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Chinese investments in the Czech Republic: changing the expansion model

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The serious financial problems of the private company CEFC China Energy, which are related to the arrest in February in China of its founder Ye Jianming, have affected the company's activities in the Czech Republic. Its subsidiary CEFC Europe failed to repay a debt of around €450 million it owed to J&T Private Investments, which belongs to the Slovak-Czech J&T financial group; this led to J&T seizing some of CEFC's Czech assets on 17 May (including the takeover of the board of CEFC Europe). Finally, on 25 May, CEFC's debt was paid by the Chinese state financial company CITIC, whose representative took over as chairperson of CEFC Europe's Board. At the same time, two subsidiaries of J&T and the Rainbow Wisdom company (controlled by CITIC) concluded an agreement on strategic cooperation, which includes their declared desire to jointly develop further business projects. Despite increasing concerns in the Czech public debate around China's business activities in the Czech Republic, Ye Jianming remains an honorary adviser to President Miloš Zeman on economic and Chinese matters (as he has been since 2015).

Ye Jianming's arrest ended a period of spectacular growth for CEFC China Energy, which over several years acquired the status of the sixth largest Chinese private company (with anannual revenue of around €38 billion). CEFC made a number of foreign acquisitions in the oil and financial sectors apart from the Czech Republic, in Kazakhstan, Georgia and the United Arab Emirates. In 2018 it announced the purchase of 14.16% of shares in the Russian oil group Rosneft, although in the end this was not concluded. The circumstances of Ye's detention remain unclear, and this topic has been subject to censorship in the Chinese internet and press. According to the *South China Morning Post*, the arrest was carried out at the personal order of Xi Jinping. As a result, the poor financial health of the Chinese companies belonging to CEFC was exposed (revealing debts of the order of €15 billion); some of these companies have since declared insolvency. As of March, the board of CEFC China Energy has been taken over by the Guosheng Group investment fund, which belongs to the Shanghai municipal government. This means that CEFC has become another private Chinese company, after the Anbang Insurance Group, whose foreign expansion (based on excessive debts) has been interrupted by the arrest of its private owners and had its public assets put under state ward.

Commentary

- In a relatively short period of time, CEFC China Energy became the dominant locus of Chinese investment in the Czech Republic. Since September 2015 it had accumulated a portfolio of assets with a total value of €1.5 billion. These mainly concerned investments in real estate, as well as purchases of already operating companies with a wide range of interests. The standouts here were investments in tourism businesses and the banking & financial sector. In the latter case, this primarily involved the purchase of 9.9% of the J&T Finance Group (belonging to the J&T Group) which manages three banks in the Czech Republic and Slovakia. This share was to have risen to 50% for a price of around €1 billion, which would have made it CEFC's second largest investment outside China. However, the transaction was blocked by the Czech National Bank because of ambiguities concerning CEFC's ownership structure. CEFC's problems meant that its planned takeover of the Central European Media Enterprises group (CME), the owner of the most popular Czech TV station Nova (among others), also did not take place. According to media reports concerning its acquisition, the owner of the group, the US media giant Time-Warner, had been in talks with a consortium of CEFC and the Slovak-Czech investment group Penta. CEFC had also counted on building up a good image through investments such as buying the Slavia Prague football club.
- CEFC's investments were distinguished by a high degree of opacity, particularly with regard to the diverse ways in which they acquired their assets in the Czech Republic: some were purchased through their subsidiary CEFC Europe (e.g. most of the property), some through another related company, the Hong Kong-registered China International Group Cooperation (e.g. Empresa Media), and some by both (e.g. the Lobkowicz brewery). Nor has CITIC's current entry into the Czech Republic always been direct; for example, the repayment of the loan and the acquisition of shares in J&T Finance came about through the Rainbow Wisdom company which CITIC controls. In addition, according to Czech press reports, although CITIC has only acquired 49% of the shares in CEFC Europe (the rest still belongs to CEFC China Energy), it chose the new chairman of the board of directors, and it is likely that no strategic decisions can be taken without CITIC's consent.
- The Czech authorities, by opening up the country's market to Chinese capital, counted both on investment from Chinese companies creating high added value (in particular of the greenfield and brownfield types), and on preferential conditions for local companies to gain access to the highly regulated Chinese market. However, in recent years the expectations for such investments have come through to only a small extent. According to the German Merics Institute, the total volume of Chinese investment in the Czech Republic is (after Slovakia) the smallest among the V4 countries, and also a dozen or so times smaller than that in Germany and France. Just in 2016, President Zeman – the main advocate of opening up to China – announced that Chinese investments would reach 95 billion crowns (€3.7 billion), while according to the Czech Central Bank the actual FDIs from China reached only 12.5 billion crowns (€500m), and the year after were less than half that figure. The main Chinese investor CEFC did not invest in greenfield projects or the technological development of the companies acquired, mostly concentrating on collecting assets. In addition, the disputes between the Czech directors of CEFC Europe and the heads of J&T (widely discussed in the Czech press) contributed

to the deterioration of the atmosphere around the Chinese investments.

- The hopes in recent years for a major offensive by Czech business in China have also failed to bear fruit. Only a small number of Czech companies have managed to enter the Chinese market, and some of them have been experiencing a range of problems there. The most important investors include the Czech Republic's richest man, Petr Kellner, who operates on the consumer credit market in China: at present up to 55% of the loans from his company Home Credit have been made on the Chinese market. However, this is loaded with a high business risk; in the first quarter of this year Home Credit in China has suffered a loss of €88 million, mainly as a result of stricter rules for granting loans and advances on this 'overheated' market. The leadership of J&T also hopes to expand in China; the strategic cooperation it has agreed with CITIC, after settling the dispute with the CEFC, should help with this. Czech exports to China have been increasing year on year (in 2017 at 23.2% YOY), although they still stand at a relatively low level of €2.1 billion, which in 2017 made China only the seventeenth biggest destination country for Czech exports. Significant imports from China (€18 billion), which is the second biggest supplier of goods to the Czech Republic, mean that the Czech Republic has for years had the highest (and still rising) trade deficit with China (€15.9 billion in 2017, compared to €10.2 billion four years previously).
- The expansion of the CEFC and other Chinese entities into the Czech Republic has been made possible by deep political and business ties with some of the left-wing elites in the Czech Republic. President Zeman is especially heavily involved in strengthening Czech-Chinese business cooperation; he has visited China three times since 2014 along with numerous trade missions (and also met President Vladimir Putin twice on these occasions). He plans another visit in November. CEFC's problems have not fundamentally affected Zeman's assessment of the prospects for developing bilateral cooperation. China has also managed to acquire influence with a number of influential current and former politicians of the ČSSD (the Czech Social Democratic Party), the most prominent of whom include Jaroslav Tvrdík, the head of CEFC Europe and a former defence minister; and Štefan Füle, a member of the company's supervisory board, a former EU Commissioner and Czech ambassador to NATO. On the other hand, a much more cautious attitude towards the activities of CEFC (and certain other Chinese entities) has been adopted by Prime Minister Andrej Babiš (ANO); even when he was deputy prime minister and finance minister in the previous government of Bohuslav Sobotka, he repeatedly drew attention to the opacity of the Chinese investments and the minimal benefits for the Czech economy resulting from them. Currently, for reasons including his political alliance with President Zeman, Babiš is avoiding making critical statements on this topic. We may assume that the Czech Prime Minister – who had unsuccessfully tried to invest on the Chinese market even before he had entered politics – will try to develop the relationship with CITIC on a pragmatic basis.
- The takeover of CEFC's assets by the Chinese state marks the end of the model wherein a private company had been the main actor in China's expansion into the Czech Republic. Hitherto, this behaviour had been beneficial from Beijing's point of view; it gave its open support to CEFC, by signals including the presence of Xi Jinping when CEFC signed the key contracts in Prague in 2016, a positive portrayal in state media, and grants funded by

state banks (the China Development Bank). In the state press this model was presented as operating in complement to the expansion of state companies. At the same time, CEFC openly stated its support for Beijing's strategic interest in the Czech Republic, including building good relations with the Czech political elite and society (this is how Ye Jianming explained the investments in historic buildings or the football club, in terms of public image). The other declared purpose was to promote the expansion of more Chinese companies in Central Europe, and to acquire technologies and know-how relevant to the Chinese economy. Probably there was also direct coordination with the Chinese government, and according to the *Financial Times*, CEFC's detained chief Ye Jianming had had close ties with Chinese military intelligence. Czech counter-espionage, in turn, has noted that Chinese investment in the Czech Republic was accompanied by an increase in Chinese intelligence activities. The model based on the activities of a private company allowed Beijing to a certain extent to alleviate the accusations about its direct accumulation of political influence which were usually raised by the expansion of state companies.

- The destiny of CEFC's Czech assets is uncertain, after its management was taken over by the state-owned CITIC and Guosheng Group companies. According to the public statements from CEFC's previous board of directors, its investments in the Czech Republic played a dual role in the company's strategy. Firstly, they were intended to allow further financial expansion, opening up access to European financial markets. The takeover of J&T was supposed to allow CEFC to obtain loans for further foreign acquisitions, taking advantage of interest rates which were lower than those in China. In addition, having a bank with a European license was supposed to allow further acquisitions in the financial sector in a simplified regulatory regime. The second of CEFC's officially declared objectives was to make Prague a transfer hub for air passenger traffic, which would have been served by acquisitions in the tourism industry, air transport and business services. This was accompanied by the rapid opening of direct flight routes to Prague from four Chinese cities. Ultimately, the Czech Republic was to become a tourist centre and 'gateway' for Chinese business in Europe. These statements should be seen more as a strategy by CEFC's previous board to build up its image, rather than as an official plan by the Chinese government; it thus remains an open question as to what extent the new state owners of CEFC's assets will continue this approach.
- CEFC's new state owners' interest in maintaining a presence in the Czech Republic should continue, as indicated by CITIC paying off the debts to the J&T group. However, the arrest of Ye Jianming, whose personal contacts and ambition for CEFC's international expansion were the main driver of the foreign investments, will very likely lead to a drop in activity in the Czech Republic. For CITIC, which manages assets amounting to around €500 billion, the Czech Republic will probably not play an important role as a financial centre. Until the debt management problems of CEFC's parent company (operated by the Shanghai-owned Guosheng Group) are resolved, foreign expansion will probably remain limited. As part of the restructuring process, some of the Czech assets in the aerospace or production areas may be sold to Chinese investors operating in these sectors. Nevertheless, Beijing is interested in maintaining both its strategic presence in the Czech Republic and its high level of political relations. China's agenda for the Czech Republic will be closer to the implementation of the general policy for Central Europe, which is

focused on taking over technology companies, making investments in the area of production, and implementing energy (including nuclear) and transport projects as part of the One Belt One Road initiative.

Appendix. Chinese investments in the Czech Republic

Most of the Chinese investment in the Czech Republic has been carried out by the CEFC company, which has made investments including the following:

- in sport: 60% of shares in the football club Slavia Prague and the purchase of its stadium;
- in real estate: two five-star hotels (the Mandarin Oriental and the Le Palais Art Hotel), the former Živnobanka building and the Florentinum office complex;
- in the tourism sector: a 75% stake in the online travel agency invia.cz, purchased from the Polish MCI fund; almost 50% in the Canaria Travel agency; 49.94% in the Travel Service airline;
- in the engineering industry: 100% in the machinery company ŽĎAS;
- in the brewing industry: 100% of the Lobkowicz brewery, the fifth largest in the Czech Republic;
- in the media sector: 30% in the Médea Group and 49% in Empresa Media, which owns TV Barrandov, a station which broadcasts weekly interviews with President Zeman.

Other Chinese entities have invested in the Czech market with varying degrees of success. The few Chinese investments that have been created from the ground up include the Changhong LCD TV factory near Nymburk in the centre of the Czech Republic, which since 2006 has had around €35 million invested in it. Meanwhile, the attempt to develop the production of canned meat by Shanghai Maling in the Ústí nad Labem region ended with the collapse of the Chinese investor; the factory started operating in 2008, although in 2016 its bankruptcy was declared due to heavy debts. In 2016 the Chinese investment company Eurasia Development Group, based in Hong Kong, bought a network of 74 Mountfield stores (home & garden equipment) in the Czech Republic and Slovakia.

In autumn 2017 President Zeman announced that the Moravian-Silesian region would host the first European tyre factory of the Chinese group Linglong. However, the company encountered problems with finding appropriate land, among others; and in a situation of record low unemployment, the Czech government is unwilling to provide incentives for investments with relatively low added value, and which moreover could be environmentally harmful. There has also been speculation that this investment will eventually be located in one of the countries bordering the Czech Republic, or in Serbia. The China General Nuclear company (CGN) has been mentioned as one of the six companies or consortia that could take part in the expansion of the Czech nuclear power plants at Dukovany and Temelín. However, the final decision on the contractor has been postponed due to problems finding the optimal way to finance the construction.