

# Geographical and Strategic Factors in Chinese Foreign Direct Investment in Europe

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## 1. Introduction

China's cumulative foreign exchange reserves inspire both hope and fear among the regions and countries that are potential recipients of the bounty made possible by China during the last four decades). The "Going global" policy contributed to the strong growth in outward direct investment, which was facilitated by the importance of the accumulated reserves withdrawn from foreign exchanges. Some see it as a form of expansionism (Guichard, 2014), others as a way to recycle financial resources out of conventional channels (buying American treasury bonds). It is also the means for China to secure its supplies of raw materials and energy, access to new markets for its products. Within the *One Belt, One Road Initiative*<sup>2</sup> (OBOR), this is the means to mobilize acquired skills at the domestic level, in particular in the construction of infrastructures such as trains, ports, roads, telecommunications. Supply of primary and energy resources, acquisition of assets and search for new markets on the one hand, integration into global and regional value chains of the other, Chinese FDI, still modest in volume, reflect a new phase of the growth of the economy of the Middle Empire

In recent decades, Chinese FDI (foreign direct investment) has focused on countries with significant natural resources such as the Persian Gulf, Africa, and Latin America. China have also demonstrated interest in developed and intermediate market economies in the past several years, particularly in EU member-states (EU-28<sup>3</sup>), countries waiting to join the EU in the Western Balkans, and neighbors farther East, including Russia, Ukraine, and Belarus (Richet, 2016). Another component of the Chinese presence, alongside FDI, is the state-owned firms that offer their services in the areas of highway construction, ports, and communications infrastructure. These firms operate in the countries of the region thanks to the financing provided by the China through special Funds financed political banks such as Exim Bank. These activities, therefore, do not constitute FDI.

These massive investment flows have inspired hopes that they might augment low levels of gross fixed capital formation in the EU since the 2008 crisis, although the region remains the premier destination for FDI, ahead of the United States and China (Ernst & Young 2015). It is also hoped that they will complement European investments in New Member States (NMSs) and the Western Balkan states awaiting accession (Central and East European Countries – CEEC). To underscore the importance of China's engagement with its partners in the region, the latter with 16 countries, founded an association, the *Cooperation between China and Central Eastern European Countries*<sup>4</sup>, also known as the *16 + 1 Initiative*. It is an

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<sup>2</sup> recently officially renamed Belt and Road Initiative (BRI)

<sup>3</sup> EU-28= EU 15 plus 13 New Member States (with the exception of Cyprus and Malta, all former socialist economies linked to the former USSR, two Republics of the former Federation of Yugoslavia) and 5 countries from Western Balkans of which 4 former Yugoslav Republics plus Albania. The five countries are expected to become members of the European Union and beneficiate of pre-accession programmes.

<sup>4</sup> 11 of these countries are NMS of the European Union, 5 of which are members of the euro area, 5 are accession countries to the EU.

institutional wrapping associated to the strategy to increase trade volumes, to invest heavily in infrastructures in this part of Europe alongside the goal of reaching more mature markets of the EU-15.

The fears provoked by Chinese FDI stem from concerns that Chinese firms are gaining partial or even complete control of the EU's industrial "crown jewels."<sup>5</sup> This vast investment offensive (Le Corre, Sepulchre, 2015) involves nearly every economic sector in the EU. Like *Les bourgeois de Calais*, national officials in EU countries have extended a warm welcome to this new class of investors (Ian Bond, 2015), and did not hesitate to launch competing strategies to attract Chinese FDI in both advanced economies (EU-15) and less developed and heavily investment-seeking economies even at the risk of fiscal dumping and lowest-bidder practices. Recently the European countries most targeted by the acquisition of sensitive technologies from Chinese firms have decided to favor more protectionist measures against this type of acquisitions. The European Commission is considering the adoption of specific measures to protect sensitive sectors targeted by Chinese investors<sup>6</sup>.

The decision to invest in this part of the world, like elsewhere, no longer involves exclusively state-owned Chinese companies. Private, publicly traded companies, small and medium-sized companies, start-ups, and born-globals have also become part of this trend. An increasing number of small-scale Chinese family firms are now scattered throughout the region particularly in Serbia, Hungary. (Cardena & Araùjo, 2013).

Does the presence of Chinese firms in CEEC represent a threat to the future integration of West European firms that have been crucial in the transformation of the region's industrial landscape? These firms' investments will only prove to be a threat if they generate activity and exchange flows that match pre-existing flows with the EU, the primary partner of countries awaiting integration. On the other hand, it is necessary to underline the slowness of the integration process initiated by the European Union which focuses mainly on the adoption of economic policies of stabilization and institutional reforms. For New member-states like Bulgaria and Romania, these investments merely supplement FDI emanating from the EU, which remains the region's most important source of foreign capital (Richet 2016). For other countries, such as Poland and Hungary, which criticize the strong presence of Western firms in their countries, which are largely at the mercy of their economic successes, the Chinese economic presence can be seen as a means of relieve this constraint.

More to the south a number of specific aspects of the Western Balkans might have limited appeal for Chinese investors, particularly in terms of substantial unrecoverable costs<sup>7</sup> that are held over from the decade-long conflicts that afflicted the industrial sectors of the region's economies, particularly in ex-Yugoslavia. The risk is limited, however, when it comes to the provision of services (construction of highway, highway) mainly financed by the Chinese political banks (Exim Bank).

Given these circumstances, it is worth asking whether Chinese investors see CEEC as a convenient gateway into Western European markets or as a land of opportunity. It is primarily a market of more than 100 million consumers, although fragmented, with rising income levels, still low wage costs, and a high level of labor productivity. These factors contribute to the attractiveness of the region even if the target, in the region, remains the mature markets of the EU-15.

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<sup>5</sup> Entrance into the capital of the French company Areva (nuclear industry) , as well as PSA, Club Med, the acquisition of Pirelli in Italy, the robotic manufacturing company Kuka in Germany and the Swiss group Syngenta

<sup>6</sup> 'Juncker to lay out plans for screening foreign takeovers in EU', Financial Times, 12/9/2016

<sup>7</sup> Absence of investments for several decades, impact of the economic disintegration of ex-Yugoslavia, physical and human destruction due to inter-ethnic wars and NATO bombing, and mass migration.

Whatever the explanation, it has become obvious that Europe in its broadest sense has become the premium destination for Chinese FDI. Patterns of geographical and sectorial distribution of Chinese FDI in terms of volume, company types, and the variable attractiveness of European economies offer a more complex portrait of the realities facing this flood of Chinese capital. The acquisition movement is associated with numerous risks for source-country stakeholders and host countries, despite Chinese government support via a range of agreements.

Chinese FDI in the region appears to be motivated by traditional factors that include the institutional context, factor costs, resources, market growth, and integration in regional value chains. These factors appear to be aligned along several axes:

- An East-West axis with FDI tending towards the high- and mid-tech in the EU-15 and greenfield-type investments with low labor costs in the NMSs.
- A North-South axis inside the EU-15 with FDI concentrated in Northern Europe tending towards high value-added FDI, and in the South with low value-added FDI
- A Southern East axis in countries awaiting accession and Southeastern European countries-- to take advantage of pre-accession opportunities and a lack of EU regulation to insinuate themselves into regional activities and eventually interfere in EU-Balkan relations.

The distribution of Chinese FDI in Europe is not perfectly aligned with this view, primarily due to the variety of investors and the convergence of economic policies in host countries, even if the crisis and the drop in value of various assets enhances the appeal of some countries. Significant factors related to investments' countries of origin are also worth noting, including geographic (the Americas, Africa) and sectorial diversification, the fight against corruption in China that both impedes and fuels capital flight up to recently following the introduction on administrative measures, in order to clean up and better control the procedures for the distribution of capital to invest abroad both by SOE and non-SOE enterprises.

Section 2 provides an overview of recent trends in Chinese FDI and a detailed summary of investment flows towards developed market-based economies, with a particular focus on Europe. This is followed in section 3 by a discussion of the geographical and sectorial features of Chinese FDI. Section 4 analyzes the expansion of Chinese FDI in Central Europe and the Balkan region. A concluding section discusses patterns and implications involved in Chinese FDI in Europe and profile with respect to larger foreign investors in the EU.

## **2. Chinese Firms Assault Markets**

### **2.1 The Internationalization of Chinese firms.**

China experienced accelerated FDI growth in the early 2000s following the country's membership in the WTO in late 2001, the launching of the "Going global" policy, but the internationalization among Chinese firms began as early as the 1980s (Richet 2015). After much early hesitation, the ascendancy of the Chinese economy boosted the international turn, a trend that was further amplified by the 2008 crisis, particularly in terms of the boom in Chinese FDI.

Over the recent period, China has become the third largest investor in the world after the US and Japan, with a total of USD 116,000 million. Today it is the 9th country in the world in terms of cumulative investments. 15300 Chinese companies invested abroad in an amount of USD 776 500 according to MOFCOM (USD 729 585 million according to UNCTAD statistics) (Casaburi, 2017). Available statistics reveal significant differences between sources, how to calculate FDI. Compared with the official data provided by MOFCOM (the Chinese Ministry of Commerce) (Table 1), other data, after recalculations, place a greater emphasis on Europe

23%) and North America (24%), and write the share of Asia (see China Global Investment Tracker, heritage Foundation).

**Table 1: Major Targets of Chinese FDI**

<b>Geographical distribution of Chinese FDI Stock, 2003-2015, (%)</b>		<b>Sectoral Distribution of Chinese FDI (%) 2013</b>	
Asia	70.0	Business service and Leasing	6.8
European Union	8.0	Financial	29.7
North America	4.3	Mining and Energy	17.7
Latin America	11.0	Trade	16.0
Africa	3.0	Manufacturing	13.3
Oceania	3.0	Transport	6.4
		Construction	4.8
		Real Estate	2.9
		Other	2.3

Source: MOFCOM

Higher skill levels, a burgeoning need for resources like raw materials and technology, and the search for new markets in the North and the South prompted Chinese authorities to gradually open access to domestic financing and capital outflows so that Chinese firms were prepared to enter foreign markets. Perspectives changed significantly in 2001, when China became a member of the WTO. This partially opened the domestic market to foreign firms and granted increased asset protection to firms already operating in China, particularly in terms of technology and intellectual property rights. For the government and Chinese firms involved, internationalization also implied, in addition to a “*politique de la grandeur*,” moving closer to technology production centers by acquiring assets that these firms were unable--or no longer able—to obtain locally through traditional industrial cooperation.

The acquisition of the Swedish Volvo group by the mid-sized Chinese firm Geely exemplifies this strategy (Balcet, Wang, & Richet, 2012). The quest for strategic assets is simultaneously a strategy to catch up technologically and a way of upgrading domestic firms so that they can compete with foreign firms operating in the country. Reinforcing “national champions” with government support, such as access to financing and R & D, also enabled certain state-owned firms in traditional industrial sectors such as machine tools, heavy equipment, and energy to specialize, increasing their competitiveness with Western firms in their own markets (for example, Chinese firms in the nuclear sector in the UK and defense companies in Turkey) (Huchet, 2015). Such companies were among the first to internationalize.

The situation has changed as internationalization involves a broader range of actors, destinations, and sectors, and as Europe has become a key destination for Chinese foreign investment (Box 1).

**Box 1: Chinese FDI--Stakeholders, Destinations, and Objectives**

<p>A variety of stakeholders: The central government, provinces, and municipalities, State-owned banks and companies, capital corporations, private, SMEs, family business</p> <p>A variety of financing strategies: public, subsidies, private, self-funding, conglomerate leverage</p> <p>US vs. Europe ?</p>
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Europe : EU-28, EU-15, 1+16<sup>8</sup>

Direct investments and/or trade routes: *One Belt, One road*, New silk road

Technologies: medium, high

Insertion or construction of regional value chains

Search for Strategic Assets *vs.* Market for Chinese products.

Capital flight, round trip investment, financial investment, speculation

Mergers and acquisitions *vs.* Greenfield investments

Majority/minority ownership of acquired companies

Industry *vs.* Services, finance, commercial real estate

Specialization, deepening, diversification strategies through FDI

Multi-nationalization *vs.* repatriation to the domestic market, stripping foreign assets

Market growth: China or global market

Large state-owned firms continue to account for the lion's share of the manufacturing and export of high-value-added goods. They continue to account for the bulk of FDI, although private companies have begun to catch up. Among the top 20 Chinese firms investing abroad, there are 19 state-owned enterprises in the energy, construction, transport and engineering sectors. Only the last one, Huawei, a huge telecom company is not state-owned, company, that is private, has the status of employee stock option.

Gaining access to technology by investing in market-based economies has been the greatest driving force behind internationalization, ahead of other factors like searching for new markets, diversifying risk, and financial investment (Chaminade, 2015).

## 2.2 Different Types of Investors

Early Chinese investments abroad were exclusively made by large, state-owned companies. Several types of firms exist in China in terms of control and organization, an indication that the Chinese industrial system reflects a very unique configuration (Zhao, 2015; Huchet, 2015), which in turn influences their motivations to invest abroad. First, there are state-owned companies, which receive generous government support in terms of capital access, innovation, and aid (Haley & Haley, 2013). They enter foreign markets seeking raw materials, technologies, and markets. In some countries, they are an important component of the "Chinese infrastructure diplomacy". Despite comparatively weak performance with private companies, these firms enjoy a certain advantage over private Chinese firms. Second are non-state-owned firms of varying sizes and types (ranging from publicly-traded private firms to SMEs and family-owned firms). Private firms, often more innovative, contribute to the breakthrough of Chinese FDI in search of new markets, industrial cooperation, notably through acquisitions and partnerships. Their incentives to invest are also explained by their desire to escape internal control by the government, which obliges them to cooperate with less efficient state-owned firms. Today, some of them are obliged to invest in the OBOR initiative in risky projects. Among private non-state firms, there are sub-contractual companies of an OEM type<sup>9</sup> that manufacture goods to order.

These companies have either lacked access to public innovation or have experienced difficulties in gaining access, with little or no access compared to purchasers. The transition from being an ODM forces them to ascend the value chain in order to acquire the necessary technologies. The internationalization of these firms towards developed market economies represents a way of gaining access to the knowledge and technologies that they lack domestically. Increase in public spending in R-D is time consuming in terms of impact and appropriation by firms, of spin off. The majority of these firms still face numerous obstacles to

<sup>8</sup> 1+16: China + NMS (11) + Western Balkans (5)

<sup>9</sup> OEM (Original equipment manufacturing), as opposed to ODM (Original Design Manufacturing) or OBM (Original Brand Manufacturing), which develop their own products.

become true multinationals (Box 2), despite the fact that they demonstrated capacities to assimilate organizational skill (Richet 2015). Nonetheless, some of them have been able to create some competitive advantages, build up international networks with numerous facilities, resources and R-D centers abroad (Huawei).

## Box 2: Limited Internationalization?

### *Chinese FDI towards the North:*

Search for strategic assets, brand purchases, market shares for medium- and high-technology products  
 Construction of Chinese value chains, which continue to be weak, even non-existent  
 Integration into international/regional value chains in medium-high technologies  
 Acquisition of bankrupt companies (IBM, Volvo, PSA, Club Med), participation in firms experiencing difficulty (EDF, AREVA), and, more recently, acquisition of companies with higher technology content (Kuka)<sup>10</sup>.

### *Multinationalization:*

Chinese companies operate in traditional industries such as mining and metallurgy, protected domains such as banks and telecoms, and mostly state-owned firms  
 Truly internationalized Chinese with global strategies continue to be very limited  
 Absorption technological and innovations capacities remain necessary  
 Insufficient financial resources to ensure financing, intercultural management issues

### *Firms providing services (not FDI)*

Development outside know-how and competences acquired at the domestic level in a monopolistic framework with privileged access to state financing (political banks)  
 Component of the "infrastructures diplomacy" developed by the government. Gateway to Chinese investments  
 Assurance of extensive subsidies from the Chinese government (> 80%), loans to host governments to finance the rest  
 Control of the design, construction, marginal role of local subcontractors

## 2.3 Is China's Goal to Conquer the World?

Is China buying the world? (Nolan 2012), does it specifically target Europe (Le Corre & Sepulcher, 2015)? Recent acquisitions across a spectrum of sectors ranging from airports to holiday and football clubs offer insights into China's growing profile in developed markets. The underlying organization of these operations in terms of transparency, financing sources, and ties to government also sheds doubt on these projects' viability of and the reputations of the individuals and forces behind them. The recent measures taken by the Chinese government against firms investing abroad have several objectives: to control capital outflows, to discipline firms by ending the leverage mechanism, to rationalize outward investment by linking them mainly to their core activities.

Peter Nolan (2012) analyses the emergence of China on the international scene, the internationalization of its companies, and their hunger to acquire foreign assets in the natural resources and technology sectors relativizes the prominence of Chinese FDI in general, in particular in emerging economies. He raises questions about China's capacity to absorb technology through its acquisitions. He demonstrates that in terms of level, the Chinese financial reserves mobilized for acquisitions are only equivalent to the capitalization of two large US firms, Exxon and Apple.

The "savage capitalist globalization" has left a relatively modest amount of elbow room for emerging countries, including China. The high level of capital concentration took place 'among us' (capitalist countries), strengthening the connections between companies and banks

<sup>10</sup> 'China 's Robot Revolution', Financial times, June 6, 2016

and financial institutions in high-income market economies. ‘For them’ (China, emerging countries), only the crumbs from this giant feast remain. The great capitalists corporations have focused on core innovation systems and increased their lead over firms from emerging countries. Chinese acquisitions in advanced market economies have involved firms that are either in bankruptcy or are experiencing substantial financial difficulties, such as Volvo, PSA, and Club Med. More recently, in Europe, Chinese FDI acquisitions has shifted towards profitable higher-tech firms, reflecting both the need to integrate into regional value chains closer to the sources of innovation (automotive industry in Germany) and access to more advanced technologies (robotics)<sup>11</sup>.

The objectives set out in the documents concerning the 13th Five-Year Plan (2016-2020) clearly show the intentions of the Chinese government and present a checklist of the priority sectors that need to be developed and, consequently, the technologies that companies in these sectors must develop either by benefiting from domestic R-D policies, or by incorporating technologies acquired from outside. The *2025 Made in China* program is even more explicit and refers to particularly targeted objectives in the fields of robotics, artificial intelligence. At the same time, the Chinese government is increasing its pressure on foreign firms to increase their contribution to the research and development efforts (making it easier to access licenses, integrating foreign companies to meet certain priority objectives). Implicitly, this attitude reflects the devotion of Chinese investors on the real impact of technology transfer through cooperation within joint ventures in China.

### 3. Europe: A Prized Destination?

#### 3.1. Recent Acceleration

Economic relations between China and the European Union in the early 1980s focused primarily on trade, turning only later to FDI. Europe is China’s leading trade partner and is one of the world’s primary investors in China. With the EU and other Asian countries such as South Korea, Europe has rapidly become a top-ranking partner, particularly through numerous direct investments in the region that have contributed the development of new sectors either via industrial cooperation (*joint-ventures*) or by locating 100% foreign companies in the country. Increased exchanges between the two partners have triggered the development of a major asymmetry—a trade imbalance in China’s favor and an imbalance that favors Europe in terms of FDI (Table 2).

**Table 2: Trade flows and FDI stocks between China and the EU (€bns)**

	EU Imports	EU exports	Balance
Trade in goods, 2016	364.6	170.1	-174.5
Trade in services, 2006	26.4	37.3	10.9
	Inward stocks	Outward stocks	Balance
EU-China, 2015	34.9	168.4	+133.5

Source: Eurostat, Trade

The entrance of foreign capital into Europe has unfolded in several phases, with the 2007-2008 financial crisis functioning as an accelerator. With the appreciation of the RMB and the euro’s decline, acquisitions of assets in the region were stimulated. The absence of uniform regulations covering Chinese investment in Europe has also facilitated entry (Figure 3).

<sup>11</sup> ‘China’s robot revolution’, Financial Times, June 6, 2016

Chinese investment has rapidly become welcome in both the EU-15 and the NMSs, as more advanced economies like the UK, Germany, and France have adopted policies to attract Chinese investment before becoming more cautious concerning Chinese acquisitions in sensible sectors. NMS and Western Balkans countries, through the *16 + 1 Initiative*, constitute a component of the new Silk Road. In this respect, the Chinese presence is manifested by the realization of direct investments, by providing numerous services (motorway constructions, port modernization). It is also in this space that ends the different lines, maritime, terrestrial, in the card of the OBOR / BRI project before reaching different destinations in the EU-15. To achieve its objectives, China has set up a specific fund of \$ 10 billion, recently increased by \$ 3 billion.

**Table 3: The Three Phases of Chinese FDI in Europe**

<b>Pre-crisis (2001-2008)</b>		
China joins the WTO. Domestic deregulation, Catch-up policies	Chinese companies: Reacting to deregulation, WTO, experimentation, Outgoing FDI: weak % towards the EU	EU unimpressed by Chinese FDI outflows
<b>During the crisis (2009-2012)</b>		
China: Encouragements, “take advantage” of the EU’s crisis	Chinese firms: Seize a unique opportunity	Member-states compete with each other to attract Chinese FDI
<b>Post-crisis (2013 to the present)</b>		
China: New government with Xi and Li, new incentives and initiatives ( <i>Silk road infrastructure Fund</i> , OBOR)	Chinese firms continue to invest by pursuing more sophisticated strategies Multiple actors	EU: bilateral treaties on investment, collective interest/demand for identical treatment on the Chinese market

Source: Adapted from Jia (2015)

The entry of many Chinese firms into the capital of several European firms has been facilitated by the long cooperation developed in China between these firms in various sectors such as the nuclear industry (EDF) and the automobile industry (PSA). Cooperation between French and Chinese firms also facilitated entry into third markets (in the nuclear industry in Britain, in the construction of ports in Africa).

**Table 4 : The Different Types of Chinese Firms Present in Europe**

	State-owned Firms	Private Companies	Entrepreneurs and Family businesses
Motivations	Search for assets (infrastructure/resources/key technologies)	Search for markets and assets (key distribution sectors/supply chains/brands/technologies)	Opportunities for bargains (combined with emigration)
Location	Key EU countries (incl. Germany, the UK, and France)	EU-15, CEEC	CEEC and Southern Europe (the Balkans)
Forms of Entry	Mergers and acquisitions	Mergers and acquisitions	Greenfield investments
Partnership	Global multinational firms and large European firms	European SMEs	Chinese, ethnic Chinese SMEs

EUSME (2015)

### 3.2.Pronounced Geographical and Sectorial Diversity

According to the Rhodium Group (2015), a total of 1,047 transactions took place in the EU-28 between 2000 and 2014, encompassing 726 greenfield-type investments and 321 acquisitions. Annual investment flows were modest until 2008, after which they rose to approximately \$2 bn in 2009, 2010 and \$7 bn in 2011-2012. Following a short-lived drop to \$6 bn in 2013, investment grew to over \$14 bn in 2015.

**Table 5: Chinese FDI Stock in the EU, 2000-2016 (€ mios) and by sector (%)**

UE-15 (millions of €)		EU-NMS (millions of €)		By sector (%)	
Great Britain	23 636	Estonia	23	Energy	28
Ireland	2723	Latvia	3	Automobile	13
Netherlands	5598	Lithuania	33	Agriculture, Agro-business	12
Belgium	1808	Czech Republic	569	Real estate	11
Luxemburg	499	Poland	936	Heavy equipment	9
France	11459	Hungary	2051	Information technologies	6
Spain	3015	Romania	889	Raw materials	5
Portugal	5726	Slovenia	8	Finance and financial services	4
Italy	12839	Croatia	4	Transportation and construction	4
Greece	840	Bulgaria	337	Health and biotechnology	2
Germany	18817	Cyprus	45	Consumer goods and services	2
Denmark	209	Malta	70	Electronics	2
Sweden	1502	<b>Total</b>	4968	Metals and minerals	1
Finland	6854			Leisure activities	1
Austria	551			Aviation	1
<b>Total</b>	72440	<b>Total EU-28</b>	<b>82376</b>	<b>Total</b>	<b>100</b>

From Thilo Hanemann and Mikko Huotari (2015) and (2017)

The cumulative value of all transactions during the period rose to \$46 bn.

The heart of Europe (UE-15) remains the principal target of Chinese FDI and among them, the ‘big three’: France, Germany and the UK. Between 2000 and 2014, over 50% of cumulative FDI targeted the UK, Germany, and France. Chinese FDI has become more geographically diverse in recent years, particularly in southern European economies<sup>12</sup> increasing from 10% before 2011 to over 30% from 2012 to 2014, with Chinese firms taking advantage of the local context by investing in previously state-controlled sectors, especially utilities and transportation. The proportion of FDI in NMSs, notably in manufacturing, agriculture, and infrastructure, has gradually expanded to roughly 8% of investment in the region. The diversification of Chinese FDI in this part of Europe is confirmed despite the fact that the highest volume of investments continues to be directed towards more developed and prominent economies. A strong asymmetry is also at work, with the majority of Chinese investment in the NMSs and Western Balkans, (table 6) being placed due to advantages and risk levels that are specific to the region. More focused investments in medium and higher technologies in the north part. Much less important in the south where infrastructure building is favored with the help that they could open future markets (Serbia). In Bulgaria investment in the automobile sector aims at supplying regional markets with Chinese brands. In Serbia and Romania investments in the telecommunications sector are part of the network strategy at European level (Huawei).

Chinese FDI prioritizes the energy and advanced manufacturing sectors. Over \$13 bn have been invested in public utilities, fossil fuels, and renewable energies, for example. The advanced manufacturing sector--the automotive industry (\$6 bn), heavy equipment (\$4 bn),

<sup>12</sup> Portugal, Italy, Greece, Spain

and telecommunications (\$3 bn)--represent the second sector, followed by services, particularly transportation (\$2 bn), and high value-added sectors like biotechnology and finance (\$3 bn). Chinese investments have more recently encompassed agriculture and agri-business (\$5 bn) and commercial real estate (\$5 bn).

Legislation that covers Chinese FDI is not yet uniform across the 28 EU member-states, a situation that enables investors to take advantage of variations in market access, taxation, and protection. At the same time, regulations have been tightened in the US - another prime destination for Chinese FDI -, especially with regard to mergers and acquisitions in strategic sectors.

Le Corre and Sepulchre (2015) review the internationalization strategies of Chinese businesses with respect to advanced EU economies by analyzing their driving forces, means, and modes of entry, as well as the financing behind acquisitions and how their integration into parent companies is managed.

The survey carried out by Antwerp Management School (2014) shows the geographical distribution of firms by type of property (Table 6). The SOEs favor the heart of Europe, the CEEC attracts more private firms and especially the SMEs and family firms. In the control period, the same study reveals that total control is preferred in all acquisitions (Table 6 and 7)

**Table 6: Geographical distribution of Chinese FDI by Ownership**

	SOE	Private firms	Individual and Family business
Western Europe	59.34	62.10	21.79
Northern Europe	21.58	11.57	1.41
Southern Europe	7.47	4.44	14.07
Eastern Europe	11.62	21.89	62.73

Source: Antwerp Management School (2014)

**Table 7: FDI distribution by level of control, knowledge and technology intensity**

	Entry form per type of firms			Knowledge and Technology Intensity			
	SOE	Private firms	Individual And Family busienss	Knowledge intensive sector	Less Knowledge intensive sector	High tech. Manufacturing	Low tech manufacturing
Minority JV	10.88	9.60	15.81	21.12	14.21	11.00	17.92
50:50 JV	2.51	3.59	18.46	9.11	17.44	8.00	13.21
Majority JV	18.83	15.88	19.82	13.95	19.65	24.50	19.34
Wholly Owned susidiaries	67.78	69.54	45.91	55.81	48.70	56.50	49.53

Source: Antwerp Management School (2014)

**Table 8: Comparative Attractiveness of the EU-15, NMSs, and WesternBalkans**

Host Countries in Eastern Europe and the Balkans	
Advantages	Disadvantages
Complement FDI from the EU-15 Diversification In-flows of capital, markets, jobs Renewal of industrial sector Development of exports	Increased external control (dependent capitalism) Intercultural and communications shock Distance from EU standards and insertion into Regional value chain standards Defiance with regard to the EU

Insertion into Chinese value chains	
<b>Chinese firms' Expectations</b>	
<b>EU-15</b>	<b>NMSs + Balkans</b>
High-earning markets, returns Opportunities for technology access Lower euro value, increased RMB value Weak regulation of foreign investments Experience with Chinese-EU cooperation (European FDI in China)	Low labor costs Greenfield investments encouraged: volume Markets growth Continuity between Northern and Southern roadways in the framework of OBOR Geopolitical game: Mixing among EU businesses (1+16): Services providing in infrastructures

The financial crisis reduced the value of numerous available shares<sup>13</sup>, thus clearly facilitating takeovers across a variety of sectors. The impulse to acquire technology assets through purchases of large firms such as Geely-Volvo and more modest-sized companies has attracted some investment, while others are scattered across a broad range of sectors that includes real estate, infrastructure, leisure, and finance. Geely's purchase of Volvo, for example, represents an attempt, by a Chinese medium size car maker to enter the premium market, competing with firms such as Mercedes, BMW in the Chinese market. The firm appears to be secondarily using this acquisition as a mean of penetrating tertiary markets like Uruguay, Ukraine and Belarus, where they assemble and sell only entry-level Chinese car.

After reorganizing its production and building additional factories in China, Geely-Volvo has recently entered the premium American market by exporting high-end cars manufactured in China, and latter in US invested firms.

Other firms have pursued higher-end markets by internationalizing and ascending (or descending) subsidiaries. This is the case with basic and mid-market firms such as Haier, and mid- to upper-market ranges and technology content, including Huawei. Acquisitions and knowledge are more difficult to acquire in more complex technologies requiring greater engineering skills such as computers. Finally, company strategies in terms of growth are not uniform because they need to be tailored to match the competition in specific markets according to levels of concentration, levels of technology, financial capacities, and credit access.

Drawing on this analysis, the authors propose a typology of the internationalization pattern of Chinese firms in Europe :

- Products trending towards high-end appeal: Haier
- Outsourcing and direct clients: Huawei
- Massive acquisitions: Lenovo, Geely, ChemChina
- "Orientalism": Luxury hotels of Asian origin (HK, Singapore)
- National champions pushed out of China to extend their markets, Dongfeng, SAIC (automobile)

Firms can be classified into two categories based on type of investment—either specialized (Lenovo, Haier, Huawei) or diversified (Fosun, Wanda). The authors confirm Nolan's (2012) arguments regarding opaque governance (cascading shell companies, non-hierarchical organization), low percentages of foreign operations (10% on average as opposed to 80-90% for Western MNCs), strong disparities in mergers and acquisitions in terms of market, growth reserves, size, matching between the price of an acquisition and the intended target. Some firms were able to acquire relatively under-valued assets (Dongfeng/PSA or moderately valued (Geely/Volvo) from companies running deficits, albeit with predictably increased risk. A final point relates to financing foreign acquisitions, which are typically funded through loans from Chinese banks. Several companies, including Huawei, have accumulated substantial overdrafts, and the number of risky commitments backed by some banks explains

<sup>13</sup> Initially offered at \$3.6 billion, Volvo sold for \$1.8 billion. Cf. Balcet, Hua Wang, Richet (2012)

recent trends to exhibit greater restraint and reduce participation levels in purchases of foreign assets. In the case of Geely's purchase of Volvo (\$1.8 bn), 40% of the acquisition was financed using the firm's own funds, while only 10 % was borrowed from a state bank; 10% was raised by issuing stock, and the rest was furnished by the two provincial governments that hosted new factory construction as stipulated in the agreement (Balcet, Hua Wang, & Richet 2012). It is nevertheless clear that Chinese banks and institutions remain heavily involved in financing by issuing lines of credit to companies that invest in Europe.

This leverage mechanism has been abused by many Chinese companies that have made significant acquisitions in the United States and Europe (HNA Group, Dalain Wanda, Anbang, Fosung) either internally within conglomerates or externally issuing bonds and selling on international financial markets. Recently it has been questioned by the supervisory authorities and groups do not have the same latitude to raise funds and to make investments abroad often far from their core business<sup>14</sup>

#### **4. NMSs and Western Balkans: A Passageway or real anchorage?**

A strong asymmetry between the EU-15 and the rest of Europe continues to prevail, with respect to NMSs and countries in accession. Although NMSs have begun to attract Chinese FDI, the percentage remains low, and overall FDI volumes in the region, other than a few cases in Hungary and Romania, remain modest. With the exception of Hungary, no other country in the region has hosted FDI exceeding the equivalent of 1% of GDP.

Several explanations for the region's relative lack of interest for foreign investors can be offered. Chinese investors arrive on the scene in the wake of massive institutional changes that heavily influenced the transition to market-based economies. These changes included mass privatization at competitive prices, cost advantages that, although some bargains remain, are tending to diminish, and the most appealing assets have either already been sold or their value is held down by unrecoverable costs. Only such factors as proximity to markets and the greenfield investments' lower costs can justify continued investment in the manufacturing sector, in part because of stiff competition from the East, including Russia, Ukraine, and Belarus. On the other hand, like in the Balkans, family FDI is thriving in the region, contributing to the creation of a number of industrial facilities, although because they have a relatively low total value, their impact on the region's overall investment volumes remains relatively modest.

#### **4. Central and East European Countries: a passageway or an economic anchor?**

The 16 countries with which China has founded a Cooperation between China and Central and Eastern European Countries (16 + 1 Initiative) constitute a heterogeneous set by size, population, level of development, specialization, institutional affiliation. Nine of these countries are members of the European Union (Estonia, Latvia, Lithuania, Poland, Czech Republic, Slovakia, Hungary, Slovenia, Croatia, Romania and Bulgaria) Slovenia) that they have integrated in different waves (2004, 2007, 2013), five others, the Western Balkan countries (Albania, Bosnia and Herzegovina, Macedonia, Montenegro, Serbia) are on their way to access to the European Union and therefore already subject to European regulations arising from their status as future members.

For China, CEEC is both a gateway, a market of nearly 100 million consumers, a stepping stone to the EU-15, it is also an area where the need for infrastructures construction is huge following

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<sup>14</sup> « Chinese crackdown on dealmakers reflects Xi power play », Financial Times, 8/9/2017

the disintegration of the former Yugoslavia and the need to build up east-west lines of communications.

It is primarily a place of transit. Poland, to the north-east, is on the land route from Belarus, the arrival point of trains crossing the Eurasian Economic Union<sup>15</sup> and continuing on their way to Germany. In southern Europe, the sea route, via the Suez Canal, reaches the port of Piraeus in Greece. China has taken control and management of parts of the port for a period of thirty years. Other nearby port terminals are of interest to China, notably in Bulgaria and Turkey near Istanbul point of arrival of another road route of the Route which passes through Iran, Georgia and Turkey.

The attractiveness of CEEC for is first of all the possibility of making a connection and entering the various European markets. This is an opportunity for Chinese construction companies to build infrastructure, including highways in different countries. The flagship project remains the construction of a high-speed rail line between Belgrade and Budapest, increasing the length of the rail link from more than eight hours to two and a half hours. The line is to be completed, later by the Belgrade-Skopje sections in Macedonia, then Skopje-Athens. The bulk is financed by loans from Chinese banks to the tune of 75%, the rest by the States that will reimburse the Chinese banks. The construction of this line obliges the Chinese firms and the States concerned to follow the European regulations on public procurement, environmental constraints.

The 'shopping list' of Chinese investors, moreover, is limited in terms of asset acquisition. Economic openness and integration into the EU, the privatization process and the proximity effect have made the region, initially in Central Eastern Europe, the backbone of the major Western European making these economies dependent capitalisms (Richet 2016). The most attractive assets are no longer numerous or even non-existent. Chinese investors buy companies that are often in difficulty and cannot be recapitalized by domestic investors in sectors such as the steel industry (Serbia), chemicals (Hungary) or participate in the modernization and extension of nuclear power plants (Romania). Construction and expansion of coal-fired power plants are also being planned in Serbia, Bosnia and Herzegovina (note that such investments, which go against the environmental commitments of multinational financial institutions to which China belongs are backed by loans from Chinese political banks).

Other sectors attract foreign direct investment in order to benefit from local know-how, higher value-added content (northern Central Europe, the Baltic States) or to create a regional resource base in certain areas (information technology in Hungary, Romania) which can serve as a springboard for entering the EU-15 markets. In other cases, such as automotive construction in Bulgaria, electric batteries in Serbia, there is a spin-off effect. The upcoming participation of Chinese investors in the privatization of Serbian companies is expected to increase the phenomenon of sectoral diversification, although it is not yet possible to measure the coherence of these participations. Here we see the effect of "infrastructure diplomacy": after signing contracts for the construction of roads, highways, ports, railway lines on favorable terms, Chinese firms are encouraged and encouraged to invest in other sectors (Table 3)

For the receiving countries, the Chinese presence is welcomed with interest but also with a certain skepticism. The countries of the region, as in other parts of Europe, are spreading the red carpet to accommodate Chinese investments that complement those made by EU-15 investments in unattractive sectors. Although railway lines provide access to Chinese markets, they do not contribute to the creation of many jobs, unlike greenfields investments.

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<sup>15</sup> A supranational institution initiated by Russia and gathering, today, besides Russia, Armenia, Belarus, Kazakhstan and Kyrgyzstan. Moldova, Mongolia and Tajikistan are expected to join this economic association, which aims to create a common market

Several countries wish to extend cooperation with China to other areas (airways, tourism). Greenfield investments rather than railway construction, opening up the Chinese market to products from the region would contribute more to job creation. Analysts also highlight the skepticism of the region's leaders regarding China's real commitment. The governments of the region do not forget that their development is fundamentally linked to the EU its regulations that oblige them and the many benefits they derive from their membership of the European Union.

Real regional anchoring or dusting to facilitate crossing this segment? Finally, the Chinese presence in the region is still weak. As a percentage, Chinese FDI is low, accounting for only a very small share of Chinese FDI in this part of the EU. In addition, FDI in the CEEC is concentrated in a few countries (Table 9). The sprinkling of Chinese government and firms would be the right of entry allowing the passage in the region to the final destination, the heart of Europe.

**Table 9: Chinese FDI 16 CEE countries in 2009 and 2014 (stock/US\$ mios)**

	2009	2010	2011	2012	2013	2014	2009-2014	% in CEE	total
Poland	97.41	465.70	475.35	507.41	532.35	556.35	471.14%	32.79%	
Czech Republic	120.30	140.31	201.26	208.11	257.04	329.35	173.77%	19.41%	
Romania	93.34	124.95	125.83	161.09	145.13	191.37	105.02%	11.28%	
Bulgaria	2.31	15.60	72.56	126.74	149.85	170.27	7271.00%	10.04%	
Slovakia	9.36	9.82	25.78	86.01	82.77	127.79	1265.28%	7.53%	
Serbia	2.68	4.84	5.08	6.57	18.54	29.71	1008.58	1.75%	
Lithuania	3.93	3.93	3.93	6.97	12.48	12.48	217.56%	0.74%	
Croatia	8.10	8.13	8.18	8.63	8.31	11.87	46.54%	0.70%	
Albania	4.35	4.43	4.43	4.43	7.03	7.03	61.61%	0.41%	
Bosnia-Herzegovina	5.92	5.98	6.01	6.07	6.13	6.13	3.55%	0.36%	
Slovenia	5.00	5.00	5.00	5.00	5.00	5.00	0.00%	0.29%	
Estonia	7.50	7.50	7.50	3.50	3.50	3.50	-53.33%	0.21%	
Macedonia	0.20	0.20	0.20	0.26	2.09	2.11	955.00%	0.12%	
Latvia	0.54	0.54	0.54	0.54	0.54	0.54	0.00%	0.03%	
Montenegro	0.32	0.32	0.32	0.32	0.32	0.32	0.00%	0.02%	
Total	410.60	852.58	1008.77	1334.00	1435.76	1696.51	3.13	100%	

Source: China Analysis (2016)

An additional question is whether the Balkans are serving as a back door into the EU for Chinese FDI. As remarked earlier, there are geopolitical factors involved, including obstacles to the Balkans' EU integration and the 1+16 alliance, as well as the possibility of a back-door initiative to conquer Europe via the South. But up to now, the level of FDI and deals remain very low (Table 10).

**Table 10: Chinese FDI in the Balkans**

	Projects	Companies	New Jobs		Investments (million \$)	
			Total	Average	Total	Average
Romania	35	23	12,136	346	1,890.20	54.00
Bulgaria	16	14	5,097	318	21,132.0	132.10
Greece	13	9	1,339	103	648.30	49.90
Serbia	2	2	59	29	154.60	77.20
Bosnia-Herzegovina	2	2	595	297	583.20	291.60
Macedonia ARY	1	1	4,500	4,500	349.90	349.00
Croatia	1	1	128	128	80.80	80.80
Total	70	46	33,854	340	5,820.20	83.10

Jacoby Wade (2015)

The region's fragile economies are also sensitive to the potential ability for Chinese FDI to strengthen them by compensating for a lack of capital. Overall capital in-flows have remained disappointingly modest, however (Table 6).

Chinese investments cannot always be considered as full-fledged offshore activities. In fact, they often consist of agreements assigning financial roles to the various parties to large infrastructure projects--building and renovating port facilities, railways, or electrical and nuclear power plants—with Chinese firms simply serving as the general contractors. It is difficult to categorize such cases as FDI, which implies offshore activity and control or the creation of new companies (Figure 7). It should also be acknowledged that Chinese capital inflows are currently slowed by the insolvency and indebtedness of regional governments that refuse to back the loans required to finance projects. The Chinese government is attempting to directly align itself with Brussels in order to obtain financial guarantees that encompass the region's individual countries.<sup>16</sup>

## 5. Conclusion

Global Chinese FDI has grown steadily over the past fifteen years, particularly in Europe. This expansion has been fueled by substantial Chinese cash reserves resulting from steady economic growth that is driven by exports and a quest for strategic assets, as well as a search for markets by Chinese firms that face increasing domestic competition. These firms are also seeking to benefit from their competitive and organizational advantages, including flexibility in terms of catching up to competitors and learning new management techniques.

Three categories of Chinese companies have driven this epic surge in Chinese overseas investments. Some large Chinese state-owned firms that benefit from distinct advantages in terms of market access, R & D, and financing have shifted towards global operations by specializing and refining their skills. As a consequence, they have been able to invest in core European industries in the EU-15, particularly the UK, Germany, and France. A second category of Chinese firms--private, non-state companies from the industry, services, and finance sectors--also accounts for massive acquisitions in Europe. Like state-owned firms, they are primarily in search of new opportunities, such as expanding their market share or assets that are either not available in China or that exhibit higher-value in the EU than in China. In terms of value chain integration, FDI by these firms tends to target Western chains rather than constructing chains based on Chinese firms. One new trend is growing diversification of investments towards other sectors (real estate, finances), both in terms of volume and individual placements. A final emergent category consists of growing investments made by

<sup>16</sup> According to the Director of the Albanian Center for Strategic Studies in Tirana (interview, February 2016)

entrepreneurial “ethno-Chinese” firms, although their total investment volumes remain proportionately low.

In terms of spatial distribution, a powerful asymmetry prevails between, on the one hand, state-owned firms, industrial capital firms, and services that have invested primarily in the EU-15 through joint ventures, acquisitions in the East, and on the other hand, greenfield and family FDI, which continue to represent greater numbers but lower financial volumes.

Southeastern Europe, including the Balkans, is uniquely situated at the intersection of a number of Chinese strategies that include a possible geopolitical effort to develop a sphere of influence by taking advantage of the region’s political weaknesses. These strategies are also commercial in reflecting a desire to increase trade in the region, because the southern EU is the end-point of a long road that is currently being constructed by China (OBOR). Chinese goods exiting the Suez Canal and arriving in Athens have to be carried by rail towards Northeastern and Eastern Europe, which explains the proliferation of rail and freeway infrastructure construction projects by Chinese firms. Investments in energy in Bosnia and Romania also serve as entry points for more promising markets such as the EU (including nuclear reactors in the UK).

China is presently experiencing an economic downturn that has caused diminished growth, financial instability, and plummeting stock values. The country has experienced difficulties in adapting its growth model. The present gloomy outlook will inevitably trigger reduced foreign reserves and as a result, will impinge upon China’s investment capacity, in turn influencing FDI in Europe. A final shadow looms over the future Chinese FDI in high-revenue market economies such as the EU: EU firms’ difficulties in adapting to Chinese management approaches.

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