

**What motivates German companies to agree to be sold to Chinese investors?**

**The case of Chinese acquisitions in the German automotive sector.**

## ABSTRACT

The present study focuses on the recent acquisitions by Chinese firms of German companies operating in the automotive sector. While the extant literature looks at motivations and driving forces behind Chinese outward foreign direct investment, this study focuses on the motivations of the acquired firms in agreeing to be sold to Chinese buyers.

The study looks at five takeovers by Chinese companies of renowned German automotive suppliers that have taken place between 2011 and 2012. The analysis is based on archival information and on interviews conducted with the two German firms that, among those acquired, proactively went to China to look for a Chinese buyer, despite offer received from automotive supplier from developed countries.

The study proposes that one important motivation is the ability of the acquired firm to maintain its identity and its autonomy post-acquisition due to an information asymmetry generated by the innovation capability of the target firm and the need of technological capability building of the acquirer. Additionally, it suggests that the possibility to expand into the Chinese market and simultaneously to offer own distribution channels to the acquirer firm, is another important motivation of the acquired firm. The access to capital in current credit-constrained times, also contribute to support the decision of German companies to be bought by Chinese firms.

The policy implications are relevant, because in the current particular situation where many companies in Germany struggle to survive the current economic downturn and turn for sources of capital to emerging market firms, China investors can facilitate German companies growth, with a positive impact for the local economy.

*Keywords: M&A, automotive industry, China, Germany*

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# **What motivates German companies to agree to be sold to Chinese investors? The case of Chinese acquisitions in the German automotive sector.**

## **1. INTRODUCTION**

Recent years have witnessed a significant growth in outward foreign direct investments by emerging market firms (Buckley et al. 2007, Deng, 2007) with emerging multinationals showing a frequent interest in acquisitions (UNCTAD, 2006), especially when investing in developed economies (Makino et al., 2002, Mathews, 2002). China has the largest FDI outflow among emerging economies since the 1990s; in 2011 China's outwards FDI net flows reached a record level of US\$ 74.65 billion, increasing by 8,5% compared to the year before (MOFCOM, 2011).

Nearly half of Chinese outward FDI is via mergers and acquisitions. The motivation of cross-border acquisition by Chinese firms in developed economies has been subject of analysis in the literature (Deng, 2004, 2007, 2009; Rui & Yip, 2008, Wang, et al., 2012). Less understood, however, is the motivation on the side of the target industrialized company. This aspect is relevant because the willingness of advanced market MNEs to sell or share their strategic business units, technology, brands or other assets makes it possible for the sharp increase in international acquisition by emerging markets multinational (Luo & Tung, 2007). In general being acquired by another firm tends to be positive for the target company (Tuch & O'Sullivan, 2007) as acquirers tend to pay a premium over the current evaluation of the firm and new managers with more creative ideas can replace old ones. The acquisition by a company from an emerging economy however, generates controversial reactions.

The concern arises if the competitive capabilities received by the target firm may be less useful to a target firm than the capabilities received if it would be acquired from an advanced

economy firm (Chen & Cuervo-Cazurra, 2012) . Additionally, a threat may occur if subsidiaries of emerging market multinationals acquire sensitive technology in the host country. Ramamurti (2012) warns that western firms tend to underestimate the competitive advantages emerging MNE use to win at home and abroad.

Finally, increase Chinese penetration into European markets is instilling some fears among government and publics alike, although the influence of Chinese capital has been encouraged by cash-strapped European governments burdened by the sovereign debt crisis in the Eurozone. Indeed, the political leverage that home governments may exercise on their internationalizing firms arises the question whether emerging market MNEs are regular economic agents or tools of foreign policy of home governments (Filippov, 2012).

The paper studies the acquisition of German firms by Chinese companies in the context of the auto components industry. The automotive industry presents an appropriate context for the study because the technological sophistication and mature market of the industry induce competition in any new market (Kumaraswam et al., 2012) and OEM expect suppliers to lead the innovation, design, development, and scale-up of advanced technologies for global platforms. China is the world's largest assembly market; vehicle production in China is expected to double during the next five to 7 years, despite a slowdown in early 2012 (PwC, 2012). The Chinese government is encouraging the overall growth of an indigenous industry also through M&A (Chu, 2011) and German companies, due to their innovative capabilities, represent a preferred target for Chinese auto-parts manufacturers.

The Chinese interest is focused on companies that are well positioned in established industrial countries and on suppliers with strong technologies (PwC, 2012). Especially small and mid-sized companies, which make up the bulk of the German automotive supplier industry fit well into the Chinese M&A focus.

The year 2011 has witnessed five takeovers by Chinese companies of renowned German automotive suppliers. If the rationale from the buyer's perspective is clear, why would a German entrepreneur want to sell his or her business to an emerging country multinational? What motivates developed countries multinationals in finding buyer companies from emerging markets that are imprinted with very different institutional configurations, business models, belief systems and stakeholder relationships (Cheung & Qian, 2009) ?

Knoerich (2010:181) has been posing that question looking at Chinese acquisition of German companies in the machine tool industry, that were carried out in the first wave of Chinese investment in Germany, in 2004. His results show that the Chinese firm's strategic approach and the nature of the cooperation between the two firms instilled in the acquired managers a sense of control and security, which increased confidence on the seller's idea about engaging in a deal with a Chinese acquirer. More specifically the author found that German companies sell to the Chinese firms in pursuance of specific goals: an extra boost of funding for future firm development and innovation, entry into the Chinese market, and expansion into lower-end market segments.

The presents study wants to build on that previous work and look at the second wave of acquisitions of German companies, initiated in 2010 and mostly focused on energy sector and automotive industry. The second wave of M&A has some peculiarities:

- 1) The deals are bigger and Chinese companies are accepting to pay premium price to acquire German suppliers;

- 2) Target companies are financially healthy companies, some of them have just completed a process of restructuring and are owned by financial investors. Chinese firms' focus is no longer only on crippled suppliers, but in the kind of companies that can help the investors from China reinforce their technical competitiveness in order to capture new markets

3). In many cases it is the target German firm that looks proactively for Chinese strategic investors interested in buying the company. As one of the interviewed companies said “we did the seeking, we were not found”

4) The acquisitions received the approval of the German OEM. In the automotive industry, characterized by a producer-driven value chain, supplier companies tend to be under a high pressure from OEMs.. If suppliers are key for the OEMs, an acquisition by Chinese buyers will also have to find the agreement of the OEMs. Until very recently German OEMs have put a veto on the sale of one of their suppliers to the Chinese buyers (von Kienlin, 2012), now they are welcome. Yet, what is reinsuring both first tiers suppliers and OEMs that being bought by a Chinese company is more an opportunity to grow than a threat to loose technological advantage in the long term?

5) For Chinese companies, investing abroad is not only a business decision but also a policy exhortation by the Government to “go out”. Since 2000, China has encouraged its companies to develop operations overseas with preferential long-term government loans in order to “go global”. The 12<sup>th</sup> Five-Year plan (2011-2015) has reaffirmed this objective, particularly in industries like the automotive, while streamlining and shortening the process for Chinese companies to invest overseas.

The remainder of the paper is organized as follows. First, it offers a description of the Chinese auto industry and elaborate on the role of the Government in the development of the industry and the importance of the Chinese market for the Germany automotive industry. Next, it theorizes on the motivations of German firms partnering with Chinese investors and presents the finding of the empirical research. Finally it concludes and discusses implications.

## **2. CHINESE AUTO PARTS INDUSTRY**

The automotive industry is one of the most dynamic sectors worldwide in terms of international reorganization of the production (Amighini, 2011). The Chinese auto industry has rapidly and massively internationalized in recent years compared to other emerging economies. In January 2009 China became for the first time the world's biggest auto-market with auto sales reaching 13,64 million. Despite the global slump, China maintained the leadership also in 2011 with auto sales of 18,5 million units (China Association of Automobile Manufacturers, CAAM). The share of foreign manufacturers in the car production in China was around 55% in 2011. GM and VW are by far the leading vendors, each commanding 12,4% and 10,4%, respectively, of the Chinese market, which is also their biggest market, in terms of numbers of car sold, in their respective global portfolio (Chu, 2011). All foreign OEM operate through joint ventures with local producers<sup>i</sup>. Among the more than 100 Chinese car manufacturers, the Big 4 Chinese automakers are SAIC, FAW Group, Chang'an Motors and Dongfeng Motor.

Although the country now produces around one-seventh of the world vehicles – with its passenger car production ranking second to Japan and in commercial vehicles output second only to USA, its auto-parts industry remains relatively small (KPMG, 2009). By value, the sector equals just one-twentieth of the world total. Indeed, while China has established itself as a global automotive giant in terms of output by units, many of the goods produced by its parts industry are at a relatively low level of the value chain.

The number of auto-parts companies registered with the Chinese government rose from 4,205 in 2002 to 10,331 in 2008 and they employed about 1,9 million people. About 15,000 non-registered automotive-component manufacturers also appear to exist in China (Haley, 2012). These non-registered companies include captive operations of diversified groups whose main

products are not auto-parts; small aftermarket-equipment manufacturers; or small companies supplying parts for the commercial vehicle, agricultural, and off-highway sectors.

Foreign companies account for only about 23% of all auto-parts companies in China, however, they constitute seven of the 10 largest auto-parts companies in China, as measured by the number of plants. The three Chinese companies among the biggest auto-parts suppliers represent the auto-parts arms of the country's leading (government-owned) vehicle makers, SAIC, First Auto Works (FAW) and Dongfeng Motor.

Since 2004 the Government has allowed 100% foreign ownership of auto-parts companies. Yet, direct and indirect Chinese government ownership or influence remains prevalent. Many of the large auto-parts companies have affiliations with large vehicle-assembly groups that local government partly own. Other unaffiliated auto-parts companies benefit from government ownership directly. Most foreign auto-parts companies have entered China through JVs with local and regional governments, thereby securing access to government equity capital as well as near-guaranteed access to preferential bank loans.

In 2010<sup>ii</sup> Chinese imports of auto-parts approximated \$43,86 billion, an increase of 162% from \$16.7 billion in 2005. Most auto-parts imports consisted of higher-end systems and components to incorporate into Sino-foreign vehicle makers' autos. Japan, accounts for about half of the total imports, and Germany for about one-quarter, reflecting the role of Volkswagen in the mass market and BMW and Mercedes in the luxury market.

#### China's governmental support to the automotive industry

The Government plays a central role in the economic development policy of the automotive industry aiming at concentrating both vehicle and component production among a small number of domestic firms. The strategy not only calls for satisfying the rapidly growing domestic market for passengers cars and trucks but also to conquer the world market with



state-of-the-art products in the medium term. To achieve this goal the Government greatly encourages mergers and acquisitions as a way to develop larger component groups able to reach across regions and develop the capabilities needed to upgrade their product levels and managerial skills. M&A acquisition offers enhanced and faster opportunities for learning (Barkema & Vermeulen, 1998). The automotive industry in China has been designated as a “pillar industry” since at least 1991, and it continues to play a central role in the government’s economic development policies today (Stewart et al., 2012). Chinese development policy towards the industry has two main strands: encouraging the overall growth of the sector and concentrating both vehicle and component production among a small number of companies.

The targets for the component industry have been laid out in main documents as the 2004 Automotive Industry Development Policy, the 11<sup>th</sup> Five year Plan, the National Development and Reform Commission in December 2006 and the 12<sup>th</sup> Five-Year Plan of 2011.

The 12<sup>th</sup> Five-Year Plan (approved in March 2011 by the National People’s Congress) designates “new-energy” automobiles and their components as one of the seven “strategic and emerging industries” in which it aims to become a world leader by 2030. The Chinese Government will invest \$1.5 trillion in these seven industries over the next five years to enable them to grow at an annual rate of 35% over the period. Specific auto parts targeted in the plan include batteries, electric motors, electronic control systems and fuel cells.

By focusing its support policies on the newest growth area in the automotive market, China hopes to overcome its industry’s historic technological disadvantages by leapfrogging to the next level of development with significant government support.

#### *The importance of the Chinese automotive industry for Germany*

One of the countries that China is specifically looking at to overcome his technological disadvantages is Germany. With 184.952 million euro of worldwide exports in 2011, the

automotive industry in Germany is the absolute export leader. The German automotive industry presents a large diversity of companies: large and medium-sized auto manufacturers, system and module suppliers, small and medium-sized tier 2 and 3 suppliers. Around 85 percent of auto industry suppliers are medium-sized companies. All of these suppliers provide up to 70 percent of value added within the domestic auto sector – ensuring that the German auto industry remains at the forefront of the competition (GTAI, 2012). Germany has the highest concentration of all European automotive OEM and tier 0.5 supplier R&D centers. Auto manufacturers and suppliers located in Germany are among the world's leading patent applicants. Around 3,650 patents per year make the German auto industry the world patent.

For the German automotive industry, China is extremely important. Every fifth car that is produced in China is a German one. In 2011 German companies have produced in China 2,1 million cars, 140% more than in 2008 and the prospects for growth are quite favorable, particularly in the manufacture of premium car where Germany has the leadership: four out of five premium cars sold in China are manufactured by German OEMs (VDA- Verband der Automobilindustrie).

Following the investment of major German OEMs, many German auto parts manufacturers have established and/or increased their presence in China. In 2010 the number of German auto parts manufactures in China increased almost a third with respect to the year before, reaching 180 companies, with more than 60.000 employees.

### **3. THEORETICAL FOUNDATION AND PROPOSITIONS**

In the context of cross border acquisitions value is created in an acquisition when two firms are more valuable under common ownership that they were under separate ownership (Barney, 1988). The value created by an acquisition is determined both by the potential for synergies

made possible by combining the two firms and by the acquirer's success at eventually realizing those synergies, a process which requires time and organization (Zollo & Singh, 2004).

The resource-based view of the firm posits that resources that are valuable, rare, imperfectly imitable and imperfectly substitutable are an organization's main source of competitive advantage (Barney, 1991). This theoretical approach is particularly appropriate for examining mergers and acquisitions because firms merge or acquire in order to gain access to others firm's valuable resources. When efficient market exchange of resources is possible, "firms are more likely to continue alone" and rely on the market (Eisenhardt & Schoonhoven, 1996: 137). However, efficient exchanges are often not possible on the spot market. Certain resources are not perfectly tradable, as they are either mingled with other resources or embedded in organizations (Chi, 1994). Hence, mergers and acquisitions are variously employed. Firms can capture value from acquisitions either by leveraging their unique resources and capabilities or by exploiting superior information. Looking at cross border acquisition by emerging country firm, however, superior information and unique resources are owned mostly by the target firm.

Acquisitions of target firms in advanced economies have been argued to be a source of advanced capabilities for the emerging country MNEs (Luo & Tung, 2007, Madhok & Keyhani, 2012). The acquirer transfers the resources from the target firm back to its home country to develop new capabilities there, helping the emerging country MNE to overcome the technological disadvantage of coming from a developing country (Lin et al., 2009). This transfer of capabilities can be detrimental to the target firm. The emerging country MNE may transfer the advanced technology of the target firm to the home country to improve its operation and may not be interested in investing in the development of new sophisticated

technologies in the target firm. Additionally, it may even close down the operations of the target firm once it has extracted the capabilities desired.

As Hennart (2012) explains, the organizational form by which two firms transact with each other depends on the contributions and costs faced by both partners. The difference lies in the types of contribution made by foreign and local partner. MNE centric theories (Hennart, 2009) assume that the local partner is in a weak bargaining position, and hence the cost and benefits that a foreign investor is facing with alternative organizational forms are determining their choice. However, in the case of the Chinese acquisitions of German companies the situation is peculiar.

When a local partner is providing advanced technology, the local partner has considerable bargaining power and its contribution is subject to high information asymmetries and high transaction costs. The knowledge that is owned by the acquired firms is knowledge of modern manufacturing and R&D processes that is embedded in the organization, and thus dependent on the organizational structure and culture. Such knowledge of the acquired firm that could help the investing MNE develop new advantages (Shan & Song, 1997) cannot easily be disembodied and transferred, nor does it easily fits in the acquiring firm.,

The transfer of embedded technology to the parent firm represents not just a challenge to knowledge transfer, but also the willingness of the acquiring organization to undergo major organizational change to be able to absorb it. This would require the acquiring firm to “unlearn some of the practices used in the domestic markets and learn new skills that sustain profitable exploitation of their capabilities . However, unlearning and learning create formidable challenges for emerging multinationals and their managers (Zahra et al., 2011). The implementation of an acquisition requires a lot of managerial resources, both in the acquisition process and in the subsequent management and integration of the acquired unit.

The acquirer therefore, faces a difficulty trade-off between maximizing returns and minimizing the risk of failure. An acquirer with less experience in the target's geography or industry may well decide that the benefits of rapid integration are outweighed by the risks of damaging the source of value that inspired the deal.

Therefore we state the following proposition

*Proposition 1: The information asymmetry in terms of technological knowledge among acquirer and target firm gives the target firm a bargaining power that allows to maintain autonomy after the acquisition. Maintaining autonomy is a major driver of target firms in agreeing to be sold to Chinese investor and /or in seeking a Chinese strategic investor*

The technological knowledge is not the only knowledge that the acquired firm has, the other asset that is often tacit is the knowledge of how successfully operate internationally and in particular host countries. Such knowledge is to a large extent experiential, meaning that is primarily developed through experience. The resources already possessed by the firm can be deployed in many markets (Barkema & Vermeulen, 1998, Johanson & Vahlne, 1977) helping the company balance the costs and risks incurred overseas due to greater managerial complexity and liability of foreignness (Tseng et al., 2007). As a result of the knowledge accumulation, it becomes easier for firms to deal with operations that have occurred before and the level of the liability of foreignness can be largely reduced.

The resource based view does not examine the social context within which resource selection decisions are embedded (network ties, regulatory pressures,..) and how this context might affect sustainable firm differences (Oliver, 1997). According to the institutional perspective organizations gain legitimacy for their operations through isomorphism with the environment i.e., by conforming to commonly accepted structures and procedures (Goes & S.H., 1997).

China's distinctive cultural and institutional legacy, including the tendency to rely on close personal relationships in business transacting -“guanxi”- (Chen & Chen, 2004) may be expected to increase the liability of foreignness faced by firm that seek to internationalize in that country. It is then important for the foreign companies operating in China to conform to local procedures and try to develop a guanxi business network.

The economic benefits of a guanxi network (Luo, 2000:44), include the lowering of transactions costs, information costs and competitive threats as well as reducing uncertainty in the operation. Guanxi enhances the institutional support (through other members in the network), adds a strategic capability to the firm and, thus, enhances the economic return (higher revenues) as well as increasing the business effectiveness and the organizational legitimacy of the operation.

German companies, through the acquisition by a Chinese firms can make use of their internationalization experience and take advantage of that company's network of relationships. Becoming a “Chinese company”, could lower the transaction costs of operating in China, showing an increased commitment to the market , and could facilitate the contact with Chinese OEMs, easing the access to financial incentives provided by the government to locally owned firms.

*Proposition 2: The expertise acquired in international markets gives the target company bargaining power to receive access to a network of relationships in China. The opportunity to access a local vehicle makers in China is an important driver in agreeing to be sold to Chinese investor and /or in seeking a Chinese strategic investor*

Germany, like most industrialized nations, did not go untouched by the current financial crisis and subsequent economic downturn. Lower levels of automotive manufacturing have had large spiraling effect on the wider economy because of the thousands of small and medium sized companies involved in the supply chain, vehicle sales and after-sales services.

In Germany around 85 percent of auto industry suppliers are medium-sized companies. All of these suppliers provide up to 70 percent of value added within the domestic auto sector. As value added is moving to the supplier side, the industry has to continue investing heavily in R&D and new product programs in order to ensure that German auto industry remains at the forefront of the competition.

Chinese companies are benefiting in these credit-constrained times from abundant government funding for what are seen as nationally strategic acquisitions, hence, they are able to provide the financial support of the growth of their target firms.

*Proposition 3: Access to equity, stimulated by Chinese government's policy, is one of the major drivers in agreeing to be sold and/or in seeking a Chinese strategic investor.*

The conceptual framework is summarized in Figure 1.

\*\*\* Figure 1 about here \*\*\*

#### **4. METHODOLOGY**

To verify the propositions, a multiple case-study approach is used. This method is appropriate for addressing questions in topic areas which have been relatively understudied and new (Yin, 2003).

The first stage of this exploratory study has identified five cases of Chinese acquisitions in the German automotive sector and is based on archival information consisting on facts and data about the companies involved, retrieved from companies websites and material available from the media. The second stage included interviews with the two German companies that have proactively looked for Chinese investors. The interviews lasted 1 hour and have been conducted in German; the translation into English has been conducted by the author.

All the cases considered were recent acquisitions conducted between March 2011 and March 2012 (other acquisitions have occurred after March 2012). In all cases, the acquirer came from the same industry sector and brought Chinese technology and market knowledge to the business.

All German subsidiaries are medium sized enterprises, employing up to 4.000 people, while the Chinese counterparts are in some cases larger. In all cases, the Chinese side acquired a majority stake in the German firm, with ownership ranging from 75% to 100%. Two of the five German companies were facing a process of insolvency prior to the acquisition, while the others were financially healthy and had successfully completed a restructuring process.

Two of the five Chinese acquirers are state-owned companies. One of the company is a municipally owned diversified group, with an activity that spans from food and drinks to chemical articles for daily use, from silicate products to textiles, paper, real estate and car components. The other firm is part of a State-owned multinational conglomerate operating in financial and non financial business. The other three Chinese acquirers are privately owned companies with a production exclusively or mainly focused to the automotive sector.

All the German company acquired are Tier 1 suppliers, supplying mainly to German but also to all market relevant OEM, counting with highly innovative and most advanced production processes. Some of them are leader in their field of activity. Table 1 reports information on the acquired companies.

Company A is the firm that invented the central locking system and is a technology leader for automotive side door latches, holding a global market share of 20%. It is also the first latch manufacturer that has developed a charger locking actuator for electric cars, a field, as defined in the 12<sup>th</sup> Five Year Plan, where China intends to achieve world leadership.



Company B is recognized as a technology leader in the global light metal castings industry and has an excellent customer base consisting of blue-chip automotive OEMs and Tier 1 suppliers. Company C is a firm which focuses on a niche market (wood-veneer trim and interior plastic parts for premium cars) and is the second world manufacturer of wood veneer trim, where it holds a global market share of about 23%. Company D is the first company that developed one of the first radio receivers in the world and is operating in the automotive electronics sector ( heating/climate control) , an area of production which is targeted in the 12<sup>th</sup> Chinese Five Year Plan. Company E develops and manufactures innovative sealing systems, complex shapes and damping elements along the entire value chain - from materials to final product formulation.

Companies A, C, D have been acquired by private Chinese automotive suppliers, while Company E (body seals) and company B (components and systems made of aluminum and magnesium) have been acquired by large state-owned conglomerates, operating in many sectors of activity but not focused uniquely in the automotive sector.

**\*\*Table 1 about here\*\*\***

## **5. FINDINGS**

The main goal of this paper is to analyze the reasons why well renowned German automotive suppliers decided to be sold to a Chinese investor in spite of agreeing to be sold to an investor from an advanced country, with a similar level of technological development. For all the German companies considered in this paper the option of being acquired by developed country firms was an existing possibility and it has been a clear decision of the management to favor a deal with a Chinese buyer.

Company A and D proactively started the search for an investor in China once the restructuring of their company was complete and once it was evident that the financial investors, who owned their assets, were looking for a buyer. For company D it was clear that they needed to look for a partner in Asia, in China. The company had already lost some important contracts for not being actively present in that country. In 2010, the CEO of Company D remembered himself of an entrepreneur from Ningbo that six years before visited the company because it was interested in a Joint venture. The German management denied the offer at that time because it considered the entrepreneur still too young and the company didn't ensure the desired level of professionalism. After a visit to the company in China, the CEO of Company D was surprised to see that the Chinese entrepreneur had done all the investments he had promised to do. The firm offered a great potential for the German manager. A joint venture agreement was then signed in 2010, 2 years later the Chinese company bought Company D.

As the CEO of company D stated *“there are no synergies and integration issues. Thus we found the offer so attractive. By contrast, with an acquisition by a real large competitor it would have resulted in a consolidation and we, perhaps, could probably have only brought our plants to the group”* He added: *“through the acquisition, Company D remains Company D and indeed, nearly everything remains as before: the name, the independence, the center for innovations in Germany, the management and largely the supervision board. Clearly better, however, is the equity base and the market access to China”*

The innovation capability of the German firm is at the core of the deal. The innovation remains in Germany. There is of course a transfer technology to China because the local company needs the know-how to manufacture the product, but this an activity done by every company present in China, independently if it has been acquired or not by a Chinese firm<sup>iii</sup>.

Yet, the innovation capability will remain in Germany. According to Company D *“buying a company, stealing its know-how and go away would not work, would be like destruction of value.. After six years an automotive supplier needs new products. If you don’t have innovation, you are out”*.

The high bargaining power of the acquired company derives mainly from its technical level. As Company D stated: *“ We are on another technical level and we have a more robust and internationally more experienced automotive management team. The owner of the acquiring firm knows that he cannot transfer this know-how to China. To maintain and protect those capabilities is for the Chinese company a highest priority. ”*

Company A also proactively started the process of looking for an acquirer in China .The managers decided that the target should be a strategic investor and that the search should take place in China. *“We are obliged to grow if we want to be competitive in the long term, we need new products, more value added and more capital ”*

The management of the company acted as an investment bank and organized a road show in China by pre-selected Chinese companies. As result of these road show a suitable acquirer was eventually found, a big holding that manages 160 companies; one of these firms is now the owner of Company A.. The main motivations behind this decision have been highlighted by the management of Company A *“ our firm remains independent, maintains its structure, gains the possibility of a better entry into the Chinese market and becomes a clearly improved equity. Moreover, in China companies are sponsored by the Government, there is a strong interest for the automotive sector and Chinese companies need to gain international acceptance and win new customers: on that issue we are in the position to offer something.”*

According to the manager of Company A there is no risk in losing technological advantage vis-à-vis the Chinese investor. There would be a transfer of knowledge to the Chinese

company but the tacit knowledge will remain at home. The primary strategy of Company A will remain to keep innovating and to be more innovative than its competitors.

With the only exclusion of Company C that has changed the name, all the acquired German firms continue operating with their name, with their structure and with a high degree of independence.

The process of acquisition was not always easy, particularly because in some cases OEMs were skeptical and wanted to be reinsured of the positive effects of the acquisition. As company D said “ *the OEMS want to know that the business will continue operationally. From the customer point of view, that looks good for the foreseeable future, because a maximum of continuity is guaranteed with contact partners and processes*”.

By company E the employees protested against the Chinese takeover., because they were scared of losing their job. As a response, the Chinese CEO invited the representative of the employees to Chongqing to show them the company. This visit has contributed to clarify misunderstandings and since then the relationship has changed, the Chinese investor is now welcome.

The management of Company E indicated: “*Despite an extremely complex transaction structure and enormous time pressure, we have managed to sell the Company E as a whole to a strategic investor with long-term interest. Overall, a very good negotiation result was achieved – among other things, we managed to safeguard nearly all jobs in the long term*”<sup>iv</sup>.

An aspect that all acquired German companies share is their internationalization experience. All the companies are active worldwide and have many productions facilities in different parts of the world, mainly USA, Mexico, Eastern Europe and China. With the only exception of Company C, all German companies had already set up a production plant in China as they were acquired by the Chinese company. In the case of Company D, she signed a joint venture

agreement with the Chinese firm in 2010, one year later the Chinese company acquired a stake of 74,9% and in 2012 it acquired then the 100%.

The possibility to offer their international experience and their international market channels to the acquirer firms and at the same time to use the facilities and contacts of the Chinese company for the expansion in China, is also indicated by the companies as an important determinant motivating the firm to look for a Chinese buyer.

A Company D said: *“I see in the new lineup great opportunities, in particular, those that concern the fast growth of our business in China. In addition, we have better access to the Chinese procurement market with our acquirer firm, and we strengthened the equity of our company with a significant capital increase: We profit from the acquiring firm’s market access to China and from their good capital resources”*

For the management of Company D the acquiring firm complements the target firm perfectly and represents the next development step for Company D in Asia. In addition the Chinese company will finance further growth in Europe and in the NAFTA Region.

Company A will significantly expand its locking systems business in the Asia region and is simultaneously planning to globalize its acquirer firm’s core products by bringing them to Europe and the NAFTA region. *“The Chinese acquirer is a financially sound partner that will also support our company in its non-organic growth. Our Company has now the possibility, in addition to its own facility in China, to use one of the production lines of the acquirer firm to build a line for its products. Using classic routes, we would have had to work extremely hard over a period of years in order to establish such contacts”*.

According to Company A *“when a supplier moves into a new region, it calls for a deep-seated understanding of the country well beyond the confines of the automotive industry....The acquirer has no foreign distribution channels; in our company and its*

*products it has an ideal platform that is well-established and functioning on a global level and able to offer access to our customers.”*

Company A is visiting its clients with the management of the acquirer firm and invites the management of the Chinese firms to the fairs organized by OEMs in order to facilitate its international expansion.

This reciprocally opening the doors to each-other is the ideal situation to learn and to build trust, step after step, because the differences are still very big. The manager of company A said *“The way Chinese establish relationships to their clients is lot more intensive. Here we don’t dare to go that far”*.

Overall the scenario seems to confirm what indicated in Proposition 2 &3. The possibility to have a better access to the Chinese market and the opportunity to be able to offer their international experience to the acquirer firm, in addition to the access to capital, motivate the target firms to be acquired by Chinese investors. The option of being acquired by a Chinese company in order to keep operating and growing in a key market is seen as the best option available, particularly if the German company has already an existing partnership with the acquirer firm, as in the case of Company D. As Company D stated: *“A bond of trust grew between our company’s management, the entrepreneur of the acquirer firm and its team”*.

Considering the profile of Chinese acquirer firms, with the only exception of the state-owned acquirer of Company B, which has become the world’s leading manufacturer of aluminum wheels and owns R&D centers outside China, the other companies are strongly focused on the Chinese market, where they are present through a large number of manufacturing sites. The Chinese companies supply both Chinese OEM and foreign OEM operating in China through JV with local companies

This confirms what indicated by Luo and Tung (2007) that the current wave of Chinese overseas M&A is carried out by a new generation of Chinese firms that have been successful in the Chinese market and are rapidly working to establish themselves globally, in conformity with the Chinese development policy concerning the automotive industry: creating a small number of global suppliers.

The goal of becoming global players makes German technologically advanced automotive small and medium suppliers the ideal partners for Chinese companies to access new technologies and to make the first step into the international market. Differently from the acquisitions conducted in the past, Chinese companies seem to have realized that by keeping the identity of the target firm and retaining its senior employees, routines, expertise and knowledge are preserved. In this case, one could say that the acquisition is somehow more similar to a strategic alliance, with a sort of “partnering approach” taking place.

## **6. CONCLUSIONS AND IMPLICATIONS**

The present study has focused on the recent acquisitions of German companies operating in the automotive sector by Chinese firms. Through an exploratory analysis, based on information on five acquisitions carried out between 2011 and 2012, the paper builds on the work of Knoerich (2010) and focuses on the seller side, looking at the motivations influencing leading German automotive suppliers to agree to be acquired by Chinese companies. Due to the difficulty in gaining information, this is still an understudied topic in the field of M&A by emerging market multinationals.

However, this is an important topic because, as the amid Eurozone debt woes, many German companies find that a lack of capital is the biggest bottleneck to expansion and even survival, and have turned for sources of capital to emerging market firms.

Building on previous work conducted on acquisition by Chinese companies of German firm in metal working machines, the study is based on archival information and on interviews conducted with the two German companies that proactively went to China to look for a Chinese buyer. Only the German managers were interviewed and this represents one of the limitations of the study as it would have been useful to compare the vision of the German managers with that of the Chinese entrepreneurs.

Our results confirm the findings of Knoerich (2010) in terms of complementary goals of the parties involved. The concept of information asymmetry introduced in this study emphasizes the issue that as long as the German firms keep innovating and the Chinese firms are in the process of technological capability building, the target firms have a bargaining power that it allows to maintain independence. Indeed, results indicate that the possibility to maintain their own autonomy, represents the most important factor pushing the German companies to prefer a Chinese investor over other investors from the industry.

The relevance of the Chinese market and the possibility to use the channels of the acquirer and its capital to further expand in the Asian country is another important motivation in favor of the acquisition. In order to increase their presence in the Chinese market, German companies need to develop a strong network of relationships with local firms and institutions. This task can reveal to be hard in a sector where the Government is oriented in reducing the dependence from foreign firms and to promote the development of Chinese global players. Therefore, considering also the demand by the Chinese government on western manufacturers to contribute to an advancement of Chinese OEMs, a takeover represents a positive option.

In terms of implications for international business and policy makers, it is important to stress that in the case of the acquisitions object of this paper is too early to see if they will end up successfully and if the Chinese parent company will have a real input in the strategic decision-making and long-term development of their German business partner.



At this stage, it is possible to argue that Chinese companies may facilitate the future growth of German companies. Greater access to the Chinese market obtained through the acquisition, would support the growth path of German firms, thus generating employment. In addition, the clearly improved equity would open new technical possibilities to the German companies, especially in the eyes of their premium customers. Longitudinal studies are recommended in to analyze the development of these acquisitions.

What remains to be considered is the issue of cultural integration, particularly at the corporate governance level, as the corporate governance standards are different and may bring therein, in addition to cultural differences, a potential conflict. As the manager of Company D said: *“I see a certain challenge in different cultures. Here both side must learn from each-other”*. Future research might focus on the challenges that German companies face as they try to embed into Chinese business networks and the components that would foster this embeddedness.

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<sup>ii</sup> GM operates a 49-51 car manufacturing venture with SAIC. It has also a venture with FAW group, making light commercial vehicles. Toyota Motor Corp operates car ventures with Guangzhou Automobile Group Co Ltd and FAW Group. Hyundai Motor Co has a car venture with BAIC. KIA motors makes car in China in a tie-up with Dongfeng Motor Group, Jiangsu Yueda Investment Co Ltd. Ford Motor has a three-way tie-up with Chongqing Changan Automobile Co Ltd, Japan's Mazda Motor Corp. and Jiangling Motors Corp. Volkswagen makes cars in partnership with SAIC and FAW. Honda Motor has ties-up with Dongfen Motor Group and Guangzhou Automobile Group Co. Dongfen also makes vehicles in ties-up with Honda Motor, Nissan Motor and PSA Peugeot-Citroen. Daimler AG makes Mercedes Benz models in partnership with BAIC. It also makes mini vehicles in southern China with GM and subsidiary Liuzhou Wuling Automobile. BMW AG makes cars in partnership with parent of Brilliance China Automotive Holdings Ltd.

<sup>iii</sup> Data from International Trade administration, 2009, 2010

<sup>iv</sup> Capital, „Die Lange Marsch durch Deutschland“, June 2013 :31-53

<sup>v</sup> Capital, „Die Lange Marsch durch Deutschland“, June 2013 :31-53

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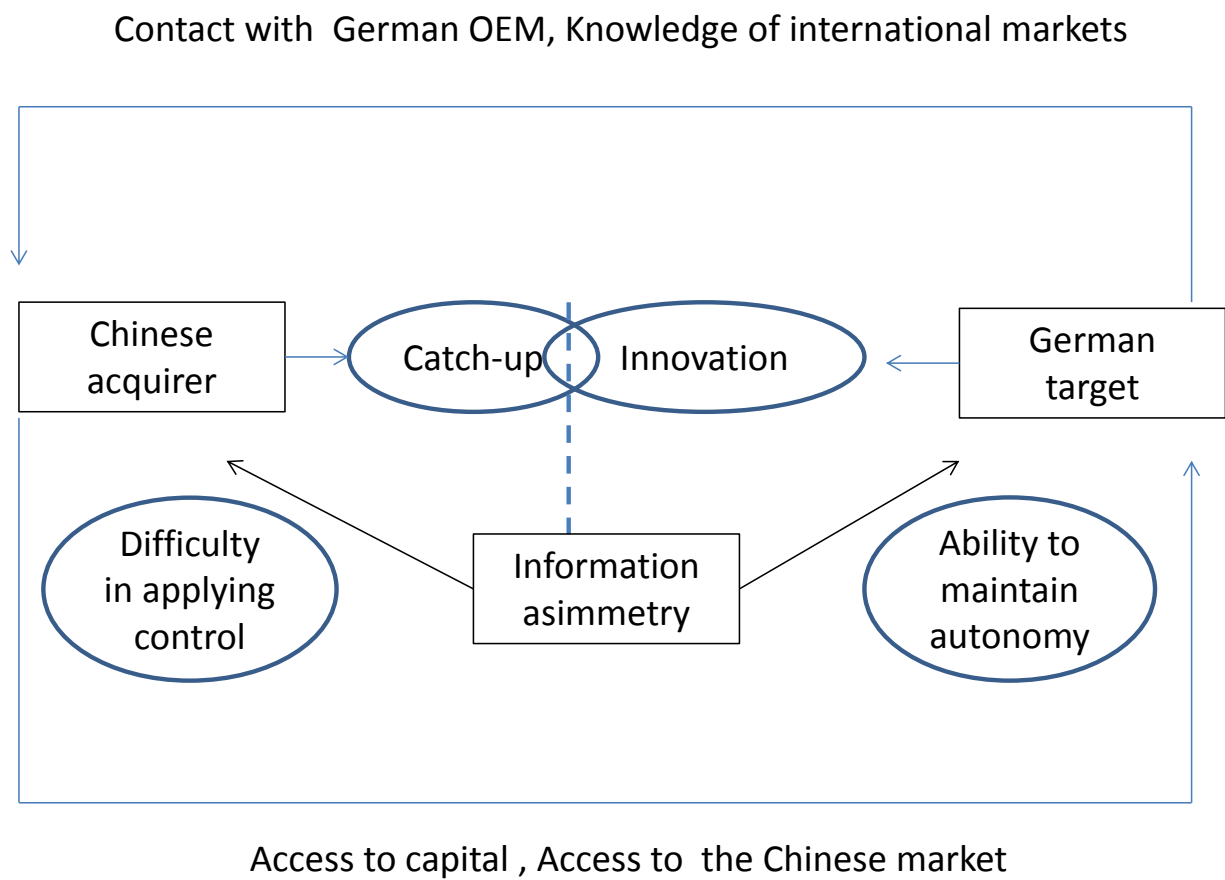
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**Figure 1: conceptual framework**



**Table 1: Chinese acquisition of German companies in the automotive sector (march 2011-march 2012)**

<b>German seller</b>	<b>Size (employees)</b>	<b>Product / International presence</b>	<b>Share acquired by Chinese firm</b>	<b>Prior Bankruptcy</b>
Company A	4.000	Door latches /Production and R&D facilities in Germany, Czech Republic, USA, Mexico and China	100%	no
Company B	2.655	Light metal castings products /Production plants in Germany, Czech Republic and China	100%	no
Company C	2,300	Innovative surfaces for the interiors of premium cars /Facilities in Germany and USA	100%	yes
Company D	2.800	Climate control, driver controls, sensor systems /manufacturing facilities in Germany, Romania, Portugal, Mexico, USA and China	74,9% 25,1% in the hand of German private equity*	no
Company E	3.700	Innovative body seals and complex moldings /Manufacturing facilities in Germany, Spain, Czech Rep., Slovakia, Russia, USA, Brazil, China and India	100%	yes

\*In December 2012 the Chinese company has achieved a full acquisition buying the share owned by the German private equity

Source: own elaboration, on data provided by the companies