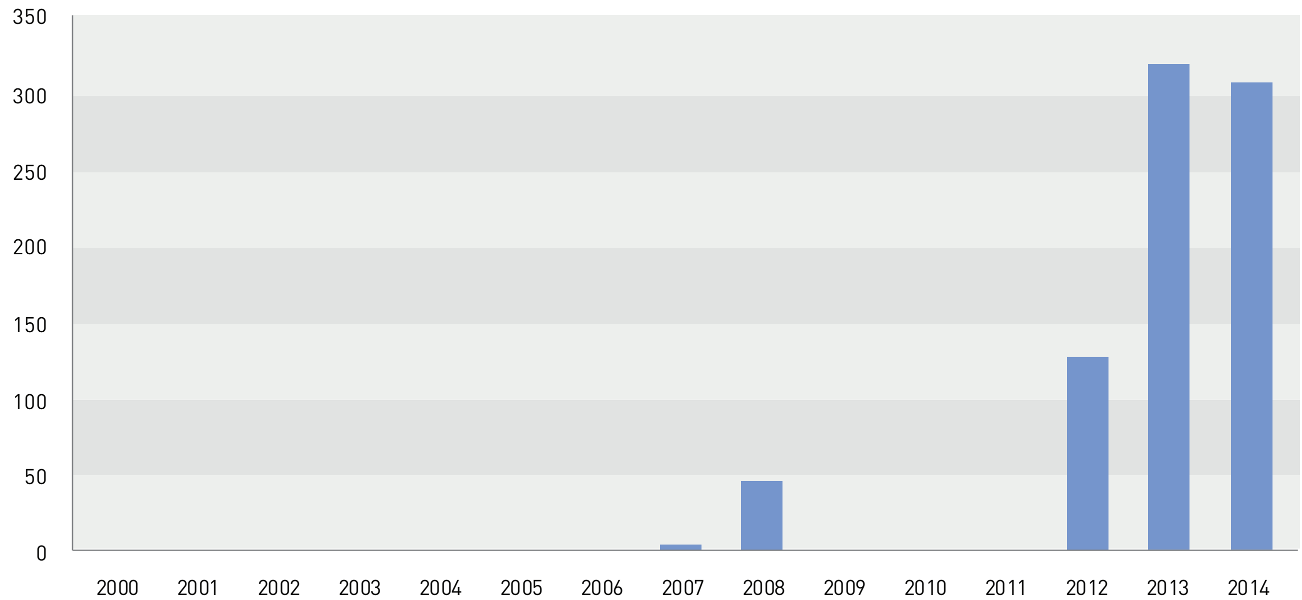
ENTERTAINMENT AND HOSPITALITY

Entertainment and hospitality is a small, but quickly growing sector for Chinese investment, totaling $790 million through the end of 2014. The most popular destinations are Spain, the United Kingdom, Belgium, and France.

The major drivers for recent growth are the popularity of Chinese tourism to Europe and a fast growing domestic market for entertainment services. Strategic buyers from the private sector have done the most deals. The biggest acquisitions was Hainan Airlines' (HNA) investment in NH Hoteles. Greenfield projects were mostly small-scale, but announced investments suggest greater activity in coming years - Dalian Wanda Group, for example, has pledged nearly $1 billion worth of investment in a luxury hotel in the UK.

FIGURE 9.8: CHINESE FDI TRANSACTIONS IN THE ENTERTAINMENT AND HOSPITALITY INDUSTRY OF THE EU-28, 2000-2014

Investment value in USD mn



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

FINANCE AND BUSINESS SERVICES

Chinese banks have a long history in Europe that spans decades, but most of these early stage investments came in the form of small-scale greenfield investments by the big four state-owned banks. In the past two years, the scope of EU investment broadened to new areas and entities, driving the total value of cumulative investment up to more than $2 billion through 2014.

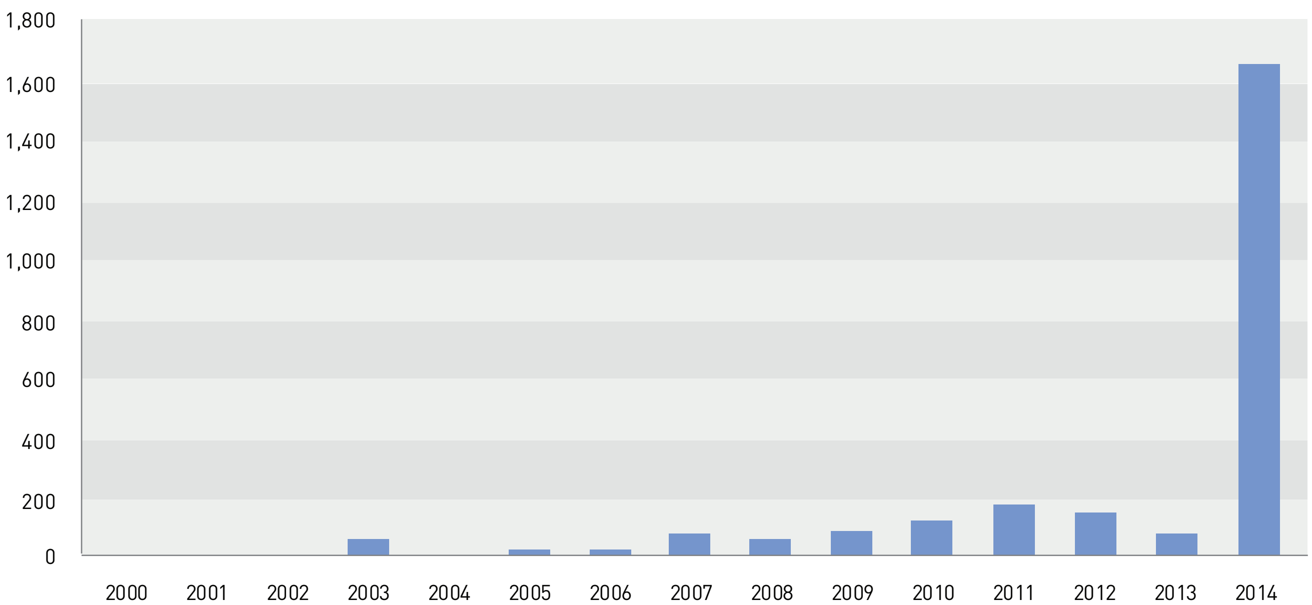
The activity and scale of bank operations grew significantly, due to a more mature financial industry in China and new business opportunities related to more open and internationalized financial markets in China.

The big state banks increased their capacity to seize those opportunities (for example the establishment of renminbi [RMB] clearing operations) or private wealth management). Large institutional money managers (State Administration of Foreign Exchange [SAFE]/Gingko Tree) also opened offices in Europe. More recently, Europe's financial sector also attracted capital from financial investors, for example Fosun's acquisition of three Portuguese insurance companies (Fidelidade, Multicare, and Cares), the biggest deal in the sector to date.

Other providers of business and other professional services are only slowly expanding to Europe. Expansion is mostly restricted to areas where firms can bring a specific advantage to the otherwise very competitive market (for example law firms). The most important countries for finance and business investment are Portugal, Germany, and the United Kingdom.

FIGURE 9.9: CHINESE FDI TRANSACTIONS IN THE FINANCE AND BUSINESS SERVICES INDUSTRY OF THE EU-28, 2000-2014

Investment value in USD mn



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

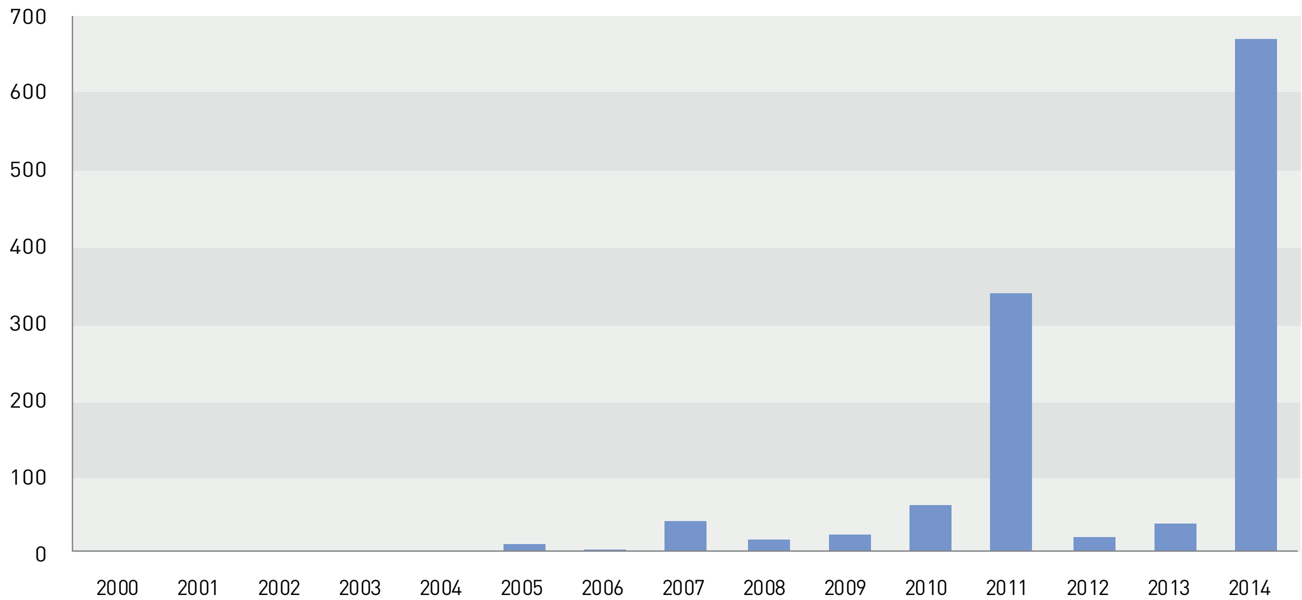
HEALTHCARE AND BIOTECHNOLOGY

Chinese investment in European health and biotechnology sectors remains modest ($1 billion through 2014) and has only recently picked up as companies are eager to tap mature industry clusters, a large talent pool, and local incentives to attract foreign R&D operations.

Prior to 2011, Chinese presence remained small and investments were mostly limited to liaison or sales offices with a small number of employees. In the past three years, investment has grown bigger, including collaboration with EU companies (Sinochem's investment in DSM Anti-Infectives) and organic growth of research operations (Beijing Genomics Institute in the Czech Republic). Lately, financial investors have entered the picture as well, represented by Fosun's investment in Portuguese healthcare provider Espirito Santo Saude.

While investments are broadly distributed, Portugal (Espirito Santo Saude) and the Netherlands (DSM) are the major recipients of Chinese capital.

FIGURE 9.10: CHINESE FDI TRANSACTIONS IN THE HEALTHCARE AND BIOTECHNOLOGY INDUSTRY OF THE EU-28, 2000-2014
Investment value in USD mn



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

Chinese presence in
15 industries across Europe

INDUSTRIAL EQUIPMENT

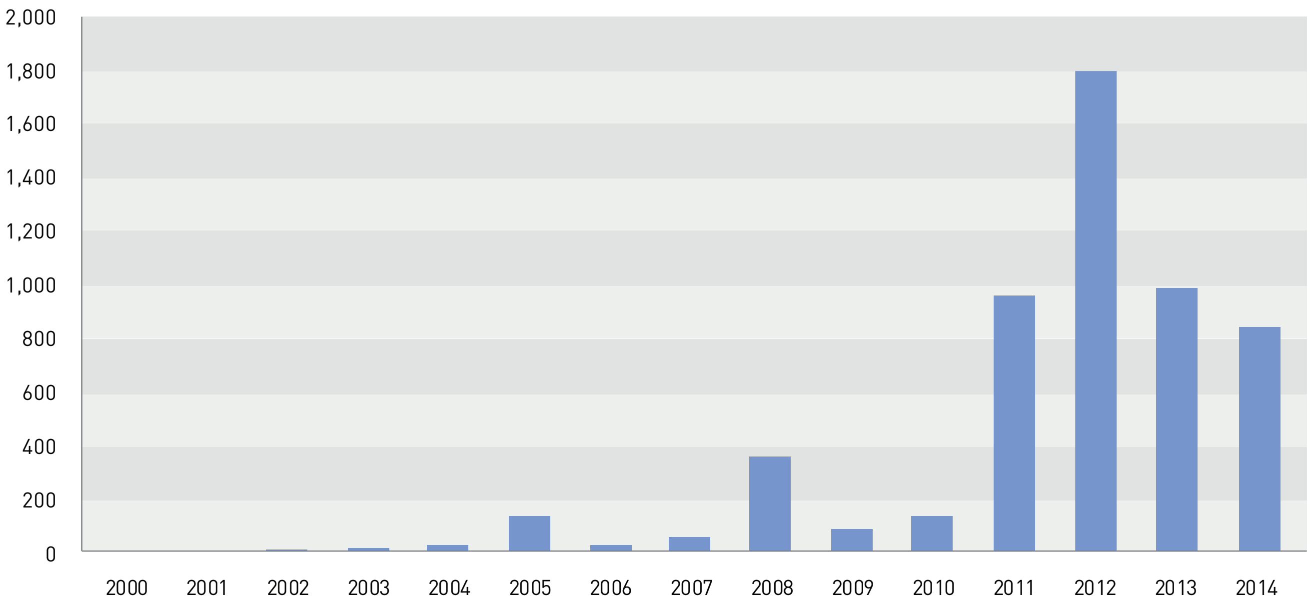
Industrial equipment is one of the top industries attracting Chinese investment, ranked fifth in total value, with $5 billion worth of deals from 2000 to 2014. Investment spans a variety of sectors, from cement plant machinery (KHD Humboldt Wedag), to cranes and lifting machinery (Palfinger), to warehouse equipment (KION Group), to agriculture machinery (McCormick). Germany is the top recipient, followed by Italy, France, and Austria.

The most important driver for investment in industrial equipment is access to European technology and know-how. The number of acquisitions noticeably increased post 2008, as financial difficulties faced by some European companies during that time offered a window of opportunity for Chinese investors. While acquisitions still dominate, there is also a trend towards greenfield investments in R&D operations and manufacturing for higher value-added products.

Strategic investors from China's industrial equipment and machinery sectors are dominating the landscape of investors, including both state-owned and private companies. The most prominent state-owned investors are Weichai Power and AVIC, while the private investor presence is led by Sany.

FIGURE 9.11: CHINESE FDI TRANSACTIONS IN THE INDUSTRIAL EQUIPMENT INDUSTRY OF THE EU-28, 2000-2014

Investment value in USD mn



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

Chinese presence in
15 industries across Europe

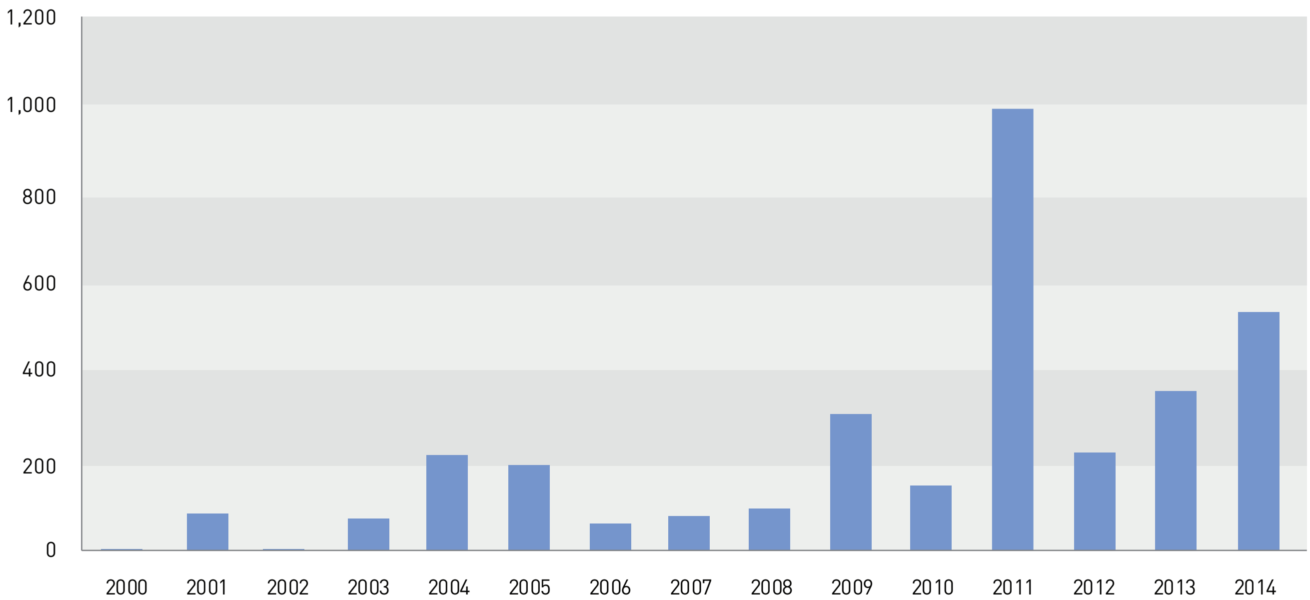
INFORMATION AND COMMUNICATIONS TECHNOLOGY (ICT)

By the end of 2014, Chinese companies had invested a total of $3.5 billion in Europe with Germany, the United Kingdom, and France as major recipients.

Similar to electronics, companies have expanded their investments in the European ICT sector from small trade-facilitating offices to a broader range of activities. In most of the 2000s, Chinese ICT companies such as Huawei and ZTE focused on small greenfield operations such as local sales offices and logistic centers. In the past three years, they ramped up spending on research and development operations (such as Huawei's R&D expansion in the UK), and larger acquisitions of consumer-related assets (Lenovo's $600 million purchase of Medion) and technology (Huaxin's $200 million acquisition of Alcatel-Lucent's telecommunication division).

FIGURE 9.12: CHINESE FDI TRANSACTIONS IN THE INFORMATION AND COMMUNICATIONS TECHNOLOGY (ICT) INDUSTRY OF THE EU-28, 2000-2014

Investment value in USD mn



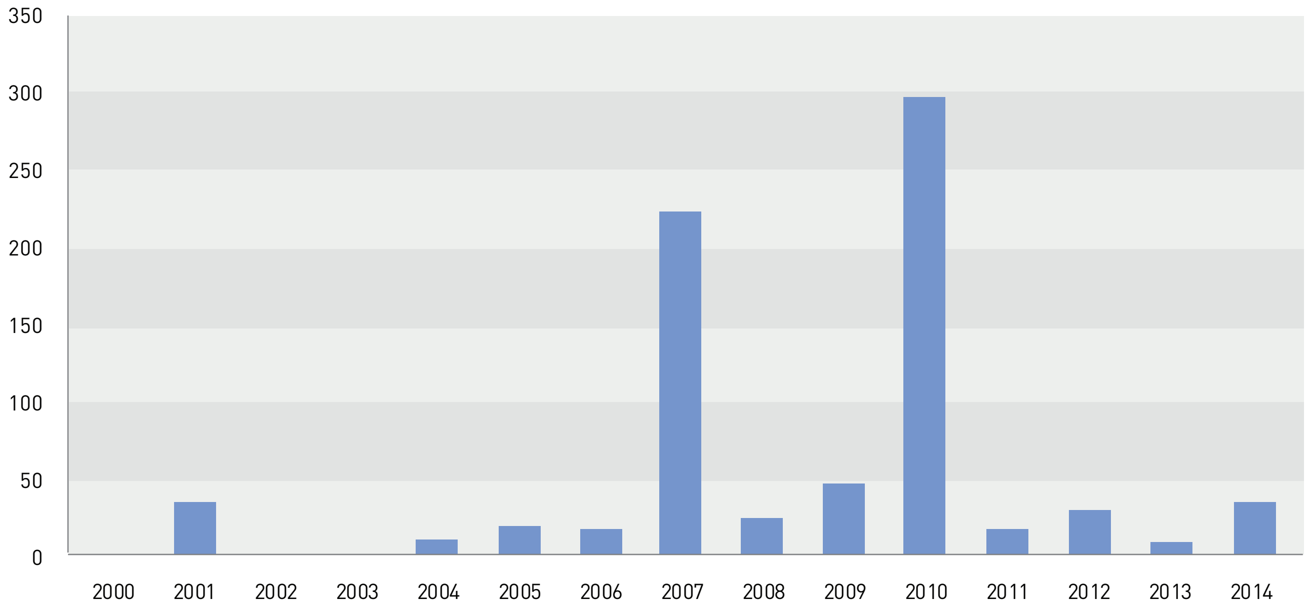
Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

METALS AND MINERALS

In the absence of large mineral and ore deposits, Chinese investment in metals and minerals assets remained limited. As of 2014, cumulative investment totaled $772 million, but the majority of it is attributable to two large acquisitions of companies listed in the United Kingdom (African Minerals and Monterrico Metals). The recent decline in global M&A activity in metals and minerals have also affected deal flow in Europe, with no major investments announced in 2013 and 2014. There are only very few greenfield investments in the metals and minerals sectors and they are almost exclusively small-scale representative offices.

FIGURE 9.13: CHINESE FDI TRANSACTIONS IN THE METALS AND MINERALS INDUSTRY OF THE EU-28, 2000-2014

Investment value in USD mn



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

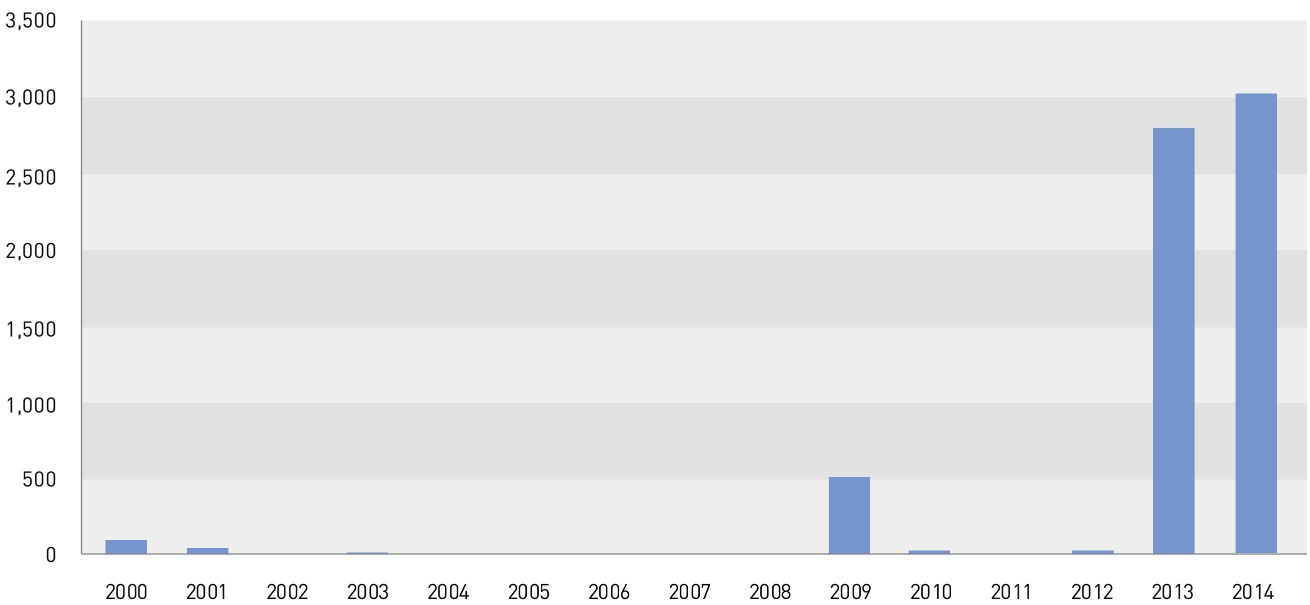
REAL ESTATE

Starting from a small base, commercial real estate investment has grown sharply in recent years: cumulative investments increased from only $614 million before 2012 to $6 billion through the end of 2014. That jump makes real estate the fourth most attractive industry by total value. The majority of these investments went to the United Kingdom (for example, Carmelit Riverside and Nine Elms), but recently spread to other European economies as well, for example Spain (Edificio Espana). Investments are concentrated in big metropolitan areas.

One important factor of greater overseas presence in real estate markets is the recent slowdown in China's real estate market. After a decade of hyper growth at home, Chinese developers feel the need to diversify their exposure and venture into stable overseas markets. Another important driver is the recent loosening of restrictions on global investment for insurance firms and other financial investors. Such investments account for nearly half of the transactions and the lion's share of total capital invested. The biggest investments were made by state-related entities, including Gingko Tree's acquisition of UPP Group Holdings, CIC's purchase of Chiswick Park in London and China Life Insurance Company Limited's (China Life) takeover of an office building in London.

FIGURE 9.14: CHINESE FDI TRANSACTIONS IN THE REAL ESTATE INDUSTRY OF THE EU-28, 2000-2014

Investment value in USD mn



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

TRANSPORT AND INFRASTRUCTURE

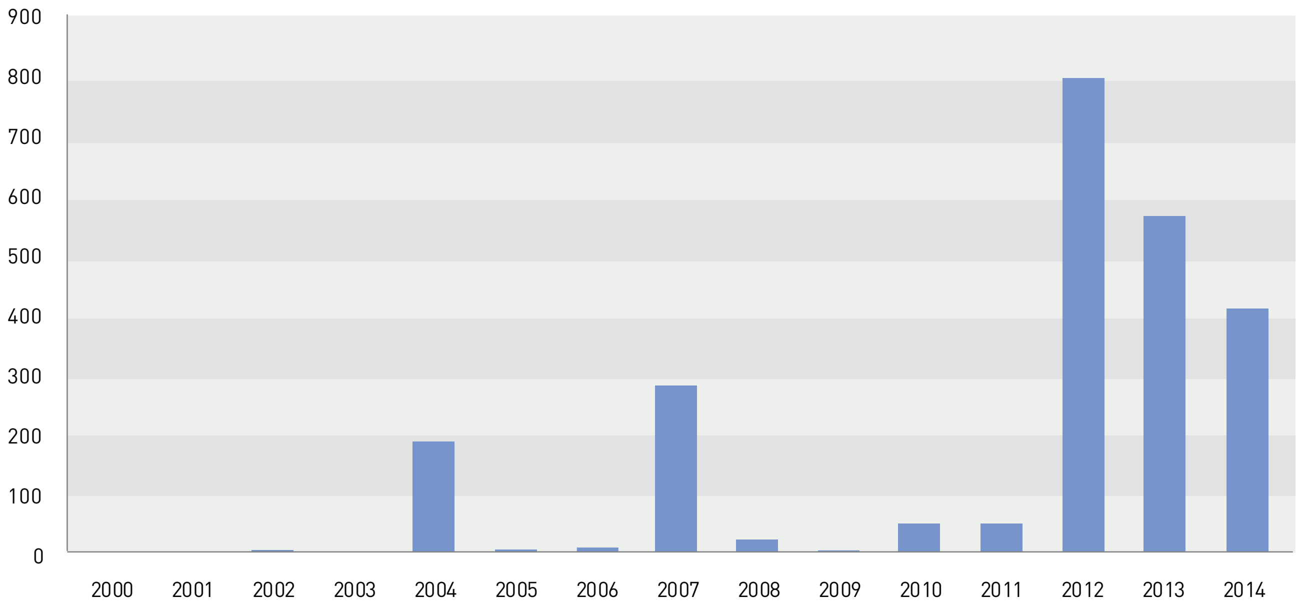
Chinese investment in transport and infrastructure totaled more than $2.4 billion through 2014. The top recipient countries are the United Kingdoms, France, and Belgium.

State-owned transportation giants such as China Ocean Shipping Corporation (COSCO) were among the first Chinese investors in Europe, as they built out their capacity along with growing China-EU trade volumes. Similarly, Chinese airlines including Air China have expanded their footprint in Europe as freight and passenger volumes have grown rapidly from a low base.

The growth in investment values only occured recently, as large state-owned companies have taken the opportunity to directly invest in infrastructure assets and operations in Europe. The biggest greenfield investment was COSCO's expansion at the Piraeus port in Greece. More importantly, infrastructure has also become a preferred target for financial investors, including CIC's $700 million stake in FGP Topco (London Heathrow Airport) and China Merchants Holdings' $500 million acquisition of CMA CGM's Terminal Link container port operators business.

FIGURE 9.15: CHINESE FDI TRANSACTIONS IN THE TRANSPORT AND INFRASTRUCTURE INDUSTRY OF THE EU-28, 2000-2014

Investment value in USD mn



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

INVESTOR CHARACTERISTICS

The evolving mix of Chinese investors in Europe reflects the diversity and recent changes in the corporate landscape in China. For the entire period of 2000-2014, privately owned companies account for the majority of transactions (62%), but only 31% of the total money invested. State-owned companies and sovereign entities account for a smaller share of transactions, but the majority of investment value (69%), as they are dominating capital-intensive industries in China.[9]

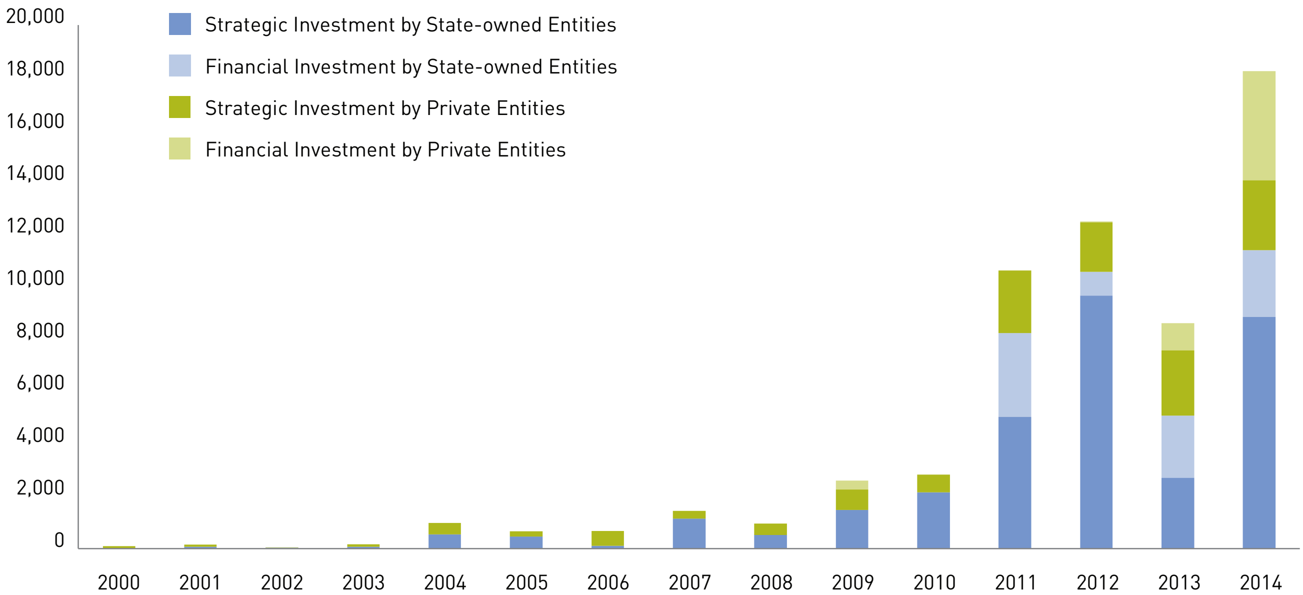
A further distinction can be made between strategic investors (real economy companies that are making long-term investments to exploit advantages, access markets, or increase competitiveness) and financial investors (companies and funds that invest primarily for financial returns). For most of the past decade, strategic investors accounted for the vast majority of deals and deal value. However, in the past two years, financial investors have emerged as important players in the China outbound space, including private funds as well as state-owned or sovereign entities.[10] Figure 10 illustrates this development over time.

9. For more information on our definition of private and state ownership, please see the Data Appendix.

10. The rise of private equity firms and other financial investors is a phenomenon that applies not only to China, but the global FDI landscape. See UNCTAD (2014b).

FIGURE 10: CHINESE FDI TRANSACTIONS IN THE EU-28 BY TYPE OF INVESTOR, 2000-2014

USD mn



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

Figure 11 provides a very granular picture of the evolution of the investor mix since 2009 by plotting each transaction in one of four quadrants for three periods. The first dimension is ownership, where state-owned companies (companies that are at least 20% ultimately owned by government) are placed in the upper quadrants, and private companies (companies with 80% or more private ownership) are placed in the lower quadrants; the second dimension is type of investment, where financial investments are placed on the left side, and strategic investments are placed on the right side. The bubble size for each deal represents its value.

The period of 2009-2010 represents the first two years of increased Chinese investment activity in Europe. Almost all deals in this period were strategic investments by real economy companies, with the exception of CIC's investment in UK developer Songbird Estates. Private companies accounted for the vast majority of transactions, but most of those were smaller sized investments related to trade facilitation, such as representative and trade offices. Private companies began to step up their presence in the EU by making substantial investments targeted at accessing technology and increasing their competitiveness (Volvo). SOEs also elevated their investments in this period, compared to previous years, and, on average, pursued larger targets (Emerald Energy and Fischer Advanced Composite Components).

The explosive growth of investment from 2011-2012 can largely be attributed to growing investment by state-owned companies that were snapping up assets in utilities, oil and gas, and logistics. In addition to strategic investments by state-owned companies, sovereign financial investors also began making large-scale investments in Europe (CIC's stakes in GDF Suez and FGP Topco, owner of the London Heathrow Airport). The number and size of private company transactions also increased in this period, as private Chinese companies improved their internal capabilities and got more political freedom to pursue overseas expansion plans (Sany's acquisition of Putzmeister and Lenovo's acquisition of Medion). Still the growth rate for private deals was modest compared to the expansion in SOE investment.

In 2013-2014, the mix of Chinese entities investing in Europe changed drastically. The most important development was the explosive growth in the number and size of financial investments, by both state and private entities. The spectrum of state-owned financial investors broadened from CIC to a greater number of sovereign investors (including Gingko Tree and other investment arms under SAFE) and large financial companies, including insurance companies, asset management companies, and banks (China Construction Bank, China Life, and China Merchants Holding). Private financial investment was quasi non-existent before 2013, but has grown rapidly. Investors include financial conglomerates (Fosun, Wanda Group), private equity companies (Hony), and private insurance companies (Ping An). This outward push is driven by maturing industry structures, declining domestic opportunities, and more liberal outward investment rules.[11] Taken together, financial investments account for almost 40% of total transaction value in 2013 and 2014, compared to only 18% in the 2011-2012 period and 6% in 2009-2010.

FIGURE 11:
CHINESE FDI TRANSACTIONS IN THE EU-28 BY TYPE OF INVESTOR, SELECTED PERIODS

Each bubble represents one transaction; size of bubbles represents total value

2009-2010

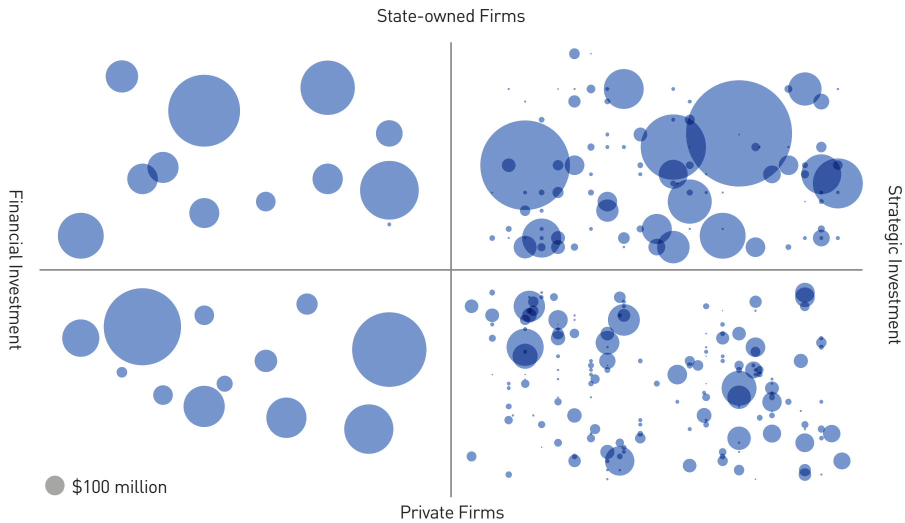
11. In addition to cutting red tape for outward investment in general (see Section 8 – Outlook), China has also lowered overseas investment barriers for certain types of financial entities. For example, new rules that encourage insurance firms to invest a greater portion of their assets in overseas markets. See "Several Opinions of the State Council on Speed up Development of Modern Insurance Services Industry", State Council, August 13, 2014, http://www.gov.cn/zhengce/content/2014-08/13/content_8977.htm.

FIGURE 11:
CHINESE FDI TRANSACTIONS IN THE EU-28 BY TYPE OF INVESTOR, SELECTED PERIODS

Each bubble represents one transaction; size of bubbles represents total value

2011-2012

2013-2014



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix. State-owned entities refer to companies that are at least 20% owned by the government, sovereign entities, and central SOE's; Private entities refer to companies with less than 20% ownership by the government, sovereign entities, and central SOE's. Strategic investments refer to those made for the purpose of long-term business development and integration; financial investments refer to those made primarily for financial returns. The four quadrants are categorical and the position of the bubbles are arbitrary.

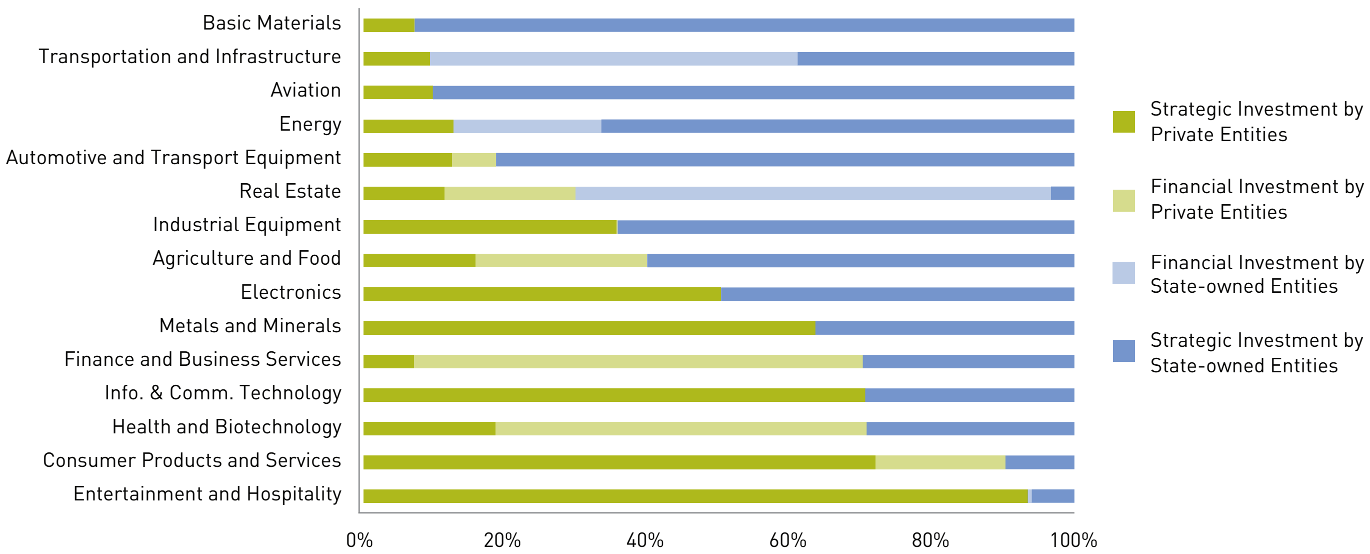
Figure 12 provides details on the distribution of investments in each sector for those four types of entities, revealing the relative importance of each.

State-owned companies remain the dominant strategic investors in several sectors they traditionally control at home, including basic materials (Wanhua Polyurethanes and ChemChina), aviation (AVIC and COMAC), energy (Sinopec, CNPC, Sinochem, CTG, and SGCC), automotive components (AVIC, SAIC, and Beijing Automotive Group), food (Bright Food and COFCO) and industrial equipment (Shanghai Electric, Weichai Power, and Zoomlion). Sovereign entities and other state financial investors are important drivers of investment activity in transportation and infrastructure (CIC and China Merchants Holdings) and real estate (Gingko Tree, China Overseas Holding, and CIC).

Strategic investments by private companies are the most common investments in higher value-added and consumer-oriented industries, including entertainment and hospitality (HNA Group), consumer products (Fosun and Haier), and information technology (Lenovo, Huawei, ZTE, and Huaxin). Financial investment by the private sector is most visible in health and biotechnology, and the financial industry (Fosun).

FIGURE 12: CHINESE FDI TRANSACTIONS IN THE EU-28 BY TYPE OF INVESTOR AND INDUSTRY, 2000-2014

Share of total investment



Source: Rhodium Group. A detailed explanation of sources and methodology can be found in the Data Appendix.

CHALLENGES

Five years of significant Chinese investment now permit a first assessment of the problems that Chinese companies face in the European market. Inexperience and a different institutional environment at home create regulatory challenges for both entering and operating in an advanced and highly complex market such as the European Union.

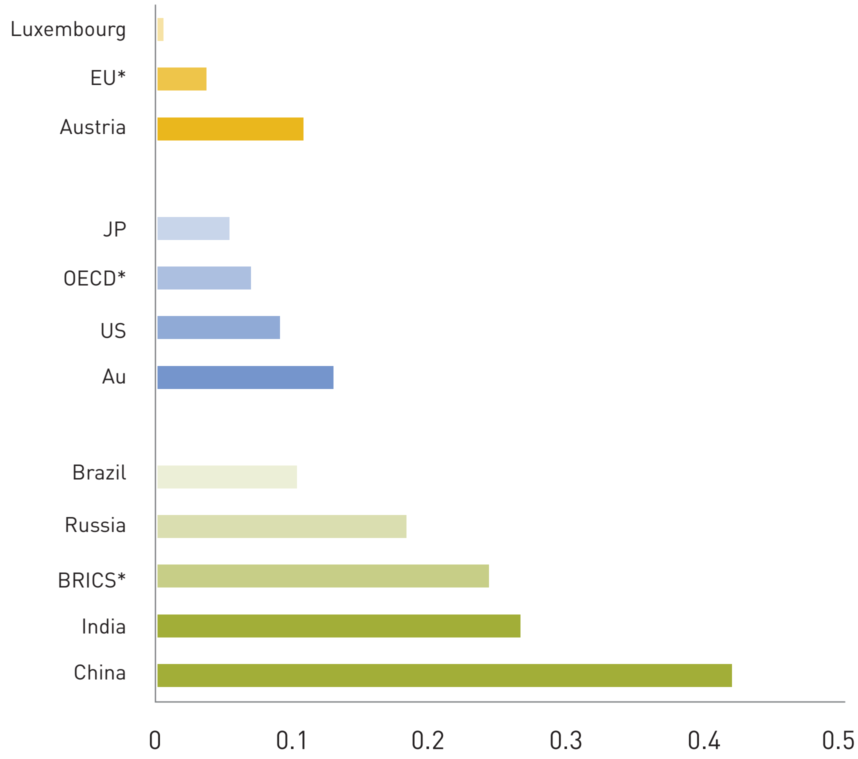
MARKET ENTRY

European countries generally have open investment regimes, with few outright investment restrictions and limitations. Free movement of capital is one of the "four freedoms" of the EU single market, which requires all EU member states to allow unhindered capital flows between member states, and generally also from third countries into the EU market.[12] It is not surprising that available measures of formal FDI restrictions (in the form of prohibitions, equity thresholds, personnel requirements, etc.) show EU economies among the most open economies globally. There are variances among EU countries, with Luxembourg scoring as the most open and Austria the least open of the 28 member states, but these are

12. See Article 63 of the Treaty on the Functioning of the European Union: http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:12008E063.

FIGURE 13: FDI RESTRICTIVENESS, EU VS. REST OF WORLD, 2013

Index, 0=Open, 1=Closed



Source: Organisation for Economic Co-operation and Development (OECD), Rhodium Group. *Simple average of available countries for each group.

modest in comparison with non-OECD regimes (Figure 13).

Most formal hurdles to foreign investment are not outright limits on foreign investment, but come in the form of approval requirements in sectors that are heavily regulated in most other economies as well – legal services, telecommunication, and air transportation, for example. The exceptions are grandfathered provisions in certain EU member states that contain outright bans on foreign investment in a small number of sectors, such as real estate in Poland, legal services in Denmark, and electricity generation in Austria (see Table 1). Most of these approval processes are straightforward and offer little leeway for politicization. However, they can substantially delay or even derail transactions when it comes to Chinese investors. For one, Chinese investors often struggle with providing required documentation or meeting deadlines due to the vastly different domestic regulatory frameworks and procedures. The sale of a Belgian bank to a Chinese non-financial buyer fell through in 2014, for example, because the buyer was not able to provide the necessary documents despite extension. Moreover, there is often no precedent for national regulators in dealing with a Chinese investor, which can increase the time it takes to assess the adequacy of home country regulatory supervision and other relevant criteria.

In addition to these sectoral restrictions and approval requirements, national governments also have the right to restrict foreign investments that pose a threat to national defense and public security interests. This process is completely at the discretion of members states and there is no pan-European framework for security screening. Not surprisingly, national governments have different views of national security threats. Some countries have specified sectors with security-related investment restrictions or approvals (also included in Table 1). In addtion, many countries do not limit national security interests to specific sectors, but leave some leeway to react to specific situations. Most governments apply security exceptions narrowly, but there are risks that they could be utilized in the pursuit of interests not truly essential to security. A prominent recent example that raised such concerns was France's attempt to influence a takeover bid from General Electric for Alstom by expanding the government's power to block inbound acquisitions to protect strategic industries.[13]

13. See "Brussels worried about French protectionism in Alstom talks", Euractiv, May 19, 2014, http://www.euractiv.com/sections/innovation-enterprise/brussels-worried-about-french-protectionism-alstom-talks-302209.

TABLE 1: EXCEPTIONS TO NATIONAL TREATMENT FOR FOREIGN-CONTROLLED ENTERPRISES, SELECTED EU COUNTRIES, 2013

AUSTRIA	• Accountancy • Architectural services • Legal services	• Air transport • Engineering services • Maritime transport/fishing
BELGIUM	• Accountancy and legal services • Inland waterways	• Financial services • Maritime transport
CZECH REPUBLIC	• Air transport	• Gaming
DENMARK	• Accountancy services	• Air transport
ESTONIA	• Air transport • Real estate	• Maritime transport
FINLAND	• Air transport • Legal services	• Auditing • Maritime transport
FRANCE	• Air transport • Legal services • Press • Radio and Television	• Inland waterways • Maritime transport • Privatization • Tourism
GERMANY	• Air transport • Maritime transport	• Inland waterways • Rail transport
GREECE	• Accountancy • Fishing • Mining • Television and Radio	• Air transport • Maritime transport • Real estate
HUNGARY	• Air transport	• International waterways
IRELAND	• Air transport • Flour milling	• Fishing • Land for agriculture purposes
ITALY	• Air transport • Maritime transport	• Fishing
LATVIA	• Air transport • Real Estate	• Gambling and lotteries • Security operations
LITHUANIA	• Air transport • Inland waterway transport • Maritime transport	• Fisheries • Land
LUXEMBOURG	• Air transport	• Land transport

NETHERLANDS	• Air transport • Maritime transport	• Inland waterways
POLAND	• Air transport • Gambling/betting	• Broadcasting • Real estate
PORTUGAL	• Air transport	• New credit institutions
ROMANIA	• Air transport	
SLOVAKIA	• Air transport	
SLOVENIA	• Air transport	• Maritime transport
SPAIN	• Air transport • Legal services	• Broadcasting
SWEDEN	• Accountancy • Legal services	• Air transport • Maritime transport
UK	• Air Transport • Inland Waterways • Radio/Television	• Banking • Maritime Transport

Source: OECD research on National Treatment for Foreign-Controlled Enterprises

Another major regulatory hurdle that inbound M&A transactions may have to clear is merger review, which screens acquisitions for potentially detrimental effects on competition. Merger reviews can be conducted on the EU level, by the EU Commission's DG Competition, as well as in member states by the respective national competition authorities – see Table 2. Such reviews have not been a significant problem for Chinese companies in the past, as their current market share in Europe is generally small enough not to trigger competition concerns. Recnetly, as many companies have revenues in Europe that exceed minimum review thresholds, a merger control review is often required. Recent Chinese inbound M&A transactions which have been reviewed and cleared include Weichai Power's investment in KION, Sany's merger with Putzmeister, and the acquisition of Kiekert by Hebei Lingyun and Henan North Xingguang.

The procedures and instruments of merger control regimes are fairly transparent and have left little room for politicization to date. Yet the treatment of state-owned enterprises has become a controversial matter that is particularly relevant for investors from China and other emerging economies. The assessment of the competitive implications for a merger is usually based on calculating how the transaction would impact the market share of the acquiring entity in the affected product market(s).[14] However, the EU Commission has made clear in several decisions that it

14. Similarly, one trigger of the notification thresholds in most European countries depends on the group turnover of the acquirer in the respective jurisdiction.

is still uncertain whether to treat Chinese SOEs as independent entities or as part of a group of entities that are controlled by the same shareholder, the State-owned Assets Supervision and Administration Commission of the State Council (SASAC).[15] There is currently no clarity on how competition authorities would treat a case in which an acquisition by a state-owned enterprise would push the combined market share of Chinese SOEs beyond an acceptable level of market concentration. This uncertainty remains a major risk factor for state-owned companies with existing EU market share going forward.

TABLE 2: MERGER CONTROL REGIMES IN THE EUROPEAN UNION, SELECTED JURISDICTIONS, 2014

	NAME OF LAW	MAJOR AGENCY	SUBSTANTIVE TEST
EUROPEAN UNION	EC Merger Regulation	Directorate General for Competition of the European Commission	Significantly impedes effective competition, in particular as a result of the creation or strengthening of a dominant position
AUSTRIA	The Cartel Act	The Austrian Federal Competition Authority	Creates or strengthens a dominant market position
BELGIUM	Belgium Competition Act	The Belgium Competition Council	Significant impediment to effective competition, in particular as a result of the creation or strengthening of a dominant position
BULGARIA	Law on Protection of Competition	The Bulgarian Commission for Protection of Competition	Creates or strengthens a dominant market position, that would significantly impede effective competition on the relevant market
CROATIA	Competition Act	The Croatian Competition Agency	Creates or strengthens a dominant position

15. See Case No COMP/M.6151 – PetroChina/Ineos/JV, Case No COMP/M.6113 – DSM/SinoChem/JV, Case No COMP/M.6141 – China National Agrochemical Corporation/Koor Industries/Makhteshimagan Industries, and Case No COMP/M.6082 – China National Bluestar/Elkem.

	NAME OF LAW	MAJOR AGENCY	SUBSTANTIVE TEST
CZECH REPUBLIC	Act on the Protection of Competition	Office for the Protection of Competition	Significant impediment to effective competition, in particular as a result of the creation or strengthening of a dominant position
CYPRUS	Control of Concentrations Between Undertakings Law 22(I)/99	The Cyprus Commission for the Protection of Competition	Substantial lessening of competition
DENMARK	The Danish Competition Act	The Danish Competition Council	Significant impediment to effective competition, in particular as a result of the creation or strengthening of a dominant position
ESTONIA	The Estonian Competition Act	The Estonian Competition Board	Significantly damages competition in particular through the creating or strengthening of a dominant position.
FINLAND	Act on Competition Restrictions	The Finnish Competition Authority	Creates or strengthens a dominant market position
FRANCE	The French Commercial Code, Law of Modernization of the Economy	The Competition Authority General Directorate of Competition, Consumer Affairs and Fraud Control	Significantly restricts competition, in particular by way of creating or reinforcing a dominant position
GREECE	Act 703/1977 "on the control of monopolies and oligopolies and the protection of free competition"	The Hellenic Competition Commission	Significantly restricts competition, in particular by way of creating or reinforcing a dominant position
GERMANY	Act Against Restraints of Competition	The Federal Cartel Office	Significantly impedes effective competition, in particular as a result of the creation or strengthening of a dominant position

	NAME OF LAW	MAJOR AGENCY	SUBSTANTIVE TEST
HUNGARY	Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices "The Competition Act"	The Hungarian Competition Authority	Creates or strengthens a dominant market position
IRELAND	The Competition Act 2002	The Irish Competition Authority	Substantial lessening of competition
ITALY	Law No. 287 of October 10, 1990	Italian Antitrust Authority	Creates or strengthens a dominant position
LATVIA	The Republic of Latvia Competition Act	The Republic of Latvia Competition Council	Creates or strengthens a dominant position, or significantly reduces competition
LITHUANIA	Law on Competition of the Republic of Lithuania No. VIII-1099	The Competition Council of the Republic of Lithuania	Creates or strengthens a dominant market position, from which results in a significant impediment to competition
LUXEMBOURG	The Law on Competition of 17 May 2004	The Competition Council	Merger leads to an abuse a dominant position
MALTA	The Regulations on Control of Concentrations 2002	The Director of the Office for Fair Competition	Substantial lessening of competition
NETHERLANDS	The Dutch Competition Act	The Dutch Competition Authority	Significant impediment to competition
POLAND	the Act on the Protection of Competition and Consumers of 16 February 2007	The President of the Office of Competition and Consumer Protection	Substantially limits competition, in particular through the creation or strengthening of a dominant position
PORTUGAL	The Competition Act	The Competition Authority	Creates or strengthens a dominant position

	NAME OF LAW	MAJOR AGENCY	SUBSTANTIVE TEST
ROMANIA	The Competition Law 21/1996	The Romanian Competition Council	Creates or strengthens a market dominant position
SLOVAK REPUBLIC	Act No. 136/2001 Coll "on Protection of Competition"	The Antimonopoly Office of the Slovak Republic	Creates or strengthens a dominant position
SLOVENIA	The Prevention of the Restriction of Competition Act of 2008	The Slovenian Competition Protection Office	Substantial impediment to effective competition
SPAIN	Spanish Competition Act 15/2007 of 3 July, "on the Defense of Competition"	The Spanish National Competition Commission	Substantial lessening of competition
SWEDEN	Swedish Competition Act	The Swedish Competition Authority	Significantly impedes effective competition, in particular as a result of the creation or strengthening of a dominant position
UNITED KINGDOM	The Enterprise Act	Competition and Markets Authority	Substantial lessening of competition

Source: National government sources, International Merger Control Research Project (mergerdata.net).

Finally, there are also specific regulatory procedures for acquiring certain types of EU assets, such as stakes in publicly listed companies. The EU's Takeover Directive lays out general principles for acquiring public companies, but implementation is handled by national regulators and therefore slightly differs from country to country.[16] Compliance with these rules is usually straightforward and there is limited leeway for politicization. However, the procedures, speed, and regulatory complexity are very different from the Chinese market, which often poses problems for Chinese acquirers.

Another special case relevant for Chinese investors is the purchase of government-owned assets in privatization sales. These often follow specific tender procedures, but sometimes also depend on political clout and negotiations. Recent successes in acquiring state-owned assets across Europe demonstrate

16. See "Application of Directive 2004/25/EC on takeover bids", European Commission, June 28, 2012, http://ec.europa.eu/internal_market/company/docs/takeoverbids/COM2012_347_en.pdf.

that Chinese companies can be competitive in both.[17]

In sum, while EU economies are very open to foreign investment by global standards, there are multiple regulatory hurdles to clear at the market entry stage depending on the industry, host country, and type of targeted company. Most regulatory processes are transparent and leave little discretion to regulators and politicians. The number of politicized Chinese deals in Europe is low compared to other markets. A more important hurdle is the incongruence of regulatory realities in China with some European requirements, particularly with regard to outbound investment approvals, documentation and response time. Greater convergence with advanced economy regulatory standards, the modernization of China's outbound FDI policy framework, more experience for Chinese companies with global deal making, and more experience for European regulators in dealing with investors from the Far East should help to reduce these stumbling blocks going forward.

OPERATIONS

While market entry hurdles command public attention, differences in regulations and business cultures remain beyond the establishment or transaction phase. Among advanced economies, Europe is a particular challenge, with its complex mix of national and supranational rules, its unfinished harmonization of national services markets, and its socio-economic and linguistic diversity.

The first area where these problems can be felt is management and corporate governance. Managing multinational operations in an advanced regulatory setup and fragmented market such as the EU is complex. It is a particular concern for companies from China, where corporate governance structures and management approaches are significantly different than in the EU and other advanced economies.[18] The lack of senior executives with overseas experience and language proficiency multiply the difficulty, and can lead to conflicts between Chinese owners and local management. Corporate governance problems have been particularly acute in situations where Chinese investors acquired an ailing European company that required restructuring, or where investors acquired partial ownership of a EU company and ownership interests were misaligned with other shareholders.

A second challenge that arises from the unique regulatory situation in China is that Chinese parent companies face certain restrictions on intra-company cash flow management. In contrast to advanced economies, China's capital account is not freely convertible, and moving money between a Chinese parent company and its overseas subsidiaries often requires approval from the central bank's foreign exchange regulator. This has negatively affected companies' ability to complete transactions, meet funding deadlines, and to utilize commonly used tools such as cash pooling or loan guarantees. While recent reforms have lowered some of these restrictions and companies have found ways to create more flexibility in spite of capital controls (through offshore structures or entities in the Shanghai Free Trade Zone), the existing limits on intra-company capital movements remain a serious disadvantage for Chinese companies in the EU and other overseas markets, particularly for smaller companies that cannot easily tap local funding sources.[19]

17. Recent examples include stakes of Energias de Portugal and CDP Reti.

18. For background on corporate governance in China, see Clarke (2010).

19. Some of the recent liberalizations include financial support for OFDI (See "Li Keqiang Holds State Council Regular Meeting", State Council, December 24, 2014, http://www.gov.cn/guowuyuan/2014-12/24/content_2796001.htm), cash pooling in Shanghai FTZ (See "People's Bank of China Opinions Regarding Financial Support for the Construction of the Shanghai Free Trade Experimental Zone", People's Bank of China, December 2, 2013, http://www.pbc.gov.cn/publish/goutongjiaoliu/524/2013/20131202094934794886233/20131202094934794886233_.html), and better cross border loan guarantees (See "Issues Relating to the Administration of Foreign Exchange in Respect of Offshore Investments, Financings and Return Investments by Domestic Residents through Special Purpose Vehicles", State Administration of Foreign Exchange, July 14, 2014, http://www.safe.gov.cn/resources/wcmpages/wps/wcm/connect/safe_web_store/safe_web/zcfg/zbxmwhgl/zjtzwhgl/node_zcfg_zbxm_kjtz_store/ce30120044b919a3a5ecf71fa25ece03/).

A third area where institutional and cultural differences have created visible problems is the management of stakeholder relationships. Many European companies are embedded in a strong network of stakeholders (including employees, suppliers, governments, and the local community) that has grown over decades. Those stakeholder systems not only vary greatly across national borders in Europe, they are also all very different compared to the Chinese market. For example, the understanding of labor relations is not only different from China, but there is also a great diversity of national traditions in within Europe, ranging from limited union rights (United Kingdom) to a very consensual model and strong worker representations in management structures (Germany). Adaptation to these complex new realities is often challenging. The most prominent example of amendable stakeholder management and engagement was the failed attempt by China Overseas Engineering Group to enter the Polish construction market.[20]

A fourth major challenge for Chinese companies operating in the EU market is compliance with laws and regimes that do not exist in the same form in China. Important examples are sanctions against specific countries, entities, or individuals[21]; strong regulations to protect intellectual property rights and copyrights[22]; restrictions on the export of particular goods[23]; national laws against corruption[24]; and data protection and privacy policies[25]. These regimes do not necessarily pose a general problem for multinationals operating in the EU market, but they represent a major challenge for Chinese companies that often do not have efficient firm-wide structures in place to ensure compliance with these rules. Non-compliance can lead to stiff penalties from regulators, potentially costly litigation and arbitration in European courts, and – most importantly – bad publicity which damages companies' reputation and the prospects of future international expansion.

In sum, the transitional nature of their home regulatory environment and a vastly different business culture can create significant difficulties for Chinese companies after entering the EU market. The question of whether China's new multinationals are able find structures and models allowing them to thrive in the EU market despite these hurdles will be critical for the success of Chinese businesses in Europe and other advanced economies.

20. See "European Project Trips China Builder", Wall Street Journal, June 4 2012, http://www.wsj.com/articles/SB10001424052702303459004577363842916410790.
21. For more on sanctions in the EU, see http://eeas.europa.eu/cfsp/sanctions/index_en.htm.
22. For more on intellectual property rights in the EU, see http://europa.eu/legislation_summaries/internal_market/businesses/intellectual_property/index_en.htm.
23. For more on export controls in the EU, see http://ec.europa.eu/trade/import-and-export-rules/export-from-eu/dual-use-controls/.
24. Such as the UK Bribery Act: https://www.gov.uk/anti-bribery-policy.
25. For more on data protection in the EU, see http://ec.europa.eu/justice/data-protection/.

OUTLOOK

> “The most important driver of past outbound investment activity was the rapid change in China’s domestic economy that increased the incentives for firms to invest overseas.”

Despite new heights in 2014, Chinese FDI in Europe is far from peaking, as commercial and political realities support a positive outlook for coming years. The most important driver of past outbound investment activity was the rapid change in China's domestic economy that increased the incentives for companies to invest overseas. While China has made progress in adjusting its growth model in recent years, the most profound reforms are yet to come. At the Third Plenum meetings in November 2013, China's leadership announced a far-reaching reform package that, if implemented, would accelerate the transition to a consumption, service, and innovation-driven economy.[26] These new realities will amplify the interest of Chinese companies in advanced economy assets including technology, brands, and human talent. Financial sector reforms will further catalyze the modernization of institutional investors, sustaining the trend towards international diversification of their portfolios.

The second factor in China's OFDI expansion since the mid-2000s has been a loosening of government restrictions on FDI outflows under its "going global" policy. Recent developments suggest that government policy will remain supportive of outflows through the FDI channel. While overseas investments by Chinese households remain tightly controlled, restrictions on outward FDI by companies have been reduced significantly in recent years and reforms have further accelerated since 2013. In December 2013, the State Council issued a notice following which its ministries lowered the approval thresholds and introduced a "recordal-only" system, resulting in new rules that only require approval by the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) for transactions above a certain size or in sensitive sectors and countries.[27] In December 2014, the State Council announced further liberalization, mandating NDRC and MOFCOM to broaden the "recordal" system and limiting the approval requirement to outbound investment in sensitive sectors and regions.[28] NDRC and MOFCOM have yet to issue regulations to implement the latest relaxation. The State Council also intensified efforts to codify rules, streamline administrative procedures, and spell out documentation requirements, which should help minimize bureaucratic leeway in the OFDI registration process.[29]

In short, in the absence of a macroeconomic crisis involving large-scale capital flight, policy liberalization will remain a net positive for outbound FDI in the coming years, particularly if current implementation problems are addressed.

While these structural factors suggest that Chinese investment in the EU has pleny of room to grow further, the long-term outlook depends on Europe's economic performance compared to its advanced economy peers. The volatility of recent years has provided a window of opportunity for Chinese investors to get a foothold in Europe, but the prospect of a prolonged economic malaise will discourage companies from making productive investments that enhance Europe's long-term prosperity. After a temporary stabilization phase, the 2015 outlook remains mixed and Europe is losing ground compared to other advanced economies, such as the United States. Some are even warning of a "lost decade" of structurally low growth. Chinese investors will only continue to flock to Europe to build productive businesses (rather than to profit from short-term fire sales) if European leaders can address structural problems and revive long-term growth prospects.

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26. For a detailed assessment of China's Third Plenum reforms, see Rosen (2014).
27. For the December 2013 State Council directive, see http://www.gov.cn/zwgk/2013-12/13/content_2547379.htm. See NDRC's liberalization measure (http://www.ndrc.gov.cn/fzgggz/wzly/zcfg/wzzcjwtz/201404/W020140410574664082783.pdf) and MOFCOM's liberalization measure (http://www.mofcom.gov.cn/article/b/c/201409/20140900723361.shtml).
28. See "Announcement of the State Council Releasing the 2014 Catalog of Investment Projects Subject to Governmental Approvals", State Council, November 18 2014, http://www.gov.cn/zhengce/content/2014-11/18/content_9219.htm.
29. See State Council comments on streamlining administrative procedures: "Li Keqiang holds State Council Regular Meeting", State Council, January 7, 2015, http://www.gov.cn/guowuyuan/2015-01/07/content_2801882.htm.

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DATA APPENDIX

This report is based on a dataset on Chinese acquisitions and greenfield projects in Europe provided by Rhodium Group (RHG). The following pages summarize RHG's interpretation of existing sources for measuring global FDI flows, known limitations of official data, specific problems with Chinese outbound FDI, and the nature and limitations of the dataset used for this report.

GLOBAL CAPITAL FLOWS AND FDI

In national accounting statistics, cross border investment flows are commonly separated into five categories: direct investment, portfolio investment, derivatives, other investment, and reserves.[30] By definition, direct investment entails cross border capital flows that achieve significant influence over the management of an invested entity and a long-term investment relationship. The common threshold for a direct investment is 10% of voting shares. Portfolio investment refers to a typically shorter-term investment in liquid securities that constitutes no control. For example, holdings of equity shares with less than 10% of voting rights or corporate debt instruments. Derivatives refer to financial instruments such as swaps, futures, and options, which are only contractually related to the underlying value of real assets such as companies or commodities.[31] Other investment entails all flows that do not fall into the previous categories, such as foreign bank deposits, currency holdings, cross border loans, or trade credits. Finally, reserves are highly liquid instruments held by governments or central banks in the form of gold, foreign exchange, or special drawing rights at the International Monetary Fund (IMF).[32]

Foreign direct investment flows can include three components: equity investment, reinvested earnings, and other capital flows. A direct investment

30. See IMF (2013).The IMF definitions are also used by other international organizations such as OECD and UNCTAD.
31. The new category of derivatives was introduced in the latest IMF "Balance of Payments and International Investment Position Manual", see IMF (2009).
32. See IMF (2009).

relationship usually starts with an equity injection into an overseas company, either for the establishment of a new overseas subsidiary (greenfield investments) or the acquisition of a significant stake, greater than 10%, in an existing company (mergers and acquisitions). All subsequent capital flows between the parent company and the foreign subsidiary are counted as direct investment, including profits that are reinvested in the subsidiary (reinvested earnings) and other capital flows between the two companies (such as intercompany debt).[33]

AVAILABLE DATA SOURCES FOR GLOBAL FDI FLOWS

A range of different measures and sources are available for tracking global FDI flows. Most countries compile balance of payments (BOP) statistics that include information on annual inflows and outflows, for each type of cross border investment and related income flows. The corresponding numbers for the inward and outward stock of each category – the accumulated flows adjusted for exchange rate and valuation changes – are recorded in countries' international investment position statistics. The IMF uses these figures, as reported by its member states, to compile global financial statistics.

In addition to national accounting statistics that capture aggregate flows with the rest of the world based on IMF standard definitions, many countries publish additional datasets that provide a more disaggregated view of their investment relationships with other economies. Several international organizations, such as UNCTAD and OECD, also collect data on FDI and other cross border investment flows. However, those figures are mostly based on input by national governments and are not independent calculations.

KNOWN PROBLEMS WITH FDI DATA

Problems with the timeliness, accuracy, and international comparability of available measures for FDI are widely known.[34] One major problem is that statistical authorities have different capacities and experience in collecting information and processing data. Countries also use very different methodologies for collecting data, often lack the capacity to make relevant adjustments from historical to market value, and have a different pace of data processing from nation to nation.

Another problem is that the use of holding companies and offshore vehicles has increased tremendously in recent years. The extent of "round-tripping" (whereby companies route funds to themselves through countries or regions with generous tax policies and other incentives) and "trans-shipping" (whereby companies channel funds into a country to take advantage of favorable tax policies, only to reinvest those funds in a third country) make it increasingly difficult to track flows accurately. Those practices and complicated deal structures with "indirect" holdings also make it difficult for statistical agencies to correctly separate FDI from portfolio investment stakes.

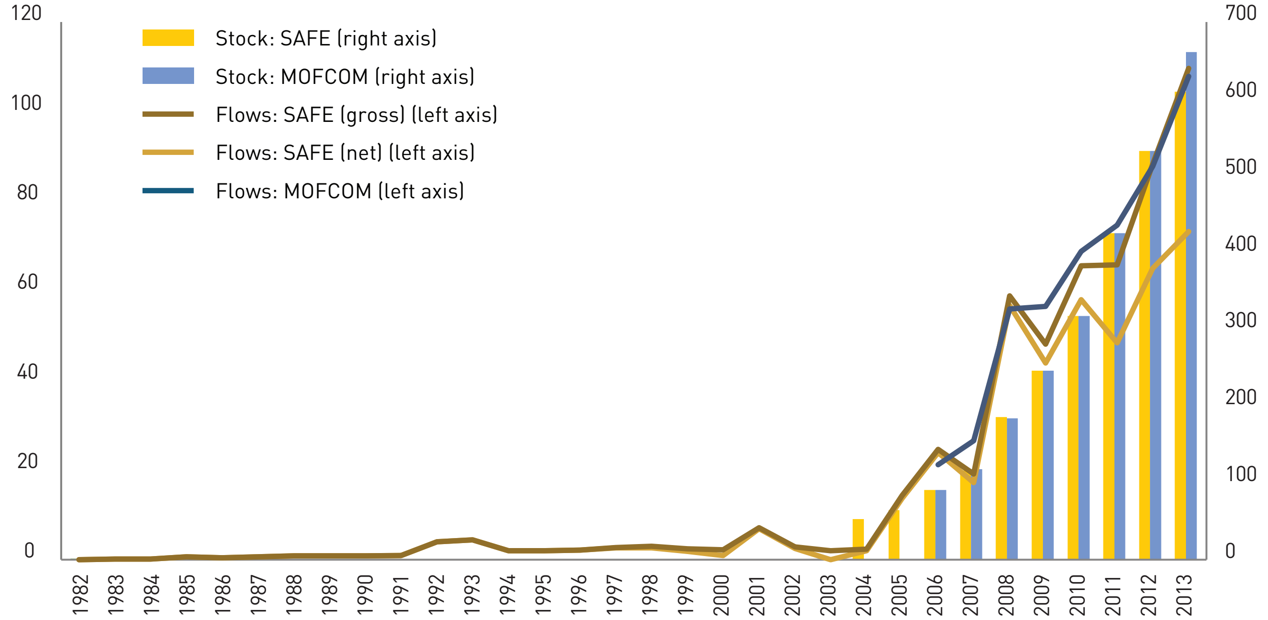
The result is that comprehensive international FDI statistics are usually published with a delay of 18 months or more. Data from home and host countries are inconsistent with each other, and global aggregate data on FDI assets and liabilities do not match. These problems make a holistic, real-time assessment of global FDI flows increasingly difficult and require analysts to find ways of working around existing gaps and distortions.

33. For detailed information on the nature of direct investment and its measurement, see OECD (2008).

34. For an overview, see UNCTAD (2005a).

FIGURE A-1: CHINESE OUTBOUND FDI, OFFICIAL CHINESE DATA, 1982-2013

USD bn



Sources: Ministry of Commerce; State Administration of Foreign Exchange/People's Bank of China.

CHALLENGES IN MEASURING CHINESE CAPITAL OUTFLOWS

Problems with collecting and disseminating FDI data are a global phenomenon, but they apply particularly to FDI flows to and from emerging economies. Local statistical offices often do not have the manpower or adequate training for collecting detailed and accurate data on FDI flows and the operations of transnational enterprises.[35] In addition, emerging economy investors often have additional incentives to use offshore holding companies because of capital controls, or a domestic institutional framework that does not meet the demands of multinational operations (for example availability of financial products to hedge against currency volatility or courts for international dispute settlement). The case of Chinese FDI statistics illustrates these problems.

In China, FDI statistics are compiled by two government agencies. SAFE, China's foreign exchange regulator under the People's Bank of China, is responsible for collecting and publishing FDI data used for China's balance of payments and international investment position statistics. In compiling such data, SAFE follows the principles outlined in the fifth edition of the IMF's *Balance of Payments Manual*.[36] SAFE's data are published on a quarterly and annual basis. The second government agency involved in FDI data compilation is MOFCOM, which publishes monthly data on outbound FDI by nonfinancial companies. MOFCOM also takes the lead in publishing an annual statistical bulletin on Chinese outbound FDI, in cooperation with SAFE and the National Bureau of Statistics, which provides detailed breakdowns of Chinese OFDI by country and industry.[37]

The first difficulty with China's system lies in understanding the

35. See UNCTAD (2005b).

36. See IMF (1993). IMF General Data Dissemination System (GDDS) on China is available at http://dsbb.imf.org/pages/gdds/ComprehensiveFwReport.aspx?ctycode=CHN&catcode=BPS00.

37. See Ministry of Commerce (2014).

roles of the two agencies and reconciling differences between their data. In recent years, China has streamlined its OFDI statistical system. Both agencies are now working with the same definition of FDI, as summarized in a statistical manual on outbound FDI that is updated every two years, though they are still responsible for different parts of data collection.[38] In theory, China's OFDI figures should be based on MOFCOM's outward FDI reporting system for nonfinancial companies, and SAFE data on OFDI by financial companies and reverse investment flows. In practice, however, the dual-agency system continues to complicate compilation and dissemination of China's OFDI data. The two agencies separately publish monthly, quarterly, and annual data on their respective parts and total FDI, showing significant discrepancies. Both agencies reconcile their stock figures during annual data revisions, but the discrepancies between annual flows still persist in some years (Figure A-1).

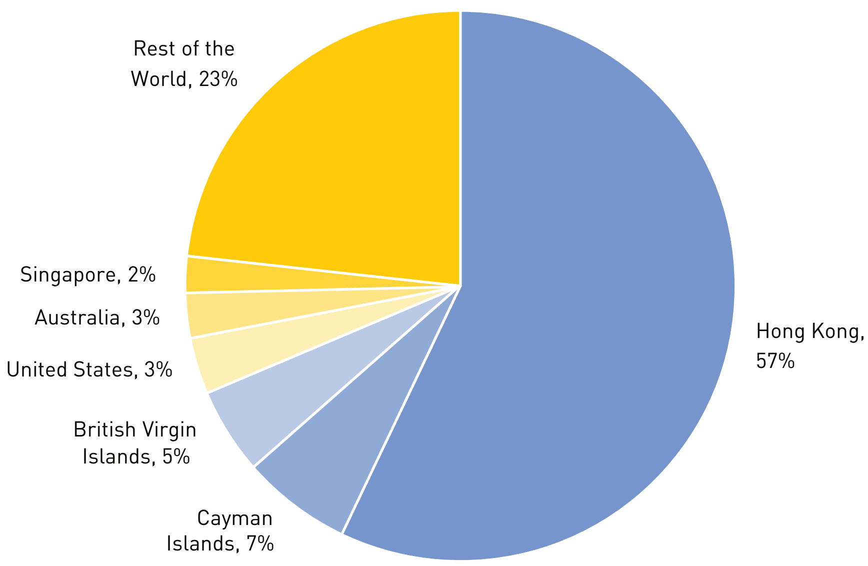
A second problem is that official Chinese FDI statistics are not suitable for an in-depth analysis of distribution by industry or country, because they do not accurately capture the final destination of outflows. The increasingly common use of offshore financial centers is a global trend, but Chinese companies have even greater incentives to use special offshore vehicles to structure their investments because ofexisting capital controls, and burdensome regulatory requirements for outbound investors.

While Chinese statistical agencies have made improvements to create more transparency, the current official data on the distribution of China's outbound FDI stock must be seen as an unreliable snapshot. According to MOFCOM, more than 70% of China's 2013 outbound FDI stock was registered in either Hong Kong or tax havens such as the Cayman Islands, British Virgin Islands, and Singapore (Figure A-2). Similar problems are apparent in MOFCOM's statistics on the industry distribution of China's OFDI stock, where "business services" is the biggest category (34% of total OFDI stock in 2011) and mining only accounts for 17% of the total – a stark contrast to observed deal patterns around the globe in the past decade.

Data from host countries can offer an alternative perspective on Chinese outbound investment, though these mirror data display similar problems and shortcomings. Since 2009, the IMF has run a new initiative

FIGURE A-2: CHINA'S OFDI STOCK BY COUNTRY, MOFCOM, 2013

Share (%) of total OFDI Stock



Source: Ministry of Commerce.

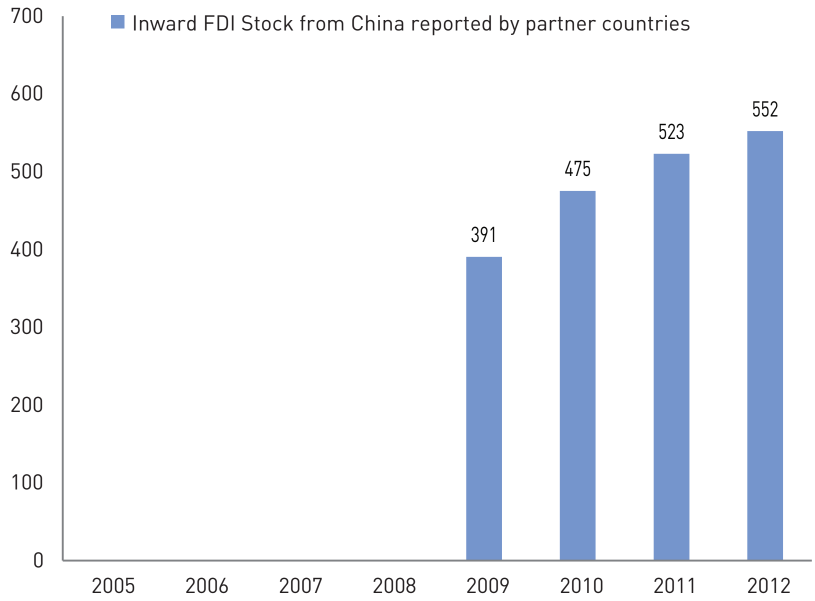
38. See Ministry of Commerce (2012).

to improve the quality and availability of global FDI data, the Coordinated Direct Investment Survey (CDIS).[39] One of the CDIS datasets presents mirror data for a country's outward FDI stock based on the inward FDI stock reported by partner economies. The resulting data hint that Chinese official data may be too low, with 82 countries in the CDIS survey reporting a stock of $552 billion at the end of 2012 (Figure A-3), compared to China's official OFDI stock of $532 billion for the world in the same year.

However, the CDIS data are not very useful for analyzing the patterns of China's global OFDI, as they are compiled according to direct counterpart economies and not ultimate beneficiary ownership. That means that Hong Kong and financial centers with favorable tax environments, such as Singapore and Luxembourg, again dominate the picture (Figure A-4). In short, mirror data offer a useful

FIGURE A-3: REPORTED INWARD FDI STOCK FROM CHINA, IMF CDIS, 2009-2012

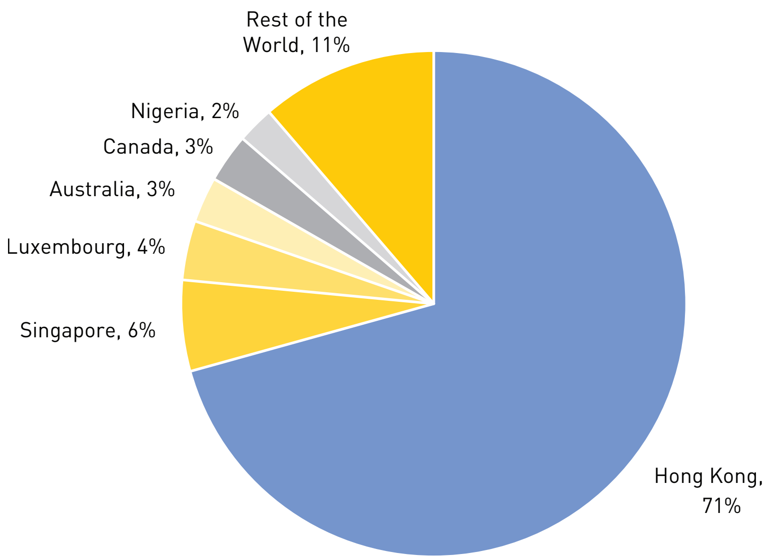
USD bn



Source: International Monetary Fund, Coordinated Direct Investment Survey.

FIGURE A-4: CHINA'S OFDI STOCK BY COUNTRY, IMF CDIS, 2012

Share (%) of total OFDI Stock



Source: International Monetary Fund, Coordinated Direct Investment Survey.

39. CDIS is available at http://cdis.imf.org/, accessed February 17, 2014.

additional perspective, but unless host countries present data on an ultimate beneficiary ownership principle, these data do not help to better understand the global distribution of Chinese OFDI.

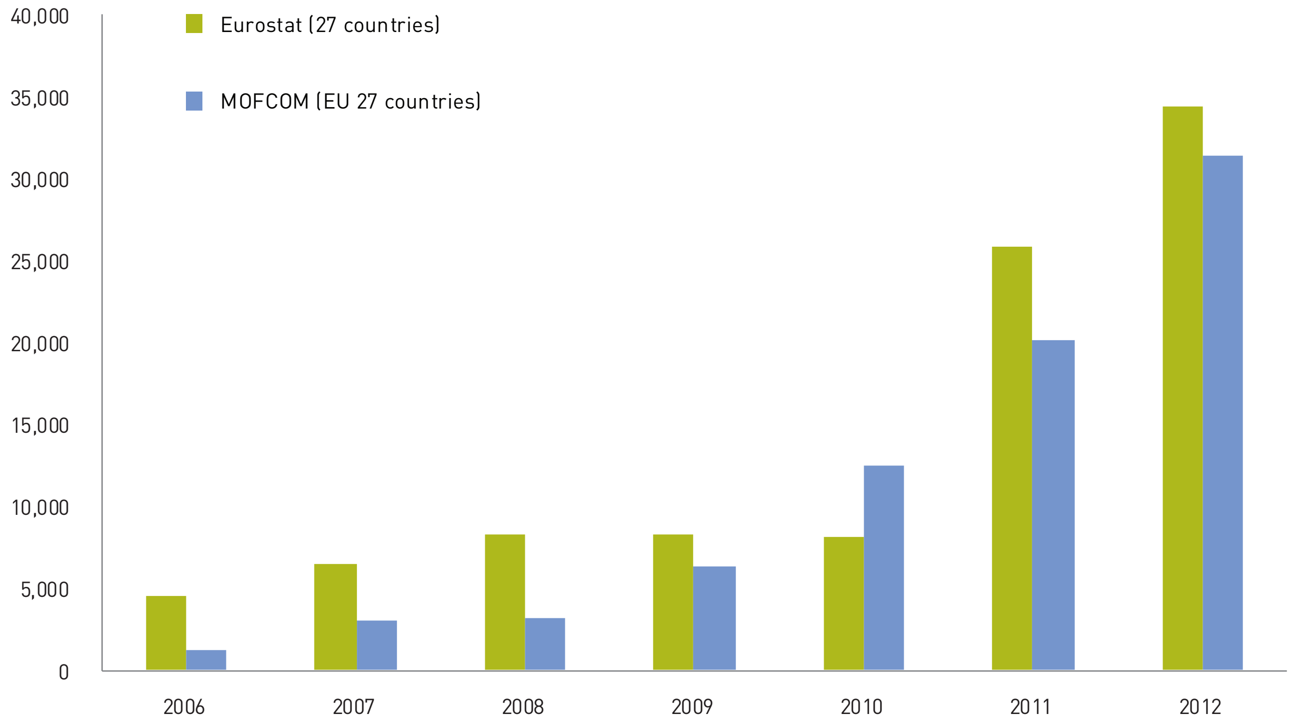
OFFICIAL STATISTICS ON EU-CHINA FDI

A comparison of official statistics from Eurostat and MOFCOM illustrates the difficulties discussed in the context of Chinese outbound FDI in the EU.

Eurostat and MOFCOM data show China as an emerging investor in the EU, but both sets of data areoutdated and does not match up. As of November 2014, the latest available data points are more than two years old (2012). For that year, Eurostat recorded USD 9.8 billion of FDI inflows from China, whereas MOFCOM's figure is USD 6.12 billion. Total stock data from Eurostat show that FDI from China was USD 34.4 billion, compared to USD 31.4 billion from MOFCOM (Figure A-5).

It is important to note that this discrepancy is not necessarily only related to problems with Chinese statistics, but also to a sub-optimal data regime on the European side. While Eurostat has recently adjusted its data and significantly revised earlier figures on Chinese FDI stock in the EU, pan-European data collection is still problematic. There is significant variance in the scope and quality of statistical data compilation across European countries and some countries still employ methodologies that vary significantly from international standards. Important data points (such as FDI based on ultimate beneficiary ownership) are not available from all countries (particularly smaller economies in Southern and Eastern Europe), so they need to be estimated. Additionally, official statistics repress information for confidentiality reasons and often lack important metrics such as distribution by industry and country; ownership of the ultimate beneficiary investor; or operational characteristics such as assets, revenue, or jobs created.

FIGURE A-5: CHINA'S OFDI STOCK IN EUROPE, EUROSTAT VS. MOFCOM DATA.
USD mn



Source: Eurostat, Ministry of Commerce. *Figures in Euro are converted into USD using annual average exchange rate.

ALTERNATIVE APPROACHES AND DATASETS TO MEASURE CHINESE FDI

Given the problems with quality, accuracy, and timeliness, official data from both China and recipient countries are not sufficient for an in-depth, real-time analysis of Chinese investment patterns. This is particularly true for policy research, which requires timely information for decision makers. Therefore, researchers at think tanks, academic institutions, and consultancies have come up with alternative solutions to address those shortcomings and further improve the transparency of China's global investments. Most of those alternative datasets are based on a bottom-up approach of collecting data on individual transactions or companies.

The most important datasets that cover Chinese investments in Europe are the Heritage Foundation's China Investment Tracker, which tracks global nonbond investments with a value of $100 million or more[40]; the ChinaObs fdiMonitor, a non-public database on Chinese FDI compiled by TAC consulting for the EU Commission[41]; the Antwerp Management School's Euro-China Investment Report, which is compiled based on company databases[42]; Ernst & Young's EU Investment Monitor, which is largely focused on greenfield projects;[43] and Rhodium Group's China Investment Monitor datasets, covering Chinese FDI transactions in the United States and Europe[44].

Rhodium Group's dataset is used for this report, as it provides the most comprehensive and detailed picture of Chinese direct investment transactions in Europe since 2000. Data are compiled from a transactional approach, which relies on the aggregation of relevant Chinese business establishments and expansions into a headline figure. Relevant transactions are defined as investments by mainland Chinese companies in Europe that qualify as direct investment under common international definitions; that is, greenfield projects or acquisitions of stakes in existing companies that exceed the FDI threshold of 10%.

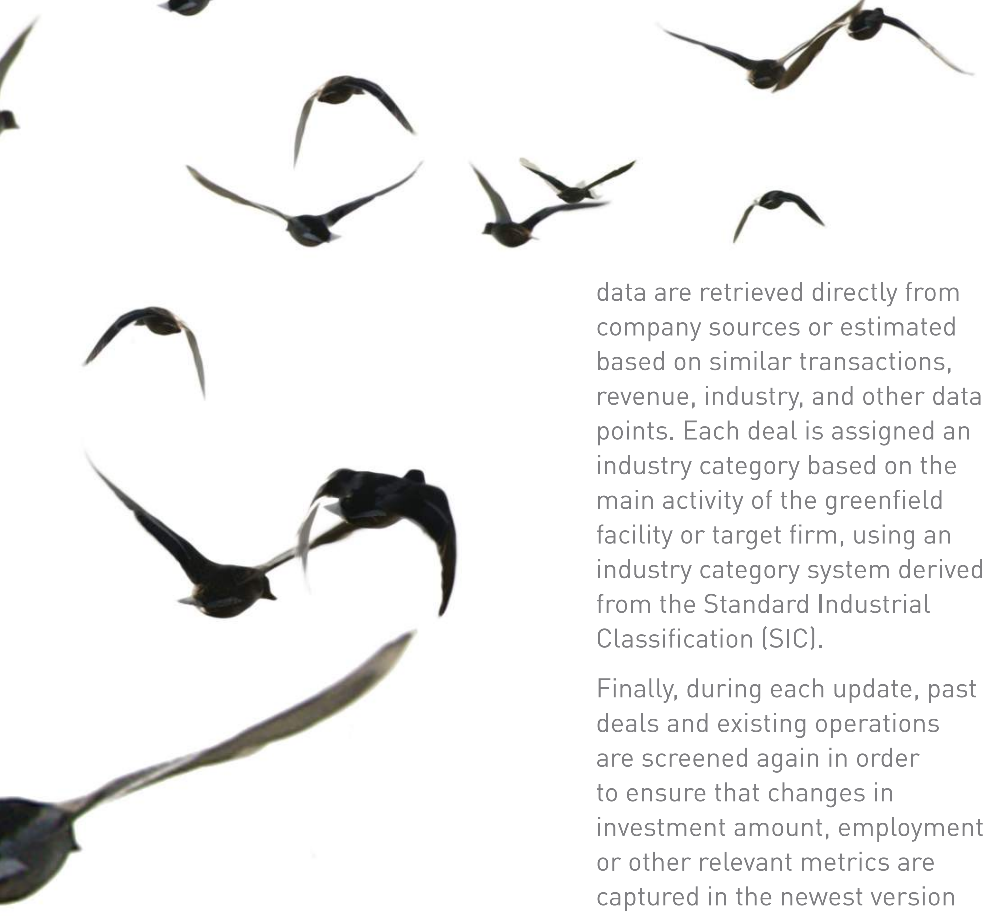
The RHG dataset is compiled through several steps:

First, raw data on outbound investments by ultimately Chinese-owned companies in the European Union are collected. The data mining relies on a wide range of channels, including commercial databases, online search algorithms, media reports, regulatory filings, company reports, industry associations, official sources, investment promotion agencies, industry contacts, and other sources. The minimum value for individual deals included in the database is $1 million.

Second, completed deals that formally qualify as direct investment (following the generally accepted threshold of 10% of equity or voting shares) are identified and detailed information on each investment

is collected. Pending and withdrawn deals are excluded. Acquisitions are added to the list at the date of their completion; greenfield projects are added at the date construction commences (i.e., if there is clear evidence that they have broken ground). Greenfield projects that stretch over multiple years are logged incrementally over the entire period of time, where the actual amount invested during a specific time is logged for that quarter rather than the total investment all logged at the commencement date. For transport and logistics contracts, only the portion of investment that goes into building physical assets in the target economy is recorded. The deal values

40. China Global Investment Tracker, http://www.heritage.org/research/projects/china-global-investment-tracker-interactive-map.
41. ChinaObs fdiMonitor, http://www.chinaobs.eu/.
42. The Euro-China Investment Report 2013-2014, http://www.antwerpmanagementschool.be/en/faculty-research/research-projects/euro-china-investment-report-2013-2014.
43. European Investment Monitor, http://www.eyeim.com/.
44. China Investment Monitor, http://rhg.com/interactive/china-investment-monitor.



are added based on either the officially announced investment volume or estimated value, based on variables such as the number of employees, annual revenue, or the value of similar projects. Reported transaction values in local currency are converted to USD using the average exchange rate in the year of deal completion. The values for M&A transactions include equity investment as well as debt assumption.

Third, each FDI transaction is coded with additional variables such as employment, geographic location, and ownership of investing company. To qualify as a private enterprise, a company must be at least 80% owned by private investors. Employment data are retrieved directly from company sources or estimated based on similar transactions, revenue, industry, and other data points. Each deal is assigned an industry category based on the main activity of the greenfield facility or target firm, using an industry category system derived from the Standard Industrial Classification (SIC).

Finally, during each update, past deals and existing operations are screened again in order to ensure that changes in investment amount, employment, or other relevant metrics are captured in the newest version of the database. Therefore, the data are never final, but instead subject to constant updates.

By recording investment flows from an establishment perspective several problems are avoided, most importantly the significant time lags and distortions resulting from extensive use of pass-through locations. Thus, the dataset is useful for a real-time assessment of aggregate investment patterns, as well as the distribution of those investments by industry, modes of entry, geographical spread, and ownership. However, there are important caveats in using the dataset. Most importantly, data resulting from a transaction-based approach are not directly comparable to FDI statistics compiled according to balance of payments principles.[45] As such, it cannot be used to analyze balance of payments-related problems and other issues associated with the national accounting framework.

The combined annual value of FDI transactions in the RHG dataset is generally higher than annual flows from official statistics for a few reasons. First, transactions data has more detailed coverage as it can trace investments back to the ultimate beneficiary owner, whereas BOP data largely misses investments routed through Hong Kong and other offshore financial centers. Second, definitions and accounting used for the RHG dataset slightly differ from BOP principles. The most important distinction is that the RHG dataset counts the full value for M&A transactions (including assumed debt, without separating overseas from local funding sources). The RHG data also does not account for reverse flows back to China through, for example, intracompany transactions or divestures. There may also be differences in counting transactions that are at the edge of portfolio and direct investment flows, such as commercial real estate transactions, non-operating stakes in extractive industries, and expenses related to long-term port leases, air transportation and infrastructure projects.

45. For more information, see the IMF (2009).

About CICC

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