



Oh Dragon, Where Art

Chinese investments in emerging Europe pose in official statistics, yet Chinese businessmen parks across the region. They are looking for very over which even the Chinese government has little

By Armin Haeberle

In Hong Kong, there is a famous hotel with a large hole right in the middle of the building. It was included to allow the dragon that is said to be living in the hill behind the hotel to fly freely without being disturbed by the construction. Expectant tourists will not be able to see the dragon, but people know it is there.

The same can be said for Chinese investments in emerging Europe. They seem to be omnipresent and elusive at the same time. “The statistics of Chinese investments in emerging Europe are almost negligibly small,” says Gabor Hunya, an economist at the Vienna Institute for International Economic Studies (WIIW) with a focus on foreign direct investment (FDI). Of the largest greenfield investments in all of central and eastern Europe over the last few years, he adds, no more than six have been undertaken by investors from China. In Poland, for example, the EUR 237 million Chinese FDI stocks recorded by Euro-

stat, the statistical office of the European Commission, represent only 0.2 per cent of total FDI stock.

Yet statistics tell only part of the story. People active in business in the region have a very different perception. “They are in every country,” says Paulo Correa, lead economist at the Private and Financial Sector Development Department of the World Bank’s regional group. Compared to just a few years ago, he says, you can see how Chinese investors are busily scanning emerging European markets for business opportunities.

Treading cautiously

So are they there or not? The puzzle can be resolved when looking closer at the structure of Chinese investments in the region. In Romania, for example, “China ranks number five in the list of the top FDI countries by number of companies,” says Alexandru Arsene from the Romanian

Centre for Trade and Investment. “But it only ranks number 16 in terms of subscribed capital.” That means Chinese investors are very active, but also very small. Hungary is home to a diaspora of more than 40,000 people of Chinese origin, but bigger companies have only recently started to invest. “With western FDI you usually see big companies taking the lead in tapping new markets and small firms following later on,” says Waltraut Urban, a WIIW economist focusing on China and on Asian development patterns. “With China, you often find that small firms venture abroad first, and big ones follow slowly behind,” she says.

In particular, Chinese firms are still extremely cautious. Wanxiang, China’s largest car-parts supplier, is an excellent example. With annual revenues of more than USD 10 billion (EUR 8.3bn) and 30,000 employees, it considers itself China’s second largest private company. Still, all decisions are taken by the company’s innermost family circle. This also means

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that “our company treads extremely carefully and actually has already turned away a number of investment opportunities because they just didn’t seem 100 per cent right,” says Mark Woock, Wanxiang’s European representative.

The Chinese government has been trying to change this for some time now. In 2001, it introduced a “Go Abroad” policy to encourage firms to internationalise. The results for the first couple of years, however, were nothing to write home about. It only really picked up in 2008, with Chinese companies increasingly developing the technologies and skills to actually succeed abroad, financed with help from state-backed banks. In Africa and Latin America, Chinese companies have been going in with billions of dollars to gain control over natural resources and food supplies. In Europe, they are much less prominent because the task is not to dominate, but to learn. “They come here for the much more sophisticated regulatory and business environment in terms

of technologies, management know-how, customer expectations and employee skills compared to what they find at home,” says Qinghua Xu-Pionchon, partner in charge of Chinese overseas investment services for Europe, Middle East, India and Africa (EMEIA) at Ernst & Young.

Hence, unspectacular as the FDI projects in emerging Europe might be in terms of volume, they play an important role in China’s economic development. In this respect, emerging Europe is the perfect incubator for learning how to compete under free-market conditions while keeping labour costs low and benefitting from spill-over effects in clusters dominated by western firms. For example, Jianghuai Automobile Company is reportedly planning to set up a car plant in Slovakia, next-door to western car manufacturers like Volkswagen or Peugeot Citroen, while Great Wall Motor recently signed a deal with Litex Motor in Bulgaria to manu-

facture low-cost sports cars. Shantuo Agricultural Machinery Equipment plans to open a tractor plant in Romania, and Luoayang Float Glass Group is set to invest EUR 80 million in a flat glass plant in Razgrad, Bulgaria.

While knowledge and skills are good reasons to invest, market access comes a close second. Facilities set up by Chinese investors in eastern Europe are generally designed “to supply western European markets,” says Julia Cox, operations director at Oxford Intelligence, an FDI research group. And showcase projects are to open the doors of potentially more sceptical clients in the west. One area where this works particularly well is at large scale infrastructure deals. China Overseas Engineering Group is part of a consortium that will build a new segment of the A-2 highway in Poland. Shanghai Construction Group (SCG) is interested in building >>

■ Small numbers (Foreign Direct Investment Stock in Europe, in EUR million)

From China to ...	2002	2003	2004	2005	2006	2007	2008
Bulgaria	n.a.	1	1	1	4	5	6
Czech Republic	1	0	1	3	25	79	56
Hungary	n.a.	12	19	19	18	23	20
Poland	11	23	17	55	73	138	238
Romania	n.a.	199	88	86	54	72	59
Slovenia	0	0	0	0	0	0	0
Slovakia	0	0	0	0	0	4	12
Croatia	0	n.a.	n.a.	n.a.	0	0	1
Turkey	0	1	0	3	0	1	1
Germany (for comparison)	153	156	191	235	328	370	406

Source: Eurostat

roads in Slovakia. In Belgrade, Chinese construction companies are to build a much-needed bridge across the Danube. And power plant projects are being discussed, or already underway, from Rovinari in Romania to Pozarevac in Serbia.

What makes these deals particularly attractive to governments in emerging Europe is that funding is not an issue. For Belgrade's bridge, for example, the necessary credit will come from China's Export-Import Bank at 3 per cent interest for 15 years – far cheaper than what Serbia could get from financial markets. With the Chinese as primary contractors, Poland's A-2 highway section now comes in at 40 per cent cheaper than the price estimated by the government, partly because the contractors are awash with cash and do not have to finance the project through credit. Slovakia is hoping for a similar effect. Reportedly, the government is keen on having SCG build their highways, because the company is able to secure the necessary finance all by itself.

Hopes, fears – and reality

With such practices both hopes and fears come along. Many governments hope that Chinese investors will substitute for the losses of capital inflows from the west. Companies, on the other hand, fear that cheap funding will give Chinese companies an unfair competitive edge. Companies in the construction sector are already alert. This also spreads to other sectors.

One of the first examples of unusually aggressive Chinese investors in the region

was the battle over Hungarian chemicals company BorsodChem. Wanhua Industrial Group originally wanted to buy equity in BorsodChem, but the private equity owners VCP Capital Partners and Permira declined the bid. The Chinese then bought a major chunk of BorsodChem's distressed debt and thus forced the private equity firms to negotiate a debt/equity-swap through which Wanhua now has become a minority owner and is likely to buy BorsodChem entirely within the next two years. The involved parties declined to comment on the case, but with distressed debt rising in the wake of the crisis, this could become a blueprint for many similar cases. With extra-cheap funding, the fear goes, Chinese buyers could out-bid almost everyone in M&A deals.

But things are not so simple. "To some degree, you may speak of indirect subsidies through abundant and relatively less expensive funding," says Ms Xu-Pionchon, "but even Chinese state-owned banks are commercial enterprises today. They still want to earn a healthy profit and will not fund just any company." Also, in day-to-day practices, things easily get complicated. Prior to February, any overseas investment over USD 30 million required quite stringent multi-federal government approvals. This slowed down or even choked off a lot of mid-cap investments.

In February, the Chinese government has, therefore, promulgated new rules to further facilitate and help accelerate Chinese companies going global. "The approval threshold has been raised to USD 100 million," says Ms Xu-Pionchon.

"This means that today any investment from USD 10 million up to USD 100 million will only need the local provincial government's approval which usually takes less than 15 working days. Any investment below USD 10 million is subject to a new fast track approval procedure of just three working days."

These administrative improvements notwithstanding, the case of Wanxiang shows that Chinese companies will not invest just because of some lofty governmental talk or the promise of cheap finance. And finally, many Chinese investors encouraged to come to Europe arrive here poorly prepared. In some cases, regional governments seem to ship potential "investors" to Europe simply to meet plan targets set under the "Go Abroad" policy. Once here, it is clear from the start that the companies are too small or too inexperienced to seriously consider setting up abroad.

Hence, neither the hopes nor the fears represent the complete picture. Even if you increasingly stumble over Chinese businessmen in hotel lobbies and business parks, they will not come in and buy up entire sectors. Unfortunately, they will also not be able to readily substitute for the loss of western FDI. At the same time, they are clearly becoming more active and will continue doing so even if much of this is happening on a scale too small to produce global headlines. Just like the dragon in the hills of Hong Kong, you might not see it right away, but you would do well to acknowledge it is there. ||

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