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Chinese Foreign Direct Investment in the EU

Jan Knoerich and Tina Miedtank The Idiosyncratic Nature of Chinese Foreign Direct Investment in Europe

The remarkable rise of foreign direct investment (FDI) from China has drawn much attention in recent years. Bolstered by the growth of China's domestic economy and its growing global economic weight, Chinese multinational enterprises (MNEs) have begun to leave a distinct footprint as investors in all parts of the world (Knoerich 2015). Part of this trend has been the emergence of the European Union (EU) as a key destination for Chinese outward FDI.

Chinese investments have covered all EU member states, with some concentration in Western Europe and the three big economies – France, Germany and Britain. A few smaller Western European countries, like the Netherlands and Sweden, have also received considerable amounts of Chinese FDI, and Eastern European states have gained some prominence more recently as a destination for Chinese multinationals. Chinese FDI into Europe is expected to continue to increase, widening geographical spread in the future.

Since their rapid growth started just over a decade ago, Chinese investments have been subjected to heightened levels of analysis and scrutiny. Alon and colleagues (2018) found that between 2003 and 2016, 382 scholars published 206 academic articles on the internationalisation of Chinese enterprises in 72 journals. Chinese FDI is regularly covered in the media and analysed by think tanks and consultancies, while governments, businesses, workers and other social groups are also focused on how their interests are affected by the rise in Chinese FDI. Chinese investments in Europe have not been greeted with enthusiasm alone, but have also met with a great deal of scepticism and concern (Knoerich and Vitting 2018). These concerns exist despite the fact that FDI is a common economic activity in EU countries, where multinationals from Western advanced economies

and Japan have made large-scale investments for many decades, at times with a considerable local impact. What is it then about Chinese FDI in particular that has sparked such strong interest, scrutiny and sometimes even concern?

In this article, we focus on the aspects that set Chinese multinationals and their FDI apart from the 'traditional' investors that have their origins primarily in advanced Western economies (including FDI among EU countries) and Japan. As we will show through our examination of Chinese FDI in the EU, there are several areas in which Chinese investments exhibit unique properties and characteristics that justify the considered analysis and careful examination that they have received in recent years. We show how these particularities and special features have become a source of many questions and concerns, which are currently being voiced about Chinese MNEs and their investments in Europe.

CHINESE OUTWARD FDI IS NEW AND EXPANDING RAPIDLY

Chinese outward FDI has risen exponentially over the past 15 years. The pace of its expansion is unprecedented – never has FDI from one economy increased so rapidly. According to UNCTAD data, total outward FDI stock from China was insignificant at 37 billion US dollars in 2002, but increased 40-fold in just 15 years to reach almost 1.5 trillion US dollars in 2017. Annual outward FDI flows increased 50-fold from 2.5 billion US dollars in 2002 to 125 billion US dollars 15 years later. In 2016, Chinese outward FDI flows even reached a record of 196 billion US dollars, before dropping to more modest levels a year later. Chinese outward FDI stock and annual flows are now on a par with the inward FDI China receives into its economy, which has remained at high levels for many years. As a result, China already ranked as the second largest source of FDI flows worldwide back in 2016, dropping to the third largest in 2017 (UNCTAD 2018).

Chinese FDI in Europe has mirrored this global trend. According to data from the Chinese Ministry of Commerce (MOFCOM), Chinese FDI into the EU rose from a few million in 2003 to 86 billion US dollars in FDI stock in 2017, an over 90-fold increase. The annual inflow of FDI from China into the EU reached



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a record of 10.3 billion US dollars in 2017, rising to over 200 times 2003 levels (MOFCOM 2018). But these figures from national accounts do not factor in the FDI Chinese MNEs trans-ship *via* offshore financial centres (e.g. Hong Kong and the British Virgin Islands). Estimates that count the ultimate source country of an investment are thus higher, with calculations by the Rhodium Group suggesting that Chinese FDI in the EU alone had reached a record of 35 billion euros in 2016, followed by 30 billion euros in 2017 (Hanemann and Huotari 2018). In 2015, China already ranked among the top 10 source countries of FDI flows into the EU (Eurostat 2017).

This pace of increase in Chinese outward FDI after 2004 was most certainly magnified by the Chinese government's decision to relax regulations and approval procedures prior to that year, which included permission given to private firms to invest abroad for the first time (Buckley *et al.* 2007). While some modest investments had taken place since the early 1980s, the government's change in policy approach towards outward FDI, manifested in the so-called 'going out' policy, suddenly made it possible for many more Chinese companies to contemplate investing outside of China. Thanks to this artificial government intervention, Chinese outward FDI probably rose faster after 2003 than it otherwise would have, catching up on foregone opportunities of earlier years.

The suddenness of the emergence of Chinese outward FDI and the rapidity of its growth globally and in Europe is the first special characteristic that differentiates the Chinese from other investments. FDI from 'traditional' multinationals had emerged and grown over many decades, starting as early as the 1950s and 1960s for Western MNEs, and a decade or two later for Japanese firms (which, incidentally, were also scrutinised for some time). In Europe, this rapid growth of FDI from China is an important opportunity as it brings in new investment capital and promotes business activities. The unanticipated and unexpected rapidity of its rise, however, also created uncertainties. The increased interest, scrutiny and sometimes caution in countries suddenly receiving such heightened investment from a new source country must be understood in this context.

How much Chinese outward FDI will continue to rise in the future is difficult to judge. Despite the recent downturn in FDI flows after the record year 2016 – which was induced by domestic policy in China aimed at curtailing excessive debt-fuelled investments and preventing unfeasible mergers and acquisitions (M&As) – there is little evidence pointing to a substantial reduction in the pace at which Chinese multinationals expand globally. Similarly, Chinese MNEs continue to have a strong interest in the EU as an investment destination, with the EU receiving far more Chinese FDI than the United States in recent months (Brattberg and Soula 2018). China's unique position as the holder of the largest pool of foreign exchange

reserves in the world, currently worth approximately 3 trillion US dollars, could further bolster its outward investment position. Yet, Chinese outward FDI still has a long way to go until it reaches US levels, which, according to UNCTAD data, are currently the largest in the world at close to 8 trillion US dollars. According to data from the US Department of Commerce, US FDI stock in Europe alone reached 3.6 trillion US dollars in 2017 (Bureau of Economic Analysis 2018).

CHINESE MULTATIONALS ARE LATECOMERS AND STRATEGIC ASSET-SEEKERS

Prior to the emergence of Chinese MNEs, FDI was primarily an activity reserved for companies from advanced economies, which invested in economies that were equal or less developed than their country of origin. These companies were able to invest abroad because they possessed some superior competitive advantages that made their FDI to be successful in foreign markets. Such 'ownership' advantages usually originated from a leading position in technological, managerial, branding or other capabilities (Dunning 2001).

Chinese FDI, however, is different as it derives from an emerging economy. Chinese companies have been observed to invest in economies equal to or less advanced than that of China – most notably in Africa and Southeast Asia, where they do exploit ownership advantages resulting from some technological, managerial or other position of strength. More strikingly, a considerable share of Chinese investments has gone to countries that are more advanced than China, including EU member states. Chinese multinationals have accomplished this despite technological and managerial weaknesses, a shortage of internationally known brands and a lack of international experience (Child and Rodrigues 2005). The identification of superior ownership advantages that enable Chinese multinationals to invest in more advanced economies has been difficult. This observation of Chinese companies investing in more advanced economies, such as EU member states, despite a lack of such advantages, is another distinct feature of Chinese investments, exposing two further particularities of Chinese multinationals.

Firstly, some Chinese multinationals probably possess a different set of advantages, which enable them to invest in more advanced economies and EU member states. These have been categorised into 'special ownership advantages' (Buckley *et al.* 2007), such as resilience, frugality and strong networks of Chinese firms, and Chinese 'country-specific advantages' (Rugman 2007), such as low-cost labour, government support, favourable institutions and easy or privileged access to funds. Specific research into Chinese investments in the EU has found that cost competitiveness and specific strengths in niche markets have been important drivers of Chinese

market-seeking FDI in EU member states (Knoerich 2012).

Secondly, Chinese investments in advanced economies and the EU have often been driven by the desire to overcome firm-specific weaknesses. Instead of exploiting ownership advantages, many Chinese multinationals have sought such advantages through strategic asset-seeking FDI in Europe and other leading economies (Luo and Tung 2007; Knoerich 2012; Zheng *et al.* 2016). For example, Chinese multinationals have set up R&D centres in EU countries to tap into local skills, or have acquired leading European companies to obtain and learn technological capabilities (Knoerich 2010). Well-known examples are Midea's acquisition of the German firm Kuka Robotics in 2016 and Huawei's global network of R&D centres. There is emerging evidence that such strategic asset-seeking activities have – to some extent – contributed to improving the capabilities of Chinese multinationals, with associated benefits even reaching the Chinese home economy (Knoerich 2016a; Anderson *et al.* 2015). Yet there are many limitations as to the extent to which outward FDI can successfully be used to acquire technological capabilities, and especially leading cutting-edge technologies (Knoerich 2017).

Of course, advanced economy MNEs, including US multinationals, also seek technologies and other strategic assets when they invest in EU member states. But strategic asset-seeking objectives appear to have been more dominant in the FDI by Chinese multinationals which, as latecomers in the global market, had a greater need to use outward FDI to overcome their competitive disadvantages. Many studies have identified asset-seeking as a key driver of Chinese FDI in developed economies (Alon *et al.* 2018). This behaviour has occasionally raised eyebrows amongst those concerned about Chinese FDI being used as a vehicle to catch up and close the technological gap with the advanced economies.

CHINESE MULTINATIONALS ORIGINATE FROM A UNIQUE ECONOMIC AND POLITICAL SYSTEM

Prior to the emergence of Chinese multinationals, most foreign investors globally and in the EU had been from democracies that endorsed relatively capitalist and liberal economic systems. But Chinese multinationals emerged and grew in a markedly different economic and political system. That system is characterised by state capitalism, wide-ranging industrial policies and strong government intervention. The political system in China is authoritarian and dominated by the Communist Party of China.

During its transformation from communism to a market-oriented economy, China has only partially dismantled the state sector. State-owned enterprises (SOEs) continue to play an important role in China's

economy, especially in strategic industries. Many Chinese multinationals are therefore SOEs, which in 2017 accounted for half of Chinese outward FDI stock, down from 81 percent in 2006 (MOFCOM 2018). Other Chinese MNEs are partially owned by the state (i.e. mixed ownership), and sometimes the precise ownership arrangements of a Chinese company remain obscure. The issue of ownership sets Chinese multinationals distinctly apart from the 'traditional' multinationals, most of which are privately owned.

However, Chinese state involvement in outward FDI is not limited to ownership. Through various legal measures and institutional frameworks, the Chinese government has regulated, guided and promoted outward FDI in an industrial policy-type fashion, so that it dovetails with China's economic and strategic interests (Luo, Xue and Han 2010; Sauvart and Chen 2014; Knoerich 2016a). For example, acquisitions and the establishment of R&D centres in advanced economies to obtain foreign know-how have been encouraged and supported by the National Development and Reform Commission, China's development planning body (Luo *et al.* 2010). Such government influence and support has especially targeted SOEs and has ranged from preferential treatment (e.g. providing easier access to finance) to regulatory control; and even the occasional prohibition of specific investment projects. Other countries also regulate outward FDI, but the sophistication of planning and regulation in this area is exceptional in China.

Thus, in contrast to most other FDI in the EU, many Chinese investments are state-backed, and a significant number of Chinese multinationals cultivate strong links to the Chinese government; or are even ultimately owned by the Chinese state. The gravest concerns in EU member states have been raised about this special characteristic of Chinese FDI, as the economic, political and security implications of such state involvement in FDI for EU economies remain little understood. It is unclear to what extent state backing and ownership is a source of competitive advantage for Chinese firms, for example when they compete in bids for European companies. Moreover, little is known about the extent to which state-backed asset-seeking acquisitions may, over time, undermine European companies' technological leadership.

CHINESE MULTINATIONALS ADOPT SOME UNCOMMON APPROACHES TO FDI

Chinese multinationals have occasionally adopted approaches to FDI not commonly seen in the context of investments by Western and Japanese multinationals. These approaches derive from their latecomer status and lack of international experience, from the specific characteristics of the Chinese home economy, such as a large market and strong state intervention, and from certain cultural preferences.

Chinese acquisitions in EU member states are notably characterised by the adoption of light-touch approaches to post-acquisition integration. ‘Traditional’ investors from the United States, for instance, prefer to integrate acquired firms with their own operations and change the internal management and organisation of their new European subsidiary accordingly. Chinese companies, on the other hand, tend to leave the European firms they acquire largely untouched. They leave the management team intact and grant it great operational autonomy, whilst often committing to keeping many of the target company’s employees. As a result, many acquired subsidiaries of Chinese multinationals in Europe operate very independently, with Chinese headquarters and a few posted expatriates assuming a supporting or observing role (Knoerich 2010 and 2016b; Miedtank 2017). Not only do such light-touch arrangements reflect the requirements by management of the European target firms before agreeing on an acquisition by a Chinese multinational. They also result from the inexperience of Chinese firms in managing and especially integrating international acquisitions, and from the asset-seeking nature of many acquisition deals. Since most strategic assets owned by EU subsidiaries are intangible in nature, relying on tacit technological knowledge and management skills embedded in European human capital, any efforts of knowledge transfer to the Chinese acquirer would have to be a long-term endeavour that involves positive and effective collaboration between the European subsidiary – in its prevalent form – and its Chinese parent. Midea’s acquisition of Kuka Robotics in 2016, ChemChina’s bid in 2017 for the Swiss agribusiness company Syngenta AG and Sany’s acquisition of German Putzmeister in 2012 are all examples in which elements of light-touch approaches form part of the acquisition arrangements.

Another interesting anomaly is the home-market orientation of many Chinese investments in the EU. Having an international profile, or even ownership of a leading European company resulting from an acquisition, has sometimes enhanced a Chinese company’s reputation at home and been viewed favourably among Chinese customers. Moreover, many Chinese investments in the EU have aimed to facilitate entry into and boost the sales of European products in the Chinese market. An example of this is Bright Food’s 2012 acquisition of Weetabix in Britain, a deal that sought to facilitate the entry of Western-style cereals into the Chinese market for breakfast foods (in 2016 it was sold on to the US company Post Holdings). Chinese purchases of wineries in France have been made with an eye on the growing Chinese wine market, and Geely’s acquisition of the Swedish automotive manufacturer Volvo in 2010 resulted in the sales of Volvo cars and technology into China. European firms have themselves sought the assistance of Chinese investors to gain better

access to the Chinese market (Knoerich 2010 and 2016b). This home-market orientation is quite unique to Chinese outward FDI, given the enormous size, growth potential and complexity of the Chinese market.

Chinese investors in Europe have reportedly been relatively cost-conscious, possibly the result of being accustomed to the low-cost environment prevalent in China. A manifestation of this is the less frequent use of services from expensive consultancy firms, at least at the early stages of internationalisation, even when such advice would have been helpful to overcome their lack of experience in EU markets. Instead, some companies have preferred to draw on the free services from EU investment promotion agencies, whose subsidiaries have proliferated in China. But when it comes to complex transactions, such as international acquisitions, drawing on the services of experienced consultancies and law firms becomes a necessity; even for Chinese companies.

A flipside of the low-cost dimension has been the ability of Chinese multinationals to successfully bid for infrastructure and construction projects overseas by making the cheapest offer, often on relatively good value-for-money terms. While this has worked well in developing countries, such as in Africa, where Chinese companies bring their own cheap labour to complete such projects in a lax regulatory environment, Chinese multinationals have faced challenges in breaking into the European market in this sector. Rules in EU member states require more local workers to be hired and paid salaries that tend to be higher than those of Chinese workers. They also insist on the observance of strict environmental and social standards, despite their additional costs. One example of the challenges involved was the successful bid by China Overseas Engineering Group (COVEC) to build a section of the motorway A2 in Poland in 2009. COVEC won the public tender based on a very low offer price, but was unable to complete the project, partially due to heightened cost pressures and misunderstandings about the European business, legal and cultural environment. A lack of familiarity with EU public procurement rules has also complicated the recent aspirations by China Railway International Corporation to construct a high-speed rail line in Hungary, and a lack of familiarity with complex EU public tender procedures has hampered Chinese efforts to bid successfully for involvement in the British HS2 high-speed railway project. Unlike other places in the world, infrastructure projects in EU member states are therefore rarely won by a Chinese bidder.

CHINESE FDI IS CONTROVERSIAL AND POORLY UNDERSTOOD

From an EU perspective, a further characteristic setting Chinese outward FDI apart from Western and Japanese investments is the quality of the EU’s

political relationship with China as the country of origin of the FDI. For the first time, a country that is not a strong ally of the EU in political and security terms, and not an obvious supporter of the liberal international economic order, has become a major source of FDI in the EU. This exacerbates some of the concerns that result from the idiosyncratic nature of Chinese investments and has created controversy over Chinese FDI in Europe. This controversy is exacerbated by the fact that Chinese FDI – and some of its idiosyncrasies – is still relatively poorly understood despite widespread interest and analysis.

Due to these uncertainties about the origin and idiosyncrasies of Chinese FDI, attitudes and approaches towards Chinese investments are double-edged in the EU. On the one hand, Chinese FDI is welcome and considered to be an important current and growing future source of capital, employment and economic activity. European businesses engage intensively with Chinese investors – sometimes becoming willing targets for acquisitions by Chinese firms – and EU governments actively promote and compete for Chinese FDI. Especially Chinese green-field FDI, i.e. investments creating a new enterprise or economic activity rather than acquiring an existing company, is welcome. On the other hand, there are intensifying concerns about technology appropriation by Chinese multinationals through extensive acquisitions of European high-tech firms, about the potential existence of an unfair level playing field when Chinese firms are state-owned or state-backed, and about the possibility of Chinese investments undermining labour and environmental standards. Concerns have even been raised about potential threats to national security if the Chinese manage to tamper with European critical infrastructure after having been involved in its construction or installation (e.g. in the telecommunications or power generation sectors).

The double-edged attitude towards Chinese FDI becomes even more apparent in the controversies surrounding some Chinese investment deals in EU member states. Hinkley Point C in Britain is a nuclear power plant being constructed by a consortium of *Électricité de France* (EDF) and China General Nuclear Power Group (CGN). While no concern existed about mainly state-owned EDF Energy's participation in the consortium, given that it was a 'traditional' foreign investor from France, the minority participation by state-owned CGN was closely scrutinised by Theresa May's government in 2016 prior to approving it. This happened despite the previous government under David Cameron having warmly endorsed Chinese participation in the British nuclear power sector. When Midea acquired Kuka Robotics in 2016, Kuka's management highlighted the opportunities arising from the deal, including better possibilities to enter the Chinese market in the robotics sector. But German politicians were less at ease about the

growing number of Chinese acquisitions than Kuka's chief executives – German Chancellor Angela Merkel apparently once remarked that she thought the latter were being a bit naïve (Mitchell 2016).

European politics are now at a stage at which uncertainties over the potential implications from Chinese FDI and dissatisfaction with some of its idiosyncratic features – most notably the question of state interference – are combining to toughen up EU countries' policy stance towards Chinese FDI. Many EU member states have established investment screening mechanisms which, although formally applicable to multinationals from various countries, were implicitly set up to vet and prevent undesired Chinese acquisitions. The German screening mechanism was used for the first time in 2018 to prohibit the takeover of Leifeld Metal Spinning AG, which produces high-strength metals for the automobile, aerospace and nuclear power sectors, by the Chinese Yantai Taihai Group. Angela Merkel's cabinet vetoed the deal citing national security concerns (Delfs 2018). Deliberations are now ongoing in Brussels to establish an EU-wide framework for FDI screening, spearheaded by the European Commission. Moreover, the perceived unfairness of state-owned and state-backed Chinese multinationals being allowed to acquire almost any European firm without restrictions is another major point of concern in the current EU policy discourse over China. As China imposes many restrictions on foreign investments and acquisitions in numerous sectors in its own territory, European demands for reciprocity in openness to FDI are becoming far louder.

There are also concerns that China is using the investments by its multinationals – and the associated money Chinese development banks provide to countries through loans – to gain greater leverage over some EU member states and to potentially divide the EU. The focus in this context lies on Eastern and Southern Europe. In June 2017, Greece vetoed a shared EU position on human rights in China at the United Nations Human Rights Council. It was claimed that Greece's policy stance was a response to China's growing investments in the Southern European country, including the stake acquired by the state-owned China Ocean Shipping Company in the Piraeus Port. Yet again, allegations of such increased Chinese leverage should be treated with caution as corresponding evidence is scant.

CONCLUSION

This article has set out several idiosyncrasies distinguishing Chinese multinationals and their FDI in the EU from 'traditional' Western and Japanese investors. These special characteristics included China's sudden emergence and rapid growth as a source of FDI in Europe, the fact that Chinese multinationals are latecomers with few ownership advantages in EU member states, their tendency to

seek strategic assets in the EU, the state ownership of many Chinese multinationals and strong state backing they receive for their investments, some uncommon approaches Chinese multinationals adopt when investing in Europe, and the controversial nature of some Chinese FDI projects. While this list may not be exhaustive, it does provide a set of good reasons for the strong public and scholarly interest in Chinese multinationals and their FDI in the EU.

After discussing the idiosyncrasies of Chinese FDI, this article implicitly demonstrated that there is no single type of ‘Chinese investment’. Instead, Chinese investments in the EU differ by entry mode (e.g. greenfield FDI, M&A), size, ownership type, industrial sector, strategic intention, the degree of entrepreneurship and many other dimensions. Some aspects of Chinese FDI are favourable to European economic and business interests, and thus deserve encouragement and support, while other aspects need to be critically assessed. There are reasons to be positive about Chinese FDI in Europe, but also reasons to feel a sense of unease. Yet it is unwise to appear overanxious and exaggerate a phenomenon that is far from dominant in Europe’s economic landscape. After all, the 86 billion US dollars of Chinese FDI stock in the EU, as estimated by MOFCOM, is dwarfed by US FDI in the EU, worth an estimated 3.6 trillion US dollars. The way forward is a balanced approach, endorsing Chinese FDI whilst taking concerns seriously and addressing them through appropriate analyses and policies. Despite the already existing strong interest in Chinese FDI highlighted at the beginning of this article, more research and analyses are needed, and especially academic research that looks beyond the business dimensions of Chinese FDI and focusing on European public policy, technology and security dimensions.

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