Vol. 146, No. 1 · Short communication

DIE ERDE
Journal of the Geographical Society of Berlin

Acquisitions of German companies by Chinese and Indian corporations – a threat to employment and knowledge retention?

Kai Bollhorn[1]

[1]Department of Geography, Philipps-Universität Marburg, Deutschhausstr. 10, 35032 Marburg, Germany, Bollhorn@staff.uni-marburg.de

Manuscript submitted: 18 November 2014 / Accepted for publication: 23 December 2014 / Published online: 25 March 2015

Abstract

The economies of China and India have grown rapidly in the last decades. This also fosters the internationalisation of domestic market companies. Unlike corporations from the Triad (USA, Europe, Japan), Chinese and Indian enterprises acquire existing companies in developed economies rather than follow the greenfield investment route. While a lot of research has gone into explaining this behaviour, the consequences for the acquired companies have hardly been examined. The few existing studies highlight a substantial potential threat for the targeted firms. Based on qualitative, semi-structured interviews with German companies acquired by Chinese or Indian companies and experts, this study arrives at the result that these investments do not pose a threat to the German companies. This study takes an opposite position to existing publications. The global production networks (GPN) approach is used as an analytical framework for this study.

Zusammenfassung

Die chinesische und die indische Volkswirtschaft sind in den letzten Jahrzehnten schnell gewachsen. Dieses Wachstum ermöglichte Unternehmen aus diesen Ländern im Ausland zu investieren. Im Gegensatz zu Unternehmen aus der Triade akquirieren sie vornehmlich in Industriestaaten Unternehmen, anstatt über Greenfield-Projekte zu investieren. Während es Erklärungsansätze dazu gibt, warum diese Form des Markteintritts gewählt wird, sind die Konsequenzen für die übernommenen Unternehmen bisher kaum untersucht. Die bestehenden Studien betonen das Gefährdungspotenzial für die übernommenen Unternehmen. Die vorliegende Untersuchung basiert auf qualitativen, teilstandardisierten Interviews mit deutschen Unternehmen, die von chinesischen oder indischen Konzernen übernommen wurden, und Expertengesprächen. Die Ergebnisse zeigen, dass diese Investitionen keine Ängste bei den ArbeitnehmerInnen der deutschen Unternehmen hervorrufen sollten. Die Argumentation und die daraus abgeleitete These sind damit als Gegenentwurf zu den Studien zu sehen, welche eine Gefährdung der deutschen Unternehmen annehmen. Der Ansatz der Globalen Produktionsnetzwerke (GPN) dient als theoretischer Rahmen.

Keywords Global production networks; acquisitions; emerging markets; employment; Germany

Bollhorn, Kai 2015: Acquisitions of German companies by Chinese and Indian corporations – a threat to employment and knowledge retention? – DIE ERDE **146** (1): 16-20

DOI: 10.12854/erde-146-2

1. Introduction and framework

China and India have become the two most important sources for foreign direct investment (FDI) from emerging economies (EE) in developed economies (DE) (UNCTAD 2014). Clients in DE, e.g. in Germany, expect their suppliers to deliver high-quality products and offer intensive services. Chinese and Indian companies are usually not familiar with these expectations from the experience in their home market where expectations are lower. This unawareness is seen as a liability for companies from EE. To overcome these liabilities the path of internationalisation into DE is taken by mergers & acquisitions (M&A) rather than by greenfield investment (where the parent company establishes a new legal entity) (*Luo* and *Tung* 2007, *Ramamurti* 2009). Often, this form of acquisition is criticised in media and research. In 2007, a German weekly news magazine called China and companies from China 'the yellow spies' on the front cover (DER SPIEGEL 2007), while *Kolstad* and *Wigg* (2012: 33) denote 'China as a ravenous dragon'. *Madhok* and *Keyhani* (2012: 32) find that "the focus [of the acquirer] is on extracting advantage from the target rather than transferring advantage to the target". The assumption is often that the extraction of existing intellectual property and know-how would make the German employees dispensable which would in turn lead to mass layoffs and plant closures in Germany.

Research on FDI is mainly conducted using the "ownership-localisation-internationalisation" framework (*Dunning* 2000) and its modifications (*Luo* and *Tung* 2007, *Moghaddam* et al. 2014). In this paper, the global production networks (GPN) framework (*Henderson* et al. 2002) is used to offer an explanation as to why structures of German companies remain relatively untouched following an acquisition by a Chinese or Indian company. The following three arguments are presented based on four subcategories: network embeddedness, territorial embeddedness, value creation and value enhancement. The remaining subcategories of the GPN approach are not discussed here. The GPN-based approach has the potential to go beyond the usual factors for FDI and point out consequences for the acquired companies. In addition, the paper contributes to fill a lacuna in the literature on GPN, as GPN research is still largely minimum on M&A from EE in DE (e.g. *Coe* 2012, *Yeung* and *Coe* 2015). The four subcategories will be applied to develop three arguments that lead to the hypothesis that Indian and Chinese companies are not a threat to the employees of the German companies they acquire.

The category 'embeddedness' summarises non-economic aspects (*Henderson* et al. 2002, *Hess* 2004). 'Territorial embeddedness' "considers the extent to which an actor is 'anchored' in particular territories or places" (*Hess* 2004: 177). Anchoring helps the companies to participate in the existing supplier-buyer networks in the DE markets and also assists in deepening their knowledge about the product/service in that specific market. Additionally, the companies improve the understanding of specific regional product standards as expectations may differ between regions. 'Network embeddedness' describes the connections of individuals and firms among each other and towards various institutions. As these connections are characterised by their durability and stability, the decision of the actors are influenced by path dependency (*Hess* 2004).

The category 'creation of value' is used to analyse the company's internal conditions and external influences under which labour potential is transferred into actual labour (*Henderson* et al. 2002). The conditions summarise the effectiveness of labour use, e.g. how labour is trained or equipped with machinery or tools. Standards differ among competitors. Companies with superior standards or services create additional value and receive organisational, management, brand or relational rents (*Kothari* et al. 2013). Creation of value summarises the transformation of labour and rents, nevertheless they are two different sources of income. 'Enhancement of value' can be implemented in internal and external networks. Clients can train their suppliers to fulfil a specific quality standard by direct knowledge transfer or joint projects (*Henderson* et al. 2002). The supplier can then use the improved internal standard to win new clients, offer additional value added in an existing client-supplier production process or transfer knowledge within the enterprise for product development (*Pietrobelli* and *Rabellotti* 2011).

2. Methodology

The study is based on 41 qualitative semi-structured interviews with managers and works council representatives of German companies that were acquired by a Chinese or an Indian company. The companies were identified in the database "Markus" by Bureau van Dijk, which offers information on the shareholder structure of a company. The interviewed companies represent economically important business segments for Germany and are sectors in which Chinese and Indian companies have made multiple acquisitions.

Typical examples of such sectors are: automotive, machinery or communication. Thus the process of selecting the companies is based entirely on these sectors, but independent from positive or negative press articles on a certain acquisition, as this would have resulted in a bias within the sample. The interviews took 60-90 minutes, were taped and transcribed to undertake a content analysis. The analysis ensures that the citations and findings presented below are representative of all interviewed companies and potentially highlight a hypothesis for those acquisitions that are not part of this study. The earliest acquisition of the sample dates back to the 1990s while the absolute majority occurred after 2005. In the interviews with companies that were acquired recently the details of employment guarantee contracts are used to develop the core thesis of this article. To reduce the bias of the disperse business segments and the differences in the year of investment and to ameliorate the representative character of the findings, 10 additional interviews with experts on Chinese or Indian FDI were conducted. Despite the fact that data gathering occurred under these rigorous conditions, the study has to be seen as an explorative approach to develop a hypothesis. The interviews were held between May 2013 and August 2014 and were conducted in German. The quotations have been translated into English and the names of companies have been anonymised.

3. Results

The findings of the interviews indicate long-term interests by the Chinese and Indian investors towards the acquired German companies. Within the sample examined, only one acquisition did not sustain. Knowledge transfers from the German company to the acquirer do happen, yet this does not diminish the position of the German company in the global market. More important, no mass layoffs directly related to the acquisition and transfer of knowledge are initiated by the new owner.

I found three arguments that lead to the hypothesis that Chinese and Indian investors are no threat to the employees of acquired German companies:

1. The acquirer gets access to the external network in which the German company is embedded. These are relations the buyer does not want to jeopardise. The network embeddedness is based on long-established relationships often based on trust. The interviewees find the Chinese or Indian companies to be regionally embedded in EE but only marginally in DE. Meanwhile, the acquired German companies are territorially embedded in DE with sales networks and occasionally also plants. Chinese and Indian companies need this regional presence to understand the specific demand and supply situation. The Indian and Chinese acquirers do not have this region-specific set-up. This is why the territorially embedded structures and international networks of the interviewed companies in DE remain untouched. This is true both for companies that are market leaders in their business segments and for companies that do not have advanced technologies. One interviewed company had a parallel structure for R&D, production and sales in Europe after the acquisition. In this case the acquiring Chinese company changed its product line, not laying off or changing the products or the strategy within the German company. In general the acquisitions do not lead to parallel structures in the buying and the purchased company.

> "The goal is that we can offer the client an 'all-in-one' package on every continent (...), not just production but also the development, the whole process-chain, the whole logistics. There is some overlapping with [Indian company 1] (...), but otherwise [the owner] looks for a continental separation" (interview with a representative of a German company acquired by Indian company 1).

2. Chinese or Indian companies cannot sell their own products to existing clients of acquired German companies, as the products do not fulfil the quality requirements of European customers. Products of targeted companies are often technologically superior to those of the acquirer and are sometimes modified for the clients' demand which is influenced by the specific territorial embeddedness. The German companies offer additional value and receive rents for superior quality, additional services and modifications. Typically after an acquisition, and before the transfer of and improvements to the product quality of the acquiring company begin, the buyers offer lower-quality products and generally receive lower technological rents. The missing potential to offer surpluses for a superior quality or territorial-specific modifications hinder the Chinese and Indian companies to sell their products to existing clients of the interviewed German companies that have been acquired. This is true directly after the takeover.

> "After the acquisition we saw and learned that the Chinese are [technologically] not as far as we

> thought. If I look at the potential risks [for us] from the Chinese, the risk is by far not as high as we thought" (interview with a representative of a German company acquired by Chinese company 1).

3. The acquiring companies cannot substitute products manufactured by German companies in the near future, as the technological catch up process of Chinese and Indian companies is slow. The internal access to technology and the production know-how of the German companies allows the enhancement of value within the Chinese/Indian companies. Cooperation between the acquirer and the acquired in the cohort analysed typically include the following: joint projects for research and development, internal sourcing for pre-products, external purchase teams between the German company and the new owner, international trainings and plant visits. The interviewed German companies producing high-quality products share the common view that the initiated learning process of the Indian and Chinese companies seems to be slower than expected. This is of critical importance for the future outlook of the acquired company. The catch-up process is slower than expected but is not denied by the interviewees. In the recent acquisitions the catch-up process could be accelerated as the acquiring companies are already more experienced.

> "The Chinese are still not able, despite our support [of 20 years], to supply the European or the American market with their products. (...) In the bigger picture I do not see any major changes with regard to the know-how or the quality difference" (interview with the representative of a German company acquired by Chinese company 2).

4. Conclusion

The acquisitions of German companies by Chinese and Indian companies has in most cases not led to the loss of jobs or the closure of plants in Germany. This result can be attributed to two reasons: 1) The EE companies do not yet have international plants and sales structures in DE, and 2) the specific strengths of the German companies cannot be transferred quickly. In all interviews, the targeted company is embedded into client and suppliers networks – globally and especially in DE. In cases where the selling of products requires production plants, these plants are already embedded in the relevant important markets. The Chinese and Indian companies generally do not transfer these assets to their own brand, and the acquired German companies act relatively independently on an operational level. This finding applies to all interviewed companies in the sample, both technological market leaders and companies that offer bulk products. Nevertheless, even those companies that are not protected by their technological superiority did not experience a mass layoff initiated by the new owner. In those cases in which the acquisition occurred some time ago, it may be expected that the unchanged organisational structures of the German company will remain permanent (not considering massive economic or company crises). There appears to be a similar trend in companies that were acquired recently. However, one must consider the fact that layoffs and restructuring might be initiated after the initial agreements run out their due course.

In addition to the regional and network embeddedness of all interviewed companies, the absolute majority of the interviewed companies are technologically superior in comparison to the Chinese or Indian acquirer. The acquired companies postulate that the generation of technological rents cannot be transferred to, or learned by, the acquirer in the short term. Furthermore, the internal enhancement of value by joint projects is slower than expected. The existent gap in the conditions under which value is created and the extended time taken to implement methods of value enhancement successfully are two additional arguments that strengthen the explorative hypothesis that M&A by Chinese and Indian companies, in the majority of the cases, are no threat to the employees of acquired German companies. However, as the majority of the investments are relatively recent, the hypothesis needs to be researched further.

Acknowledgement

This paper is based on research of the BRICINVEST project (www.bricinvest.de) funded by the Hans Böckler Foundation. BRICINVEST is a project of the Institute of Geography of the Philipps-Universität of Marburg, the Leibniz-Institut für Länderkunde and PCG-Projectconsult.

References

Coe, N.M. 2012: Geographies of production II: A global production network A-Z. – Progress in Human Geography **36** (3): 389-402

Dahlkamp, J., M. Rosenbach, J. Schmitt, H. Stark and *W. Wagner* 2007: Prinzip Sandkorn. – DER SPIEGEL 2007 (35): 18-27

Dunning, J.H. 2000: The eclectic paradigm as an envelope for economic and business theories of MNE activity. – International Business Review **9** (2): 163-190

Hess, M. 2004: 'Spatial' relationships? Towards a reconceptualization of embeddedness. – Progress in Human Geography **28** (2): 165-186

Henderson, J., P. Dicken, M. Hess, N. Coe and *H.W.-C. Yeung* 2002: Global production networks and the analysis of economic development. – Review of International Political Economy **9** (3): 436-464

Knoerich, J. 2010: Gaining from the global ambitions of emerging economy enterprises: An analysis of the decision to sell a German firm to a Chinese acquirer. – Journal of International Management **16** (2): 177-191

Klossek, A., B.M. Linke and *M. Nippa* 2012: Chinese enterprises in Germany: Establishment modes and strategies to mitigate the liability of foreignness. – Journal of World Business **47** (1): 35-44

Kolstad, I. and *A. Wigg* 2012: What determines Chinese outward FDI? – Journal of World Business **47** (1): 26-34

Kothari, T., M. Kotabe and *P. Murphy* 2013: Rules of the game for emerging market multinational companies from China and India. – Journal of International Management **19** (3): 276-299

Luo, Y. and *R.L. Tung* 2007: International expansion of emerging market enterprises: A springboard perspective. – Journal of International Business Studies **38** (4): 481-498

Madhok A. and *M. Keyhani* 2012: Acquisitions as entrepreneurship: asymmetries, opportunities, and the internationalization of multinationals from emerging economies. – Global Strategy Journal **2** (1): 26-40

Moghaddam, K., D. Sethi, T. Weber and *J. Wu* 2014: The smirk of emerging market firms: a modification of the Dunning's typology of internationalization motivations. – Journal of International Management **20** (3): 359-374

Pietrobelli, C. and *T. Rabellotti* 2011: Global value chains meet innovation systems: Are there learning opportunities for developing countries? – World Development **39** (7): 1261-1269

Ramamurti, R. 2009: Why study emerging-market multinationals? – In: *Ramamurti, R.* and *J.V. Singh* (eds.): Emerging multinationals in emerging markets. – Cambridge et al.: 3-22

United Nations Conference on Trade and Development (UNCTAD) 2014: Statistics Overview. – Online available at: http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx, 23/09/2014

Salidjanova, N. 2011: Going out: an overview of China's outward foreign direct investment. – USCC Staff Research Report. – Online available at: http://www.uscc.gov/sites/default/files/Research/GoingOut.pdf, 23/10/2014

Yeung, H.W.-C. and *N.M. Coe* 2015: Toward a dynamic theory of global production networks. – Economic Geography **91** (1): 29-58