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DRIVING FORCES BEHIND THE INTERNATIONAL EXPANSION STRATEGIES OF CHINESE MNEs

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Driving forces behind the international expansion strategies of Chinese MNEs

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Driving forces behind the international expansion strategies of Chinese MNEs[1]

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Abstract

The rise of multinational enterprises (MNEs) from emerging markets is topical, important and poses a number questions and challenges that require considerable attention in the future from academia as well as business management. This rise is driven by the Asian economy, mainly China, as Chinese MNEs have become important players in several regions around the globe, ranging from the least developed countries to the developed markets, including East Central Europe. Although several components of the strategy and attitude of Chinese MNEs are in line with what can be observed for MNEs from developed countries, but some components – with regard to motivations, operational practice and challenges – are different. Therefore, this paper will focus on these specificities of Chinese outward foreign direct investment (OFDI) in order to better understand the rise of Chinese MNEs.

JEL: F21, F23, O53, P33

Keywords: FDI, internationalisation, Chinese MNEs

Introduction

The rise of multinational enterprises (MNEs)[3] from emerging markets is topical, important and poses a number questions and challenges that require considerable attention in the future from academia as well as business management. Outward foreign direct investment (OFDI) from non-European emerging regions is not a new

[1] This paper was written in the framework of the research project "Non-European emerging-market multinational enterprises in East Central Europe" (K-120053), supported by the National Research, Development and Innovation Office (NKFIH)

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[3] As UNCTAD uses the term "multinational enterprise" or „MNE" in its latest publications (such as World Investment Report 2016) we chose to use this terminology during the research. Under this term we mean business organization whose activities are located in more than two countries.

phenomenon, what is new, is the magnitude that this phenomenon has achieved over the past one and a half decade. The recent takeovers of high-profile companies in developed or developing countries by non-European emerging-market MNEs[4] (EMNEs) – such as Lenovo, Wanhua (China), Hindalco (India), CVRD (Brazil), Cemex (Mexico), Lukoil (Russia), etc. – as well as the greenfield or brownfield investments of emerging companies (such as Huawei, ZTE, Tata, Pepco, etc.) show a new trend where new kind of firms become major players globally. According to the World Investment Report 2015 investments from emerging-markets reached a record level: "developing Asia now invests abroad more than any other region. Nine of the 20 largest investor countries were from developing or transition economies" (UNCTAD 2015, p. 9.).

Today, the rise of EMNEs is driven by the Asian economy, mainly China, however, this process is broader, incorporates a growing number of developing economies and complemented by the growing share of emerging markets in world exports (Sauvant 2008, Nölke 2014). In addition, non-European EMNEs have become important players in several regions around the globe, ranging from the least developed countries of Africa through the developing markets in Latin America and Asia to the developed countries of the United States or the European Union, including East Central European (ECE) countries[5].

Although some components of the strategy and attitude of non-European EMNEs in ECE region are in line with what can be observed for MNEs from developed countries (DMNEs), but some components – with regard to motivations, operational practice and challenges – are different.

[4] When using „non-European emerging market multinationals (EMNEs)" we primarily refer to multinationals from the BRICS economies, plus Malaysia, South Korea, Taiwan, Thailand and Turkey.

[5] Throughout the research ECE is referred to as the five new EU member states which are members of the OECD as well, namely: the Czech Republic, Hungary, Poland, the Slovak Republic and Slovenia. The Central and Eastern European (CEE) region is a broader term – comprising Albania, Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania, the Slovak Republic, Slovenia, and the three Baltic States: Estonia, Latvia and Lithuania. Therefore, the paper does not focus on the whole CEE region, however in some cases the examples of the ECE countries will be supplemented with some of the CEE countries.

Focus on China

Chinese OFDI has increased in the past decades, however, in the last decade this process accelerated significantly. In 2012, China became the world's third largest investor – up from sixth in 2011 – behind the United States and Japan with an OFDI flow of 84 billion US dollars and it still hold its position: the value of Chinese OFDI grew to 183 billion US dollars in 2016[6], making Chinese MNEs the largest overseas investors among developing countries (UNCTAD 2017). According to the estimations of Hanemann and Huotari (2017), the volume of investments has further increased in 2016 and has reached 200 billion USD, with a 40 per cent increase compared to the previous year. Several factors fuelled this shift, including the Chinese government's wish for globally competitive Chinese firms or the possibility that OFDI can contribute to the country's development through investments in natural resources exploration or other areas (Sauvant – Chen, 2014, pp. 141-142).

Although traditionally Chinese OFDI is directed to the countries of the developing world, Chinese investments into the developed world, including Europe increased significantly in the past decade. According to the Clegg and Voss (2012), Chinese OFDI to the European Union (EU) increased from 0.4 billion US dollars in 2003 to 6.3 billion US dollars in 2009 with an annual growth rate of 57 per cent, which was far above the growth rate of Chinese OFDI globally. In 2016, Chinese companies invested 35 billion EUR in the EU, a 77 per cent increase from the previous year (Hanemann-Huotari, 2017, p. 4). While the resource-rich regions remained important for Chinese companies, they started to become more and more interested in acquiring European firms after the financial and economic crisis. The main reason for that is through these firms Chinese companies can have access to important technologies, successful brands and new distribution channels, while the value of these firms has fallen, too, due to the global financial crisis (Clegg – Voss, 2012, pp. 16-19.).

In line with the above, the paper will focus on Chinese EMNEs strategies, operation and challenges in East Central Europe (ECE) by discussing its anomalies to the traditional theories as well as to other types of MNEs in the ECE region. The aims of the

[6] China's outward FDI net flows in 2016 reached 170.11 billion USD, according to Chinese data, that is the 2016 Statistical Bulletin of China's Outward Foreign Direct Investment.

paper are to better understand the rise of Chinese EMNEs in ECE and to specify their motivations. Therefore, the research will address the following questions:

1. What are the driving forces behind the international expansion strategy of Chinese EMNEs?
2. How important is the ECE region in their localization strategies?
3. What are the main factors which makes the ECE region attractive for Chinese EMNEs?

In order to assess the role and importance of OFDI from China towards ECE region, it must be evaluated within a global context, taking into account its geographical, as well as sectoral distribution. Therefore, after the theory and literature review, the third chapter briefly examines Chinese foreign direct investment globally, as well is in the European Union, taking into account trends, patterns and investors' potential motivations when choosing a specific destination for their placements. The fourth chapter describes the changing patterns and motivations of Chinese OFDI in ECE region, based on desk research, company interviews and observations. The final chapter presents the author's conclusions[7].

Theory and literature review

Majority of research on motivations for FDI apply the eclectic or OLI paradigm by Dunning (1992, 1998) that states that firms will venture abroad when they possess firm-specific advantages, i.e. ownership and internalization advantages, and when they can utilize location advantages to benefit from the attractions these locations are endowed with. Different types of investment motivations attract different types of FDI which Dunning (1992, Dunning-Lundan 2008) divided into four categories: market-seeking, resource-seeking, efficiency-seeking and asset-seeking. Localization advantages "comprise geographical and climate conditions, resource endowments, factor prices,

[7] The author will usually take into account foreign direct investment by mainland Chinese firms (where the ultimate parent company is Chinese),[7] unless marked explicitly that due to data shortage or for other purposes they deviate from this definition. Since data in FDI recipient countries and Chinese data show significant differences, the two data sets will usually be compared to point out the potential source of discrepancies in order to get a more complex and nuanced view of the stock and flow of investments. For Chinese global outflows statistics from Chinese Ministry of Commerce (MOFCOM) and UNCTAD will be taken into account and compared.

transportation costs, as well as the degree of openness of a country and the presence of a business environment appropriate to ensure to a foreign firm a profitable activity" (Resmini, 2005, p 3). Much of the extant research and theoretical discussion is based on FDI outflows from developed countries for which market-seeking and efficiency-seeking FDI is most prominent (Buckley et al., 2007; Leitao-Faustino, 2010).

Nevertheless, traditional economic factors seem to be insufficient in explaining FDI decisions of MNEs. In the last decade international economics and business researchers acknowledged the importance of institutional factors in influencing the behaviour of MNEs (e.g., Tihanyi et al., 2012). According to North, institutions are the "rules of the game" which are "the humanly devised constraints that shape human interactions" (North, 1990, p 3). Institutions serve to reduce uncertainties related with transactions and minimize transaction costs (North, 1990).

Meyer and Nguyen (2005, p 67) argue that informal constraints are "much less transparent and, therefore, a source of uncertainty". As a result, Dunning and Lundan (2008) extended OLI model with the institution-based location advantages which explains that institutions developed at home and host economies shape the geographical scope and organizational effectiveness of MNCs.

The rapid growth of OFDI from emerging and developing countries resulted in numerous studies trying to account for special features of emerging MNEs behaviour that is not captured within mainstream theories. For example, Mathews extended OLI paradigm with linking, leverage, learning framework (LLL) that explains rapid international expansion of companies from Asia Pacific (Mathews, 2006). Where linking means partnerships or joint ventures that latecomers form with foreign companies in order to minimize risks involved with internationalization as well as to acquire "resources that are otherwise not available" (Mathews, 2006, p 19). Latecomers when forming links with incumbents also analyse how the resources can be leveraged. They look for resources that can be easily imitated, transferred or substituted. Finally, repeated processes of linking and leveraging allow latecomers to learn and conduct international operations more effectively (Mathews, 2006, p 20).

Although EMNEs from various emerging countries differ in many respects but to some extent they share common characteristics. For example, Peng (2012) reports that

Chinese MNEs are characterized by three relatively unique aspects: (1) the significant role played by home country governments as an institutional force, (2) the absence of significantly superior technological and managerial resources, and (3) the rapid adoption of (often high-profile) acquisitions as a primary mode of entry.

Kalotay and Sulstarova (2010) highlights that Russian MNEs' investments are also influenced by home country policies while Barnard (2010) writes about the lack of strong firm capabilities among MNEs from South Africa and Taiwan. Ramamurti and Singh (2009) applied a different typology for internationalization strategies of Indian firms: they introduced four generic categories each of which reflects a particular type of strategy in a particular era, making differences in the companies' profiles e.g. their sectoral composition. Gubbi et al. (2010) find that Indian MNEs are also fond of undertaking acquisitions overseas. Since 2002 a marked shift in corporate attitude towards global markets took place in Brazil, too, but "multi-latinas" have emerged throughout Latin America (Casanova-Kassum, 2013).

While some EMNEs target the global market, others rather focus on neighbouring regions. According to Gubbi and Sular (2015) Turkish firms seem to be using the European countries to (1) present themselves as a European Union company, (2) make use of special features of these countries to expand their businesses within and to other countries and, (3) make use of the favourable tax treatment policies available to foreign investors.

The change of ECE countries from centrally planned to market economy resulted in significant research on FDI flows to these transition countries. During the transition ECE went through radical economic changes which had been largely induced by foreign capital. Foreign multinationals realised significant investment projects in this region and established their own production network. Investors, mainly from EU-15 countries, were attracted by relatively low unit labour costs, market size, openness to trade, and proximity (Bevan-Estrin, 2004; Clausing-Dorobantu, 2005).

Extant literature suggests diverse institutional factors that influence inward FDI. In the case of ECE, the prospects of their economic integration with the EU increased FDI inflows while in ECE countries that lagged behind with implementation of transition policies, which postponed their EU accession, FDI inflows were discouraged (Bevan-Estrin, 2004).

The example of extra-EU foreign investors in ECE is presented in a study by Kawai (2006) who analysed motivations and locational determinants of Japanese MNEs. The author found that by 2004 Japanese investment in ECE was low when compared with European counterparts and 90% of it was located in the Czech Republic, Hungary and Poland (Kawai, 2006, p 6). Japanese MNEs' investment in ECE was motivated by relatively low labour and land costs, well-educated labour force necessary in manufacturing sectors and access to rich EU markets.

Szunomár and McCaleb (2017) found that in the case of Chinese MNEs' motives in ECE significant role is devoted to institutional factors and other less-quantifiable aspects: besides EU membership, market opportunities and qualified but cheaper labour important factors are the size and feedback of Chinese ethnic minority, investment incentives and subsidies, possibilities of acquiring visa and permanent residence permit, privatization opportunities, the quality of political relations and government's willingness to cooperate.

Chinese foreign direct investment globally[8]

From the late 70s, in hand with the "Open Door" policy reforms, the Chinese government encouraged the country's investment abroad to integrate China to the global economy, although the only entities allowed to invest abroad were state-owned enterprises (SOEs). The total investment of these first years was not significant and concentrated to the neighbouring countries, mainly to Hong Kong. The regulations were liberalized after 1985 and a wider range of enterprises – including private firms – was permitted to invest abroad.

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[8] This section is partly based on a previous research of the author and the book chapter, Szunomár Á, Biedermann Zs: Chinese OFDI in Europe and the Central and Eastern European region in a global context. In: Szunomár Á (ed.) Chinese investments and financial engagement in Visegrad countries: myth or reality?. 178 p. Budapest: Institute of World Economics, Centre for Economic and Regional Studies, Hungarian Academy of Sciences, 2014. pp. 7-33.

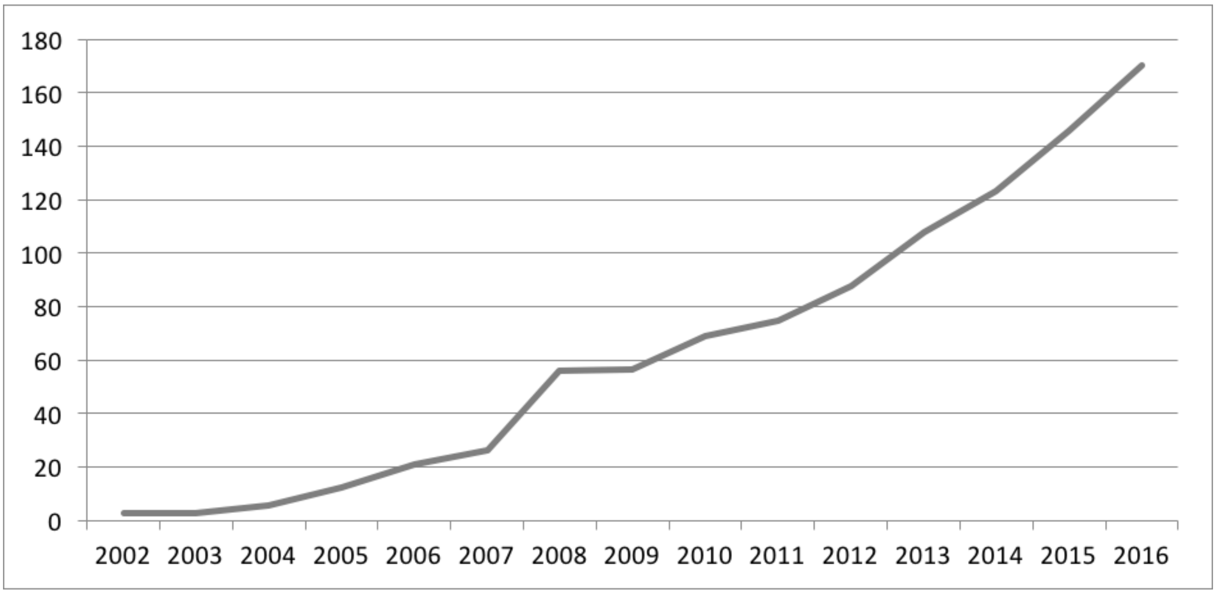
After Deng Xiaoping's journey to the South in 1991, overseas investment increased dramatically, Chinese companies established overseas divisions almost all over the world, concentrated mainly in natural resources. Nevertheless, according to UNCTADstat, Chinese OFDI averaged only 453 million US dollars per year between 1982 and 1989 and 2.3 billion between 1990 and 1999.

In 2000, before joining the World Trade Organization (WTO), the Chinese government initiated the go global or "zou chu qu" policy, which was aimed at encouraging domestic companies to become globally competitive. They introduced new policies to induce firms to engage in overseas activities in specific industries, notably in trade-related activities. In 2001 this encouragement was integrated and formalized within the 10th five-year plan, which also echoed the importance of the go global policy (Buckley et al 2008). This policy shift was part of the continuing reform and liberalization of the Chinese economy and also reflected Chinese government's desire to create internationally competitive and well-known companies and brands. Both the 11th and 12nd five-year plan stressed again the importance of promoting and expanding OFDI, which became one of the main elements of China's new development strategy.

Chinese OFDI flows and stock have steadily increased after the New Millennium (see Figure 1. and 2. below), particularly after 2008, due to the above-mentioned policy shift and the changes in global economic conditions, that is, the global economic and financial crisis. The crisis brought more overseas opportunities to Chinese companies to raise their share in the world economy as the number of ailing or financially distressed firms has increased.

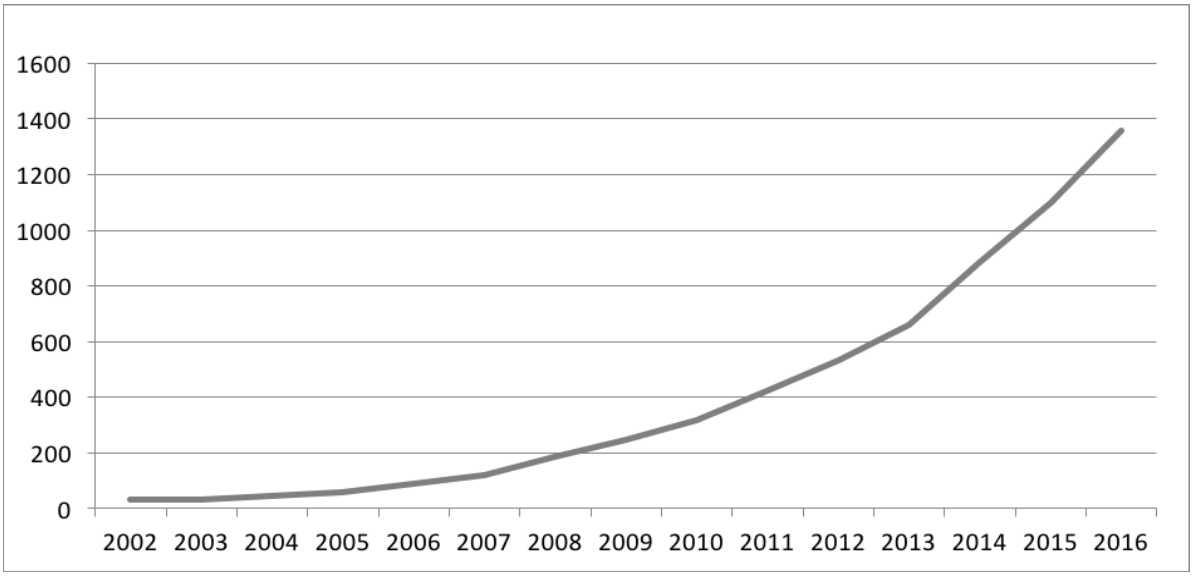
While OFDI from the developed world decreased in several countries because of the global financial crisis, Chinese outward investments increased even greater: between 2007 and 2011, OFDI from developed countries dropped by 32 per cent, while China's grew by 189 per cent (He and Wang, 2014, p. 4). As a consequence, China moved up from the sixth to the third largest investor in 2012, after the United States and Japan – and the largest among developing countries – as outflows from China continued to grow, reaching a record level of 84 billion US dollars in 2012. Thanks largely to this rapid increase of China's outward FDI in recent years; China also became the most promising source of FDI when analysed FDI prospects by home region (UNCTAD 2013, p. 21).

Figure 1. China's outward FDI flows, billion USD, 2002-2016



Data source: MOFCOM / NBS, PRC

Figure 2. China's outward FDI stock, billion USD, 2002-2016



Data source: MOFCOM / NBS, PRC

While more and more Chinese companies are investing overseas, Chinese OFDI raises concerns and therefore causes strengthening protectionism against it, especially in the developed world. Several experts believe that Chinese OFDI could be greater if host countries were more hospitable. According to He and Wang (2014, p. 4-5), there are several reasons for that:

1. state-owned enterprises (SOEs) are the dominant players in Chinese OFDI and they are often viewed as a threat for market competition as they supported by the Chinese government;
2. foreign companies often complain that Chinese companies may displace local companies from the market as they bring technology, resources and jobs away;
3. there are fears about Chinese companies' willingness to adapt to local environment, labour practices and competition. Although the above-mentioned problems indeed exist, they are overestimated as Chinese companies are willing to accommodate to the international rules of investment.

According to Scissors (2014, p. 5), if it is about national security, the role of Chinese ownership status is overblown as Chinese rule of law is weak, which means that a privately-owned company has to face as much pressure and constraint as its state-owned competitor. Nevertheless, it is worth to differentiate between SOEs, which has two types: locally administered SOEs (LSOEs) and centrally administered SOEs (CSOEs). Most of the LSOEs operate in the manufacturing sector and they are facing competition from both private companies and other LSOEs, while CSOEs are smaller in number but more powerful as they operate in monopolised industries such as finance, energy or telecommunication (He-Wang, 2014, p. 6).

Although the share of private firms is growing, SOEs still account for the majority – more than two-thirds – of total Chinese outbound investments, however, the range of investors is broader, next to state-owned and private actors it includes China's sovereign wealth fund and firms with mixed ownership structure. The role of SOEs seems to be declining in the past few years, although the government will continue to emphasize their importance as they rely on the revenue, job creation and provision of welfare provided by the SOEs (He-Wang, 2014, p. 12).

According to the go global strategy, Chinese companies should evolve into globally competitive firms, however, Chinese companies go abroad for varieties of reasons. The most frequently emphasized motivation is the need for natural resources, mainly energy and raw materials in order to secure China's further development (resource-seeking motivation). Mutatis mutandis, they also invest to expand their market or diversify internationally (market-seeking motivation). Nevertheless, services such as shipping and insurance are also significant factors for OFDI for Chinese companies if they export large volumes overseas (Davies, 2013, p 736). Despite China's huge labour supply, some companies move their production to cheaper destinations (efficiency-seeking motivation). Recently, China's major companies also looking for well-known global brands or distribution channels, management skills, while another important reason for investing abroad is technology acquisition (strategic asset-seeking motivation).

Scissors (2014, p. 4) points out that clearer property rights – compared to the domestic conditions – are also very attractive to Chinese investors, while Morrison (2013) highlights an additional factor, that is, China's accumulation of foreign exchange reserves: instead of the relatively safe but low-yielding assets such as US treasury securities, Chinese government wants to diversify and seeks for more profitable returns.

Regarding the entry mode of Chinese outward investments globally, greenfield FDI is continues to be important, but there is a trend towards more mergers and acquisition (M&A) and joint venture projects overseas. Overall, greenfield investments of Chinese companies outpace M&As in numerical terms, however, greenfield investments are smaller in value in total as these include the establishment of numerous trade representative offices[9].

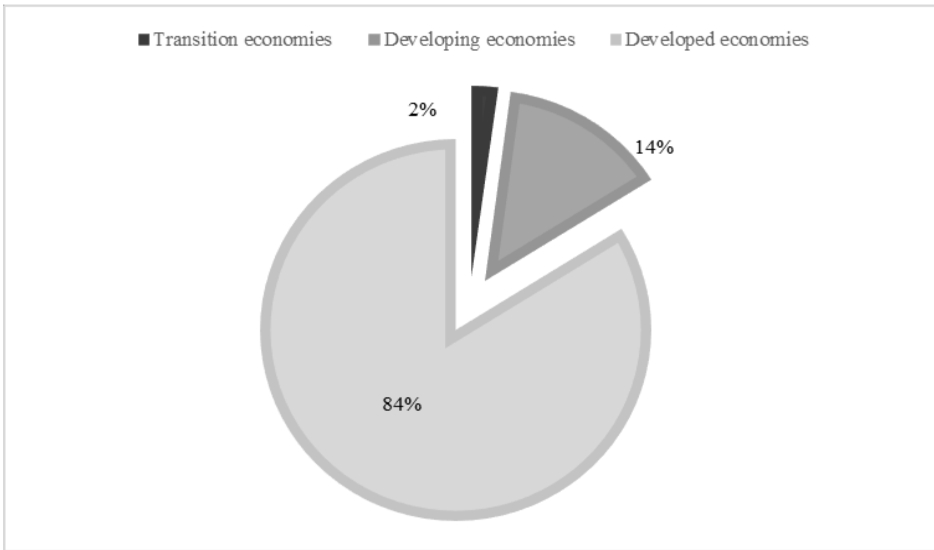
Chinese investments in Europe

Being one of the top investors of the developing world, since 2008 Chinese investment increased substantially in developed economies as well. Although this increase is impressive by all means, according to Chinese statistics, China still accounts for less than 10 per cent of total FDI inflows into the EU or to the US. However, during the examination of the actual final destination of Chinese OFDI, Wang (2013) found that – as a result of round-tripping investments – developed countries receive more Chinese investments than developing economies: according to his project-level data analysis, 60

[9] According to Chinese statistics (MOFCOM / NBS, PRC), in 2015, Chinese enterprises conduced 579 outward M&As in 62 countries (regions), with an actual transaction amount of 54.44 billion USD.

per cent of Chinese OFDI went to developed economies like Australia, Hong Kong, the United States, Germany, and Canada.

Figure 3. Structure of China's outward FDI stock in developed, developing and transition economies, by the end of 2016



Data source: MOFCOM / NBS, PRC

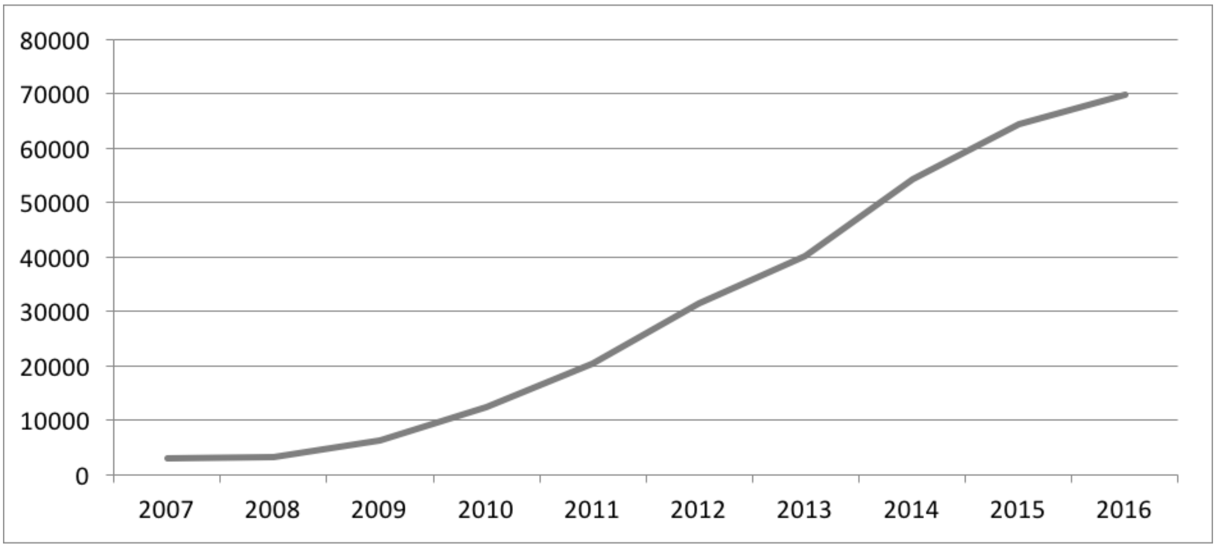
As Clegg and Voss note (2012, p. 19), the industry-by-country distribution of Chinese OFDI is difficult to determine from Chinese statistics. However, based on their findings, it can be stated that Chinese investments in mining industry are taking place mainly in institutionally weak and unstable countries with large amounts of natural resources and that these investments are normally carried out by SOEs. Investments in manufacturing usually take place in large markets with low factor costs, while Chinese companies seek technologies, brands, distribution channels and other strategic assets in institutionally developed and stable economies.

In developed economies Chinese investment are less dominated by natural resource seeking or trade-related motives but more concerned with the wide range of objectives, including market-, efficiency- and strategic assets-seeking motives (Rosen and Hanemann, 2013, p. 69 and WIR p. 46). In the case of developed countries, Chinese SOEs usually have the majority of deal value but non-state firms make the greater share of deals (Rosen and Hanemann, 2013, p. 71). In addition to greenfield investments and joint ventures, China's merger and acquisition (M&A) activity in developed countries has recently gained a momentum and continue an upward trend since more and more Chinese firms are interested in buying overseas brands to strengthen their own.

The European Union has been the major destination for foreign direct investments in the last twenty years, with a dominance of intra-European FDI, extra-European FDI representing only about one-third of the total sum. Compared to the aggregate, Chinese foreign direct investment stock in the EU remains insignificant. However, regarding the trends and dynamism of Chinese inward FDI (see Figure 4.), the economic "footprint" and impact of Chinese foreign direct investment in the EU is indisputably expanding.

Hanemann (2013) points out commercial reasons behind most investments: the acquisition of rich-world brands and technology to increase competitiveness, money-saving by moving higher value-added activities in countries where regulatory frameworks are more developed, or by acquiring firms cheaper due to the crisis or due to a stronger renminbi. So, the crisis only accelerated the long-term Chinese strategy of going global and move up the value chain (Jonas Parello-Plesner, 2013, p.19).

Figure 4. Chinese outward FDI stock in the EU, billion USD, 2007-2016



Data source: MOFCOM / NBS, PRC[10]

China's strong desire for success envisions the next phase of development building on innovation and high and green technology. In line with these ideas – besides mining, manufacturing and financial services – we've seen large-scale Chinese acquisitions in the

[10] Note: The sum of the Europe Union does not include Croatia until 2012.

chemicals sector – BorsodChem became part of the Wanhua Industrial Group – and the automotive industry – Rover Group belongs to the Shanghai Automotive Industry Corporation, Chinese Geely Automobile Holdings owns Volvo and Chinese also have a share in what is left of the Swedish group Saab. Great Wall Motors Company has opened a new plant in Bulgaria and thus became the first Chinese automaker to assemble cars in the European Union. Romania has also been attracting Chinese greenfield investments, among them a plant by Shantuo Agricultural Machinery Equipment to produce tractors.

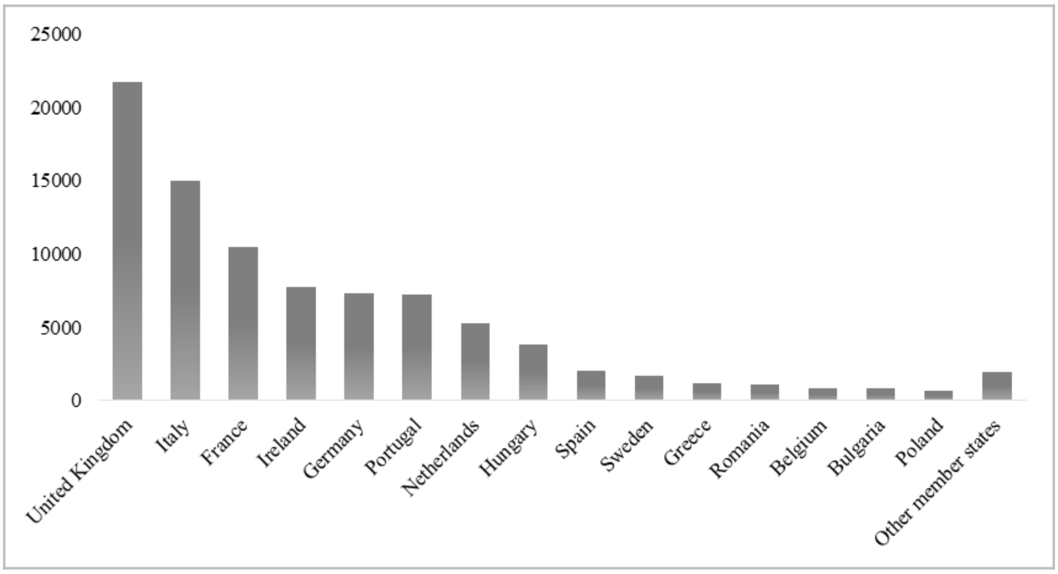
Figure 5. Chinese outward FDI in the EU by industry, billion USD, by 2016

industry	**stock**	**share**
mining	238,6	27,3
manufacturing	175,1	20,1
financial services	144,4	16,6
wholesale and retail	78,7	9
leasing and business services	70,8	8,1
subtotal	707,6	81,1

Data source: MOFCOM / NBS, PRC

Another significant research element when taking a closer look at Chinese OFDI in Europe is the geographical distribution of investments. Chinese investment is very unevenly distributed among EU countries. The top recipients of Chinese FDI are traditionally the United Kingdom, France, Italy, Ireland and Germany (see Figure 6.).

Figure 6. Chinese FDI in the EU by country, million USD, 2010-2014



Data source: ESADE China-Europe database

Changing patterns and motivations of Chinese OFDI in ECE region

The change of ECE countries from centrally planned to market economy resulted in significant research on FDI flows to these transition countries. However, most of the studies focus on the period before 2004 which is the year of accession of the eight CEE countries – the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia – into the EU (Carstensen and Toubal, 2004; Janicki and Wunnawa, 2004; Kawai, 2006). Investors, mainly from EU-15 countries, were attracted by relatively low unit labour costs, market size, openness to trade, and proximity (Bevan and Estrin, 2004; Clausing and Dorobantu, 2005).

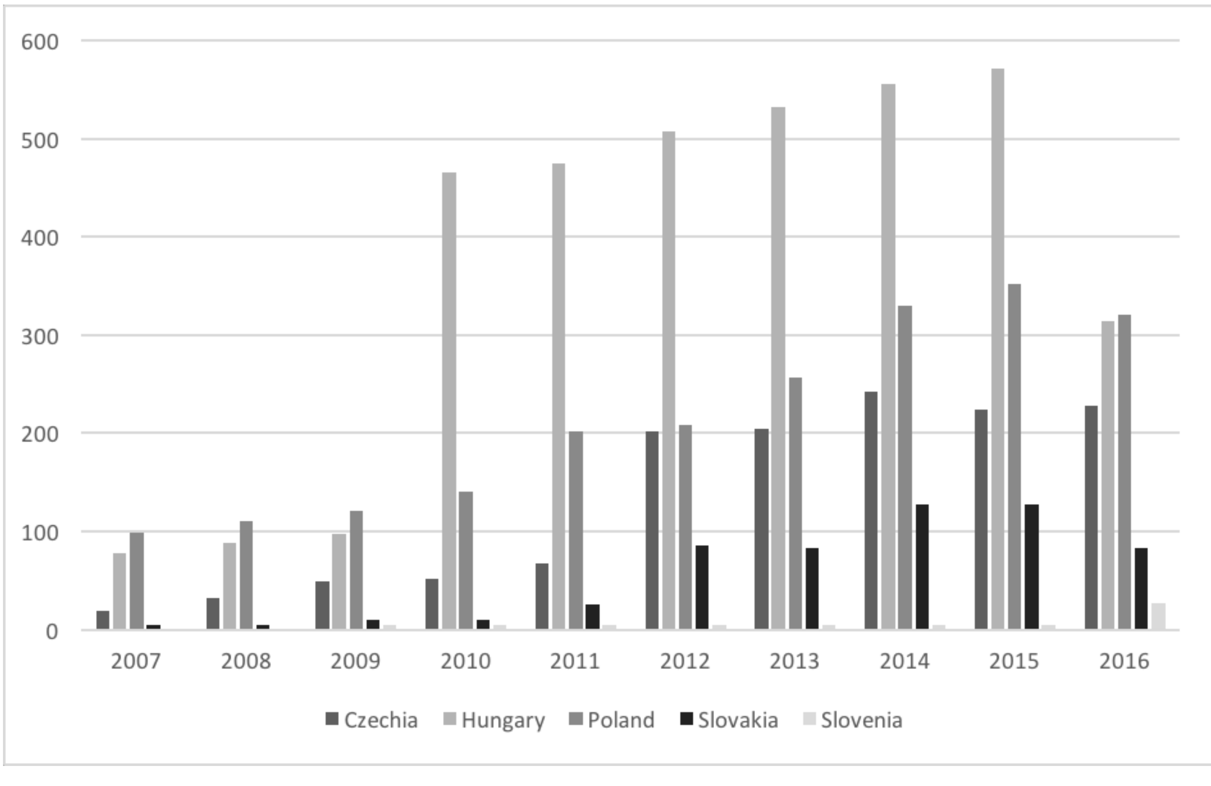
Extant literature suggests diverse institutional factors that influence inward FDI. In the case of ECE countries, the prospects of their economic integration with the EU increased FDI inflows while in other CEE countries that lagged behind with implementation of transition policies, which postponed their EU accession, FDI inflows were discouraged (Bevan and Estrin, 2004).

When analysing the impact of institutional characteristic of ECE countries such as form of privatization, capital market development, state of laws and country risk, the studies show varying results. According to Bevan and Estrin (2004, p 777) institutional aspects were not a significant factor impacting investment decisions of foreign firms. Carstensen and Toubal (2004) argue that they could explain uneven distribution of FDI across CEECs. Fabry and Zeghni (2010, p 80) point out that in transition countries institutional weaknesses such as poor infrastructure, lack of developed subcontractor network, and unfavourable business environment may explain FDI agglomeration more than "positive externalities". Campos and Kinoshita (2008) based on a study of 19 Latin American and 25 East European countries in the period 1989-2004 found that structural reforms, especially financial reform and privatization, had strong impact on FDI inflows.

The example of extra-EU foreign investors in the CEE region is presented in a study by Kawai (2006) who analysed motivations and locational determinants of Japanese MNCs. The author found that by 2004 Japanese investment in CEE countries was low when compared with European counterparts and 90% of it was located in three of the ECE countries, the Czech Republic, Hungary and Poland (Kawai, 2006, 6). Japanese MNCs' outward FDI was motivated here by relatively low labour and land costs, well-educated labour force necessary in manufacturing sectors and access to rich EU markets (Kawai, 2006; Woon, 2003). Majority of Japanese FDI in CEE was directed at manufacturing sector (more than 90%), especially transport equipment and electronics. Japanese investors in CEE from manufacturing sector region preferred countries with lower corporate tax and high rate of GDP growth.

Although the countries examined here – Hungary, Poland, Slovakia, the Czech Republic and Slovenia – differ in many respects, they have some common features as well. They have been in the process of economic catching up over the last decades, their development paths are defined mainly by the global and European powers, rules and trends and FDI has a key role in restructuring of these economies. Most of the above-mentioned countries started to get more interested in Chinese relations – more properly in attracting Chinese investments and boosting trade relations – since the new millennium, however, the economic and financial crisis of 2008 drew the attention of these six countries more than ever to the potential of Chinese economic relationship.

Figure 7. China's outward FDI stock in ECE, 2007-2016, million USD



Source: MOFCOM/NBS

When calculating the percentage share of Chinese FDI in selected CEE countries to all the invested capital, using UNCTAD's statistics on total inward FDI stock as well as MOFCOM data on Chinese FDI in selected five CEE countries, we found that only 0.22 % of total inward FDI in selected CEE countries were from China. The highest percentage is in Hungary: 0.4%, in other countries it is even lower (the lowest is in Poland with 0.17% in Poland). When using the data of China Global Investment Tracker (CGIT) instead of MOFCOM, as CGIT tracks back data to the ultimate parent companies, we found that 2.08% of total inward FDI in selected CEE countries were from China: the highest percentage is again in Hungary: 7.84%, while the lowest (below 0,5%) in Slovakia and Slovenia.

As detailed above, the role of Chinese capital in ECE – compared with all the invested capital here – is still very small, but in the last one and a half decade this capital inflow accelerated significantly. In the case of the selected countries – with the exception of Hungary – there is a growing demand for attracting Chinese companies in the last nine to ten years. In Hungary this process has already begun after 2003.

Chinese investors typically target secondary and tertiary sectors of the selected five countries. Initially, Chinese investment has flowed mostly into manufacturing (assembly), but over time services attracted more and more investment as well, for example in Hungary and Poland there are branches of Bank of China and Industrial and Commercial Bank of China as well as offices of some of the largest law offices in China, Yingke Law Firm (in Hungary in 2010, in Poland in 2012), Dacheng Law Offices (in Poland in 2011, in Hungary in 2012). Main Chinese investors targeting these six countries are interested primarily in telecommunication, electronics, chemical industry, transportation and energy markets. Their investments are motivated by seeking of brands, new technologies or market niches that they can fill in on European markets.

The main type of Chinese FDI in the selected countries is market-seeking investment: by entering ECE markets Chinese companies will have access not only to EU market but also to markets of CIS, Mediterranean and in interviews Chinese investors also speak about the possibility of accessing North American markets. In addition to that, there are cases of Chinese companies following their costumers to ECE countries, like in the case of Victory Technology (supplier to Philips, LG and TPV) or Dalian Talent Poland (supplier of candles to IKEA).

Macroeconomic and institutional factors influencing Chinese companies when investing in ECE

When searching for possible factors which make the region a favourable investment destination for China, the quality and the cost of labour is to be considered first. A skilled labour force is available in sectors for which Chinese interest is growing, while labour costs are lower in the ECE region than the EU average. However, there are differences within the region – and the selected five countries, for example, in terms of unit labour costs.

The change of institutional setting of ECE countries due to their economic integration into the EU (in 2004 and 2007) has been the most important driver that spurred Chinese OFDI in the region, especially in the manufacturing sector. Majority of Chinese firms that invested in ECE countries after their EU accession were motivated mainly by accessing the old EU-15 markets and ECE or CEE markets were of secondary importance. ECE countries' EU membership allowed Chinese investors to avoid trade barriers and the countries served as an assembly base due to the relatively low labour costs.

Chinese investment in ECE in the years 2004-2006 were dominated by firms from electronics sector, especially LCD TVs producers as their exports to the EU were restricted by quota. The examples of such investors are: TCL, Victory Technology, Digital View in Poland; Hisense in Hungary; Changhong in the Czech Republic. There are already cases of companies from renewable energy sector such as Orient Solar in Hungary and media news inform about some companies from the solar sector that consider investing in Poland. The motive of overcoming trade barriers shows similarity with Japanese investments in the region in the second half of the 1990s. Japanese MNCs established assembly plants here, but sold their products mainly in the affluent Western European markets (Woon, 2003).

Another aspect of the EU membership that is inducing Chinese investment in ECE is institutional stability (e.g., protection of property rights) as one of the drivers of Chinese OFDI is unstable institutional, economic and political environment of their home country (e.g., Morck et al., 2007). It is in line with the findings of Clegg and Voss (2011, 101) who argue that Chinese OFDI in the EU shows "an institutional arbitrage strategy" as "Chinese firms invest in localities that offer clearer, more transparent and stable institutional environments. Such environments, like the EU, might lack the rapid economic growth recorded in China, but they offer greater planning and property rights security, as well as dedicated professional services that can support business development".

In their investment decisions in ECE countries Chinese firms might also be attracted by Free Trade Agreements between the EU and third countries such as Canada, the USA (being negotiated), and the EU neighbouring country policies etc. as they claim that their CEECs subsidiaries are to sell products in the host, EU, Northern American or even global markets. For example, Nuctech (Poland), security scanning equipment manufacturer, sells also to Turkey; machinery producers such as Shantuo Agricultural Machinery Equipment (Romania) for which important export markets are Canada, Russia, USA; and Liugong Machinery subsidiary in Poland that targets the EU, North American and CIS markets. This driver might also explain some of the Chinese investment in Bulgaria and Romania before their EU accession, such as SVA Group in Bulgaria. However, this type of institutional factor requires further research.

Moreover, Chinese firms' ECE subsidiaries may allow them to participate in public procurement. Example is Nuctech company that established its subsidiary in Poland in 2004 and initially targeted mainly Western European market. In 2011 the company stated that the old-EU market became saturated and it focused now more on ECE which benefit from the EU aid funds. However, in case of government procurement one of the conditions is "Made in the EU" and Nuctech's Polish manufacturing plant allows it to meet this requirement.

Recently Chinese firms interested in investing in countries of the ECE region became more inquisitive about food safety standards and certificates. They would be interested in exporting agricultural products with EU safety certificates to China where food safety has been a problem.

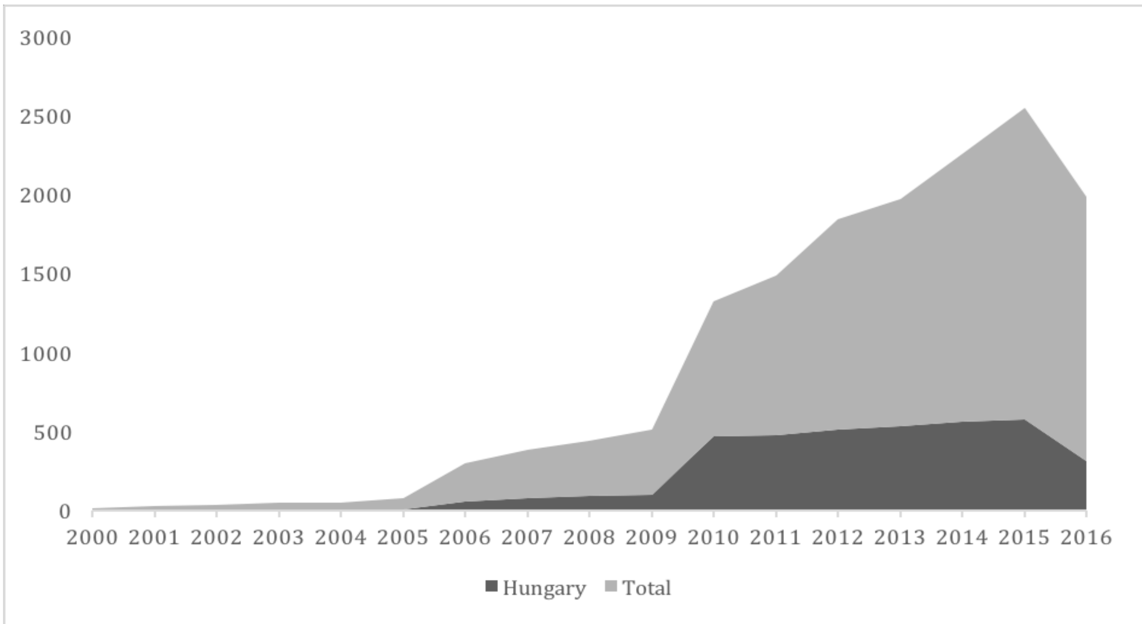
A special partner: Hungary?

Before their integration with the EU, ECE countries were mostly focused on fulfilment of the EU entry criteria and generally neglected relations with countries from other regions, except for Hungary. Only since the aftermath of the global financial crisis can we observe increased interest of the ECE (as well as other CEE) governments in attracting Chinese investors. For example, Poland started actively promoting itself with Chinese firms only at the EXPO 2010 in Shanghai.

Hungary is a country where the combination of traditional economic factors with institutional ones seems to play an important role in attracting Chinese investors. Hungary has had historically good political relations and earlier than other CEECs, since 2003, intensified bilateral relations in order to attract Chinese FDI. Hungary is the only country in the region that introduced special incentive for foreign investors from outside the EU, which is a possibility to receive a residence visa when fulfilling the requirement of a certain level of investment in Hungary. Moreover, Hungary has the largest Chinese diaspora in the region which is an acknowledged attracting factor of Chinese FDI in the extant literature, that is a relational asset constituting firm’s ownership advantage (Buckley et al., 2007). Example is Hisense’s explanation of the decision to invest in Hungary that besides traditional economic factors was motivated by “good diplomatic, economic, trade and educational relations with China; big Chinese population; Chinese trade and commercial networks, associations already formed” (CIEGA, 2007).

Although Hungary is not a priority target of the intensive Chinese FDI outflows of recent years, since the turn of the millennium Chinese investments show a growing trend here. Chinese investment to Hungary started to increase significantly after the country joined the EU in 2004. According to Chinese statistics, it means a really rapid – more than a hundredfold – increase from 5.43 million USD in 2003 to 571.11 million USD in 2015 (see Figure 2.). According to Chen (2012), in 2010, Hungary itself took 89 percent of the whole Chinese capital flow to the region. Although this share has been decreasing since then as other countries of the CEE region became also popular destinations for Chinese FDI, but the amount of Chinese investment in Hungary has continued to increase and it is by far the highest in the CEE region.

Figure 8. China's OFDI stock in Hungary compared to Chinese OFDI stock in CEE, 2000-2016, million USD

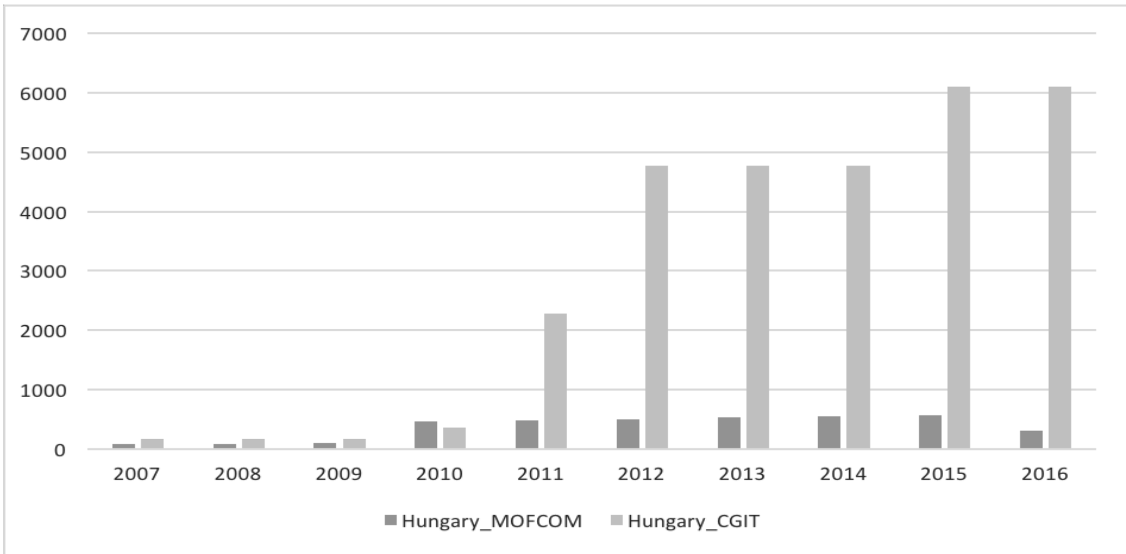


Data source: MOFCOM/NBS, PRC

As mentioned above, according to Chinese statistics, Chinese OFDI stock in Hungary was 571.11 million USD in 2015 but – due to disinvestments – turned to 313.7 million USD in 2016. Nevertheless, this amount is far greater when taking into account cumulative Hungarian data, since a significant portion of Chinese investment is received via intermediary countries or companies, therefore it appears elsewhere in national (Chinese and Hungarian) statistics. According to Hungarian reports, Chinese investment in Hungary by 2016 was about 3.5 billion USD, while China Global Investment Tracker indicates a stock of more that 6 billion USD (see Figure 9). More than 1.5 billion USD from that is the investment of the Chinese chemical company Wanhua, which acquired a 96 percent stake in the Hungarian chemical company BorsodChem through its Luxemburg subsidiary in 2010 and 2011. This subsidiary also made some investment for the development of BorsodChem later. It is the largest Chinese investment in CEE so far.

Figure 9. Comparing MOFCOM and CGIT statistics - China's OFDI stock in Hungary

2007-2016, million USD



Data source: MOFCOM/NBS, PRC and China Global Investment Tracker (CGIT) Database

Although Chinese multinational companies represent a relatively small share of total FDI stock in Hungary, they have saved and/or created jobs and contributed to the economic growth of Hungary with their investments and exports during the crisis. Furthermore, many of them (e.g. Lenovo, ZTE, Huawei, Bank of China) have turned their Hungarian businesses into the European regional hub of their activities (Szunomár et al., 2014).

In addition to the chemical industry, the investment of Chinese companies in Hungary covers industries such as manufacturing, telecommunications, trade, wholesales or retails, banking, hotels and catering, logistics, real estate and consultancy, etc. According to Hungarian statistics, more than 5000 Chinese companies operate in Hungary, most of them being small businesses operating in the service or retail sector: restaurants, perfumeries, and so called 'Chinese shops', selling bargains everything from shoes and clothes to plastic toys.

Beijing government often emphasizes that it treats Hungary as a hub for Chinese products in the European Union. In order to do so, it plans several infrastructure-related investment recent years: they want to transform Szombathely airport into a major European cargo base, develop the infrastructure and the services of the Debrecen airport and – as a part of the Belt and Road initiative – they support and finance the modernization project of the Belgrade-Budapest railroad connection.

Conclusion

As mentioned above, while Chinese OFDI in emerging or developing countries is characterized more by resource-seeking motives, Chinese companies in the developed world are rather focusing on buying themselves into global brands or distribution channels, getting acquainted with local management skills and technology, so-called strategic assets. Regarding modes of entry, investments shifted from greenfield investments to mergers and acquisitions currently representing around two-thirds of all Chinese OFDI in value. This shift is driven by the financial crisis, however it also seems to be a new trend of Chinese FDI to the developed world, while greenfield investment remains significant in the developing world.

China's OFDI has also become more diversified in the past years: from mining and manufacturing it turned towards high technology, infrastructure and heavy industry, and lately to the tertiary sector: business services and finance but also health care, media and entertainment. Asia continues to be the largest recipient, accounting for nearly three-quarters of total Chinese OFDI, followed by the EU, Australia, the US, Russia and Japan. Numbers might be misleading though due to round-tripping (the investment is placed in offshore financial centres only to flow it back in the form of inward FDI to China to benefit from fiscal incentives designed for foreign investors). According to project-level analysis, 60 percent of Chinese ODI is aimed at developed economies like Australia, Hong Kong, the United States, Germany, and Canada.

As for Chinese OFDI to the European Union, the Eurozone crisis attracted Chinese investors due to falling prices. As mentioned, Chinese investors prefer „old European" investment destinations not only because of market size but also because of well-established, sound economic relations with these countries.

Chinese investment in ECE constitutes a relatively small share in China's total FDI in Europe and is quite a new phenomenon. Nevertheless, Chinese FDI in the region is on the rise and expected to increase due to recent political developments between China and certain countries of the region, especially Hungary, Czechia and Poland.

The investigation of the motivations of Chinese OFDI in ECE shows that Chinese MNEs mostly search for markets. ECE countries' EU membership allows them to treat the region as a 'back door' to the affluent EU markets. Chinese investors are attracted by the relatively low labour costs, skilled workforce, and market potential. It is characteristic that their investment pattern in terms of country location resembles that of the world total FDI in the region.

Analysing the difference in motivations before and after the global financial crisis it can be assessed that although it did not have an impact on Chinese-CEE relations from the Chinese side directly but it did have indirectly because the crisis had an effect on the whole CEE region as most of them (not only the selected ECE countries) started to search for new opportunities after the crisis in their recovery from the recession. For example, Hungary's Eastern opening policy was initiated after (and partly as a result of) the crisis. China just took these opportunities, which can be the reason of the wider sectoral representation of Chinese firms in ECE in recent years. Another reason for this higher representation can be the diversification strategy because recently Chinese global investment strategy places great emphasis on the diversification in all respects. A good example for that is China's 16+1 initiative which provides a joint platform for all Central and Eastern European countries and China, as well as the Belt and Road initiative, which provides more and more connections for Chinese businesses.

Country-level institutional factors that impact location choice within ECE countries seem to be the size of Chinese ethnic population, investment incentives such as special economic zones, resident permits in exchange for given amount of investment, privatization, but also good political relations between host country and China (examples are Hungary's good relations and very high level of Chinese FDI when compared with other countries of the ECE region; as well as COVEC's problems with building part of Polish highway which resulted in some delayed deals such as Liu Gong's acquisition of HSW).

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