Chinese Outward Foreign Direct Investment in the EU
− Opportunities and Challenges for European SMEs to Link into the Global Value Chain of Chinese Multinational Enterprises

The outward foreign direct investment (OFDI) from Chinese multinational enterprises (MNEs) has been growing noticeably in Europe since the last decade, presenting good business opportunities for European SMEs. From 2005 to 2013 June, 98 large Chinese M&A operations were concluded in Europe, with a deal value of more than EUR 77 million\(^1\) (USD 100 million). The most targeted European countries in terms of China’s M&A value were the UK, France, Germany, and Portugal.

An improved understanding of the Chinese enterprises’ investment activities can help European SMEs develop a better business strategy to win the opportunities. This report provides an analysis of the Chinese enterprises’ expansion in Europe from a perspective of global value chain and policy recommendations for European government institutions; it also explains different value-added activities of Chinese MNEs, specific features and impact on European SMEs.

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\(^1\) Exchange rate: EUR 1 = USD 1.29
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1. Chinese OFDI in the EU

Since the last decade, there has been an enormous expansion of Chinese outward foreign direct investment (OFDI). In 2012, China became the third most important investor after the US and Japan in terms of OFDI flows (UNCTAD, 2013). The total outward foreign direct investment flows from China climbed by 15% in 2013 to reach a new record of EUR 78 billion (USD 101 billion) as a result of surge of cross-border merger and acquisitions (M&As), including the EUR 14.8 billion (USD 19 billion) CNOOC-Nexen deal in Canada and the EUR 3.9 billion (USD 5 billion) Shuanghui-Smithfield Foods deal in the United States (UNCTAD, 2014). The annual OFDI flows from China has been projected by the Chinese 12 FYP to EUR 116.5 billion (USD 150 billion) in 2016, which would make China the second largest home country of multinational enterprises (MNEs) in the world.

Does the surge of China as a new source of foreign direct investment (FDI) represent opportunities and challenges for small and medium sized enterprises (SMEs) in the European Union (EU)? The answer to this question is crucial for a better understanding of the role that European SMEs could play in the rapid expansion of the global value chain (GVC) of Chinese MNEs. It could also provide some insights for European government institutions to adopt their SME policy in the context of the rise of emerging MNEs in the EU. This study is mainly based on the second hand data, completed with a number of small case studies and personal interviews2.

1.1 Overview

Between 2009 to 2011, China’s annual FDI flows to the EU-27 were multiplied by about 30 times and amounted to EUR 3.19 billion, while its stock reached EUR 15.03 billion by the end of 2011 (Eurostat, 2013). More recent and complete data from China’s Ministry of Commerce (MOFCOM, 2013) showed that the annual flows of China’s OFDI to the EU surpassed that of the EU to China in 2010 and reached EUR 4.75 billion (USD 6.12 billion) in 2012, which accounted for 7% of the total Chinese OFDI in the world (Figure 1)3. By the end of 2012, China’s OFDI stock in the EU amounted to EUR 24.4 billion (USD 31.52 billion), of which Luxembourg, the UK and France, Germany, Sweden and the Netherlands accounted each for more than EUR 776 million (USD 1 billion).

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3 As compared to 2011, China’s OFDI in the EU declined by 19%, which does not indicate the decrease of China’s OFDI in the EU, however. By contrast, it reflects a new development of China’s OFDI. In 2012, several Chinese multinational companies used Hong Kong as a platform to invest in the EU. For instance, the acquisition of a 21% stake in Energias de Portugal by China Three Gorges Project Corporation (EUR 800 million) and the take-over of 25% in the equity capital of Portuguese Redes Energeticas Nacionais by China State Grid (EUR 387 million) were carried out through their affiliated companies in Hong Kong. The investment by Chinese multinational enterprises through Hong Kong is usually not recorded in the Chinese OFDI data.
During the second half of the first decade of the 2000s, especially after the start of the financial crisis in 2008, the interests of Chinese companies for Europe received a boost. This is clearly reflected in the evolution of recent M&A activities. According to the Heritage Foundation’s data from 2005 to 2013 (till June), 98 large Chinese M&A operations were concluded in Europe, with a deal value of more than EUR 77.6 million (USD 100 million). The total investment involved in these projects reached EUR 62 billion (USD79.86 billion).

The most targeted European countries in terms of China’s M&A value were the UK, France, Germany, and Portugal (Figure 2). These countries stood out as the preferred host countries for Chinese investments in Europe in terms of numbers and value of major cross-border deals. Determined by their desire of acquiring technology and brands, Chinese investors have tried to move up on the value chain and improve their competitiveness by acquiring western European firms, especially in sectors such as engineering, industrial technology, biotechnology, consumer brands, etc.

Chinese companies have apparently benefited from the weak financial position of European firms to speed up their penetration into the European market during the economic and financial crisis started in 2008. More than four fifths (83%) of Chinese M&A projects in Europe were concluded between 2009 and 2013. During the last two years, Chinese firms have speeded up their M&As in Europe. Here are a few examples: the takeover of German Putzmeister by Sany Construction Machinery (EUR 360 million); the acquisition of a 21% stake in Energias de Portugal by China Three Gorges Project Corporation (EUR 800 million); the holding of 25% in the equity capital of Portuguese Redes Energeticas Nacionais by China State Grid (EUR 387 million); the acquisition of a 60% share in UK based Weetabix by state-owned Bright Food (EUR 1.5 billion); the acquisition of 89% of Polish

*Admittedly, this total value is much higher than the official OFDI data released by MOFCOM and Eurostat. A reason for this difference is that the Heritage figures include ‘announced deals’, for which the estimated value may differ from the finally agreed amount that applies when the deal is signed. Moreover, these M&A deals contain portfolio investment, i.e. acquisitions with stakes in the equity capital of less than 10% which are not included in the FDI dataset.
bearings maker FLT Krasnik by Tri-Ring buys (EUR 56 million); the takeover of U.K. solar installation firm Engensa by Hanergy, and the participation of 14% by Dongfeng Group in PSA Peugeot Citroën (EUR 800 million).

Figure 2. Mapping of China’s M&A projects with a deal value higher than EUR 77.7 million (USD 100 million) in Europe (USD million), 1995-2013, June

Source: The Heritage Foundation, 2013

1.2 Recent development

Several new developments can be observed in China’s M&As in the EU:

- Private Chinese firms have become the initiators of the majority of the acquisitions in terms of volume, despite the fact that Chinese state-owned enterprises (SOEs) have led the way in investing and targeting major European enterprises;
- France, the United Kingdom and Germany stand out as the preferred countries for the completion of Chinese M&As especially for deals in high–technology and knowledge intensive sectors;
- Chinese firms have also emerged as important investors in Eastern and Central Europe and acquired production facilities and strategic assets in new EU member countries, such as Hungary and Poland;
- The reliance of M&As as the mode of entry became a new landmark for Chinese investment in Europe, a trend which is likely to continue;
- Many Chinese firms target sectors in which European companies have built up world-class operational, managerial and innovation expertise;
- There is an increase in investment by wealthy Chinese individuals or families who look at Europe as a way to acquire the distinction or “cachet” that is linked to ownership of some sophisticated sectors such as the wine industry and luxury goods industry.
Report: *Chinese Outward Foreign Direct Investment in the EU*
2. Understanding China’s GVC in the EU

Today’s globalisation is characterised by the rapid emergence of global value chain, of which different stages such as knowledge creation, operation and production, distribution and supporting services, become increasingly fragmented geographically (Figure 3). Given the fact that various stages of GVC take place in different geographical locations, local SMEs have opportunities to participate in the value added activities of GVC.

While the GVC is often ensured by multinational enterprises across different sites, local SMEs tend to participate in its forward or backward linkages. The linkages between MNEs and SMEs along the GVC have been frequently studied in the literature (Gereffi and Fernandez-Stark, 2011) to analyse opportunities and challenges for SMEs from developing countries in cooperating with western MNEs. Yet, the recent economic globalisation is no longer restricted to MNEs from developed countries; it also involves large emerging global players like foreign direct investors from Brazil, China, India and Russia.

Figure 3. A simplified global value chain and expansion of Chinese GVC in the EU

Chinese GVC in the EU

- Acquiring European technology and brands to upgrade their competitive position in the Chinese market
- Undertaking R&D activities in the EU to serve European and global markets
- Acquiring European strategic assets
- Acquiring European manufacturing of core and complex components and products
- Establishing assembly facilities in low-cost European countries
- Large acquisition of port facilities by shipping companies
- Acquiring European distribution channels
- Establishment of distribution and warehousing facilities
- Arrival/establishment of numerous small Chinese trading companies
The increasing engagement of Chinese foreign direct investors in Europe has the potential to benefit both Chinese global value chains and European local industries. A recent study (Zhang et al., 2013) analysed the specific features and extent of Chinese OFDI in the EU on the basis of firm level data. This study identified 5,867 Chinese owned enterprises in the EU including wholly or partly owned by Chinese multinational enterprises, families and individual entrepreneurs.

These companies employed 100,756 people, controlled EUR 79.24 billion assets and generated EUR 45.32 billion sales according to their annual report in the last available year, i.e. 2011. In the following section, this firm level data, combined with a number of mini cases, will be analysed to illustrate the penetration and expansion of Chinese companies in the EU from the perspective of the global value chain.

Based on NACE Rev.2 at the ‘three digit’ level, Eurostat divides service activities into knowledge-intensive services (KIS) and less knowledge intensive services (LKIS). Following a similar approach as for service activities, it further classifies manufacturing industries according to their technological intensity, i.e. high-technology, medium-high technology, low-technology and medium-low technology. Figure 4 provides an overview of value added activities of Chinese owned enterprises in the EU in terms of number of companies and their assets.

Figure 4. Types of value added activities of Chinese owned enterprises in the EU in terms of assets and number of companies (percentage)

Source: Amadeus 2013, edited by the authors
2.1 Knowledge creation

According to Eurostat’s classification of service sectors, only 8% of Chinese owned companies are operating in knowledge-intensive services (KIS) in terms of number of firms (Figure 5). Yet, the wealth of these companies is much more important, as they hold two third of the total assets owned by Chinese firms in the European Union. Among the limited number of Chinese KIS companies, about half provide knowledge intensive market services, such as activities on behalf of headquarter offices, management consultancies, architectural and engineering services, technical testing and analysis, advertising and market research, and legal services and accounting.

About one quarter of China’s investment in knowledge intensive services is situated in high-tech service activities, which mainly consist of research and development, computer programming and consultancy, as well as telecommunications. Large Chinese manufacturing companies in consumer and industry sectors, such consumer electronics, IT, machinery and food, have recently invested in knowledge creation activities in Europe through greenfield or M&As. Typical examples are Huawei, Haier, Siny, Shanghai Automotive Industry Corp (SAIC), etc. (see box 1). Yet, as compared to traditional MNEs from western countries, the R&D activities of Chinese MNEs in Europe are to be considered as technology exploration rather than technology exploitation.

The technology exploration is the most important motivation driving Chinese companies to expand their R&D activities into developed countries. Chinese companies take the initiative to invest in Western European countries to learn from their stronger counterparts. Overseas Chinese R&D units emphasize their role as knowledge-seekers and learners/absorbers for new and relevant technology.

The establishment of R&D facilities in Western European countries is driven predominantly by knowledge learning rather than technological exploitation. The acquisition of European technology is used to redress China’s capability gaps in R&D and design (ifM, 2008). Chinese R&D units appear to evolve often from a strategy of pure technology exploration, over fusion of foreign technologies with R&D activities back home, into one of technology exploitation in foreign locations (Mininh et al., 2012).

Along with technological competence upgrading, Chinese R&D units are expected to gradually fit into the local innovation system and act as knowledge contributors/creators. As a result, this type of investment might be able to create opportunities to local knowledge intensive companies, research centres and university laboratories to speed up their technology exploitation process in China, especially through their linkages with Chinese MNEs searching for new technology to upgrade their home operations (Box 1). For Chinese companies with a relatively strong technological home-base and for the ones catching up through technological learning, entering the markets of developed countries may be a secondary yet important motive for overseas R&D expansion to advanced countries. Chinese R&D units in Europe may also engage in technology-exploitation activities and participate in local market competition.

Case Study 1. R&D activities of Chinese MNEs in Europe

Huawei was founded in China 25 years ago and became today a leading global information and communications technology (ICT) solutions provider. Headquartered in the Shenzhen
innovation hub, Huawei operates in over 140 countries across the globe and has built successful partnerships with 45 of the world’s top 50 telecoms operators, of which around half are European operators. Huawei considers Europe as a second home market and has moved part of its global value chain to Europe. With about 7,500 employees in the region, local talent makes up every link of this value chain, enabling Huawei to not only understand and meet the needs of local customers but also contribute to its global offering, integrating European resources and capabilities into the global value chain. Huawei has been continuously investing in European R&D operations with annual R&D investment increasing over 20% every year since 2007. As of 2012, Huawei has established 13 research sites in Europe, while the total cumulative R&D investment in the region reached EUR 140m. Meanwhile, Huawei increasingly rely on European companies for its procurement which amounted to EUR 2.65 billion (USD 3.41 billion) in 2012 (Chen Lifang, 2013).

Shanghai Automotive Industry Corporation (SAIC) opened its European Design Centre in Longbridge in 2010, near Birmingham after a £5 million investment. In 2013, the centre has already received a further £1.5 million investment to almost double its size and to work on up to five new models at the same time. With its 35 designers, the UK office is considered as a satellite studio of Shanghai designing centre to fulfil SAIC’s global design development strategy. When asked to describe the studio atmosphere, Uhlarik, UK Design Director, doesn't hesitate: “Pure creativity - It's an open concept with everybody working together – designers, digital, clay – all next to each other. It's a cross-functional effort and we should all be inspiring each other”. “We're looking for designers right now as well as clay and digital modelers over the course of the year. We've got the opportunity to rebuild the studio so there's no compromise in terms of the quality of people. We're targeting the absolute top people we can think of” (Owen Ready, 2013).

Haier was founded in 1984. In 2013, Haier’s global revenue and profit reached EUR 22.9 billion (USD 29.5 billion) and EUR 1.37 billion (USD 1.76 billion) respectively. According to Euromonitor International, Haier is the largest global home appliance brand with a retailing market share of about 12% in 2013. Present in 30 countries with the regional headquarters in France, Haier’s European operations are extensive, including research, design and development centres in Italy and Germany and manufacturing facility in Italy. In 2011, Haier opens its R&D centre in Germany which is specialized in dishwashers for the global market. Haier has accelerated the development of high-end products in Europe in order to be able to move into the high-end market. As a worldwide leader in home appliances, Haier has applied a series of local programs in European key market segments, which are conducted in the fields of product designing, retailing, marketing and communication. In implementing these local programs, Haier has reinforced its partnerships with large market distribution networks as well as with local businesses. In terms of branding strategy, the company aims to accelerate the recognition of the Haier brand image and to increase brand loyalty through a number of innovative marketing campaigns (Haier Website, 2014).

Chinese service companies also expanded into European FIRE industry, i.e. finance, insurance and real estate. The expansion of Chinese companies in banking and financial services is likely to be related to the recent move into Europe by Chinese manufacturing and service firms. The opening of five branch offices in Europe by CIBC on the same day, forms an indirect illustration of the rapid
internationalization process of Chinese companies and their need for banking services from their home country institutions (Enrich et al., 2011). These financial firms engage into investment and trade supporting activities, which allow the Chinese multinational companies to improve their financial and administrative coordination and headquarter functions in the host countries.

These companies have also extended their services to local European companies that are trading with or investing in China. Besides banking services, recent push by Chinese financial institutions, especial sovereign wealth funds, has been involved in acquiring critical and strategic assets in Europe. China Investment Corporation (CIC) has extended into European sectors including public utilities, communication infrastructure, mining and manufacturing. With foreign exchange reserves that had grown to earn $4 trillion in 2014, of which a large proportion is invested in US Treasury bonds, China is seeking to diversify its assets.

2.2 Operation and manufacturing

China’s FDI in European agribusiness is still very limited, when compared to the recent rise of Chinese outward investment in African and Latin-American agriculture (Sun, 2011). Given the rapid increase in demand for food in China and the slow restructuring process of China’s agriculture, new opportunities for Chinese firms to secure food supplies have been provided by the opening up of Central and Eastern Europe. Also, Chinese food processing firms started to invest in the downstream parts of the agribusiness value chain, i.e. agriculture or livestock, in Europe, in order to better respond to the mounting concerns of Chinese consumers about food safety in China.

As a result, European countries, especially in Central and Eastern Europe, such as Romania, Poland and Bulgaria, can expect to host more Chinese investors in their agriculture and food processing industry. Examples of large Chinese investment projects are the Tianjin State Farms Agro Business Group in Bulgaria’s farmland in 2011 (EUR 14 million) and the take-over of the French vineyard Chateau Viaud (for EUR 10 million) by COFCO in Bordeaux in 2011. Actually, since the acquisition of Chateau Latour-Laguens by the Chinese Longhai International Group in 2008, there have been about 30 completed purchases of French vineyards in the Bordeaux area, while another 20 further acquisitions were close to completion. The growing size and wealth of the middle-income class in China, changing consumer tastes and increasing demand for western luxury and save products are major reasons for the overseas direct investment by Chinese firms in the agricultural sector.

Although the manufacturing sector represents only about 6% of the total number of Chinese owned firms in Europe, it employs 42,000 people, and control one fifth of the total assets of Chinese owned firms in the European Union. Chinese investment in European manufacturing is highly concentrated in Sweden, the UK, Germany, the Netherlands, France, Italy, Spain and Austria. Some Eastern European countries, such as Hungary, Poland and Romania, also received a sizable part of Chinese investment in manufacturing.

The Chinese investment in European manufacturing sector is strongly concentrated in machinery and electrical equipment, followed by textiles and clothing, and computer, electronic and optical products. China’s investment in manufacturing industries is mostly aimed to acquire European technology, brands, and global distribution channels. Almost half of the manufacturing activities of Chinese enterprises in Europe are in the high and medium-high technology sector. Those high levels of technology include manufacturing of basic pharmaceutical products, and the manufacturing of
computer, electronic and optical products. Western Europe leads the way and attracts the largest proportion of Chinese companies in high and medium-high tech manufacturing.

Chinese large manufacturing MNEs, often stated owned, are targeting European industries with expertise in resource assets, materials and specialised components, fields where many European businesses occupy strong positions. This operation has encompassed a range of sectors from petro-chemical, chemicals and metals through machinery and equipment, as some western companies have sought Chinese capital as an answer both to their own financial weaknesses but also as part of rationalisation of their businesses in an attempt to focus on what is deemed as “core” activity.

The examples of this type of investment are the take-over of Switzerland based Addax Petroleum by Sinopec in 2009 (USD$7.2 billion) to strengthen its oil exploration and production in Africa, the Middle East and the North Sea. In 2011, Wanhua took the full control of BorsodChem in Hungary (EUR 1.2 billion), which is a leading European producer of MDI, TDI and PVC resins as well as base and specialty chemicals. Also in 2011, China National Bluestar invested EUR 1.5 billion (USD$ 2 billion) to acquire Elkem, a Norway-based supplier of high-purity silicon for the solar power industry. Recent moves by Chinese businesses into Europe included EUR 1.5 billion (USD$ 2 billion) acquisition by China National Bluestar of Elkem, a Norway-based supplier of high-purity silicon for the solar power industry. Bluestar has also bought a former Courtaulds factory in the UK, which is a centre of expertise in carbon fibre technology. These Chinese companies have often aimed to acquire some of the know-how from the European businesses and transfer the technology to their Chinese plants.

The concentration of Chinese direct investment in the machinery and electrical equipment sector is a result of the acquisition of existing European manufacturing companies, mostly SMEs, by Chinese state owned and private industrial companies, especially in Germany. The German machinery sector is based on numerous small and medium sized family-owned enterprises, also known as the “Mittelstand”. It holds the largest share in the Chinese market for high-end machinery, which is valued at EUR 75 to EUR 85 billion, or even EUR 85.3 billion (USD$110 billion) to EUR 93 billion (USD$120 billion), according to the German consulting group ‘Struktur Management Partner’ (Lane, 2011).

Although the German machinery sector still dominates and thrives on its high reputation for engineering quality and reliability, its Chinese rivals are gaining ground not only in China, but also in the global market. In moving up quickly on the value chain to compete in the high-end machinery sector, Chinese manufacturers have gained access to German expertise through acquisitions, mostly of small, low-profile or loss-making companies. According to the merger research firm Dealogic, the value of Chinese acquisitions in Germany rose from EUR 2.8 million (USD$ 3.6 million) in 2006 to EUR 76 million (USD$ 98 million) in 2010. Nearly all the reported deals involve engineering companies. For instance, state controlled Chinese companies such as the Shenyang Machine Tool Co. and Dalian Machine Tool Group Co. have invested in and acquired equipment producers from Germany and other countries. According to Struktur Management Partner (Lane, 2011), Chinese companies invested about EUR 90 billion in hundreds of machinery-related acquisitions and investments during the period of 2003-2009.

Besides the acquisition of existing SMEs, Chinese machinery producers also invest in greenfield projects in Germany to tap into local industrial clusters for getting access to qualified engineers and
workers, market information, learning opportunities, knowledge and especially the aura of the “made in Germany” reputation. The investment of EUR 100 million by China’s Sany Group in Köln to set up a manufacturing and research base clearly fitted in such a strategic move that was later completed by the takeover of Putzmeister. Consequently even the German incumbents are undergoing stronger competition from their Chinese competitors which are making progress in the acquisition of technology and rely on less expensive labour.

Northern European countries, such as Sweden and the UK, are also an important destination of Chinese large manufacturing companies. Six out of the seven leading European based Chinese companies with more than EUR 900 million worth of assets are located in this part of Europe. Geely Swedish Holding ranks first both in terms of assets and number of employees thanks to the acquisition in 2010 of Volvo from Ford Motor Company that had earlier bought out this Swedish car manufacturer.

The emphasis of the Chinese government on the importance of environmental and energy sector has resulted in its strong supports of M&A operations along the value chain of eco-friendly businesses. This growing Chinese awareness is illustrated by two recent acquisitions of European firms: i.e. U.K-based solar installation firm Engensa by China’s Hanergy and the Goldwind Windenergy GMBH and Vensys Windpark Wagenfeld Betriebsgesellschaft MBH & co. by Xinjiang Goldwind Science & Technology Co. Ltd.

Chinese investment in the European IT and consumer electronics sector provides another important illustration of the expansion of Chinese GVCs in Europe, which is intended to avoid trade barriers, such as tariffs and anti-dumping measures. By investing in their export markets, Chinese manufacturers attempt to protect their existing and future market share. This type of investment for market protection and expansion is most likely to be used by companies operating in consumer electronics and telecommunication equipment. It is in these sectors that Chinese low priced products are perceived as a serious threat by the European competitors and as such risk to be confronted by countermeasures that would limit their market access.

Almost all Chinese leading consumer electronics companies and telecom companies have established a presence in Europe, such as Haier, Lenovo, Hisense, TCL, Changhong, Medea and Amoi either through greenfield investments or the take-over of existing companies.

The global competition and the entry of Chinese firms forces many European companies to engage in an restructuring process, to reposition themselves on the added value chain and to leverage their market knowledge to validate their assets. Therefore, to cooperate with their new competitors from China might be seen as an opportunity rather than a confrontation. For instance, the impact of TCL’s operation in Poland is a good example about the impact of the GVC of Chinese manufacturers on their backward and forward linkages with local business communities (Box 2).

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Case Study 2. TCL Operation Polska: Backward/Forward linkages

Founded in 1981, TCL is one of the largest consumer electronics enterprises in China with a global presence. The company employs more than 60,000 people and has more than 40 sales offices around the world, selling products under the TCL umbrella including TCL’s own
television sets and mobile phones as well as Thomson televisions and Alcatel mobile phones. In 2012, TCL Corporation achieved global sales of RMB60.834 billion, with a sales volume of 10.86 million LCD TV sets and 43.61 million handsets globally. Its production facility in Żyrardów, about 50 km from the capital Warsaw, was established in 1997 with a total investment of $66.38 million.

"The investment is an inseparable part of TCL's global strategic development," said Hao Yi, chief sales officer of TCL Multimedia Technology Holdings Ltd. "As a major production base in Europe, this plant has a special position in the firm's global industrial chain as well as a crucial part of its strategy in the European market." According to Hao, Poland's favourable position in Europe makes it allows TCL to deliver products and components to any corner of the continent in a maximum of four days. The plant helps TCL to avoid possible trade barriers targeting China-made products while lowering its sales costs in the European market.

The Polish plant also plays an active role in procuring raw materials, deploying production resources and servicing global clients and offering product and technology support to both its own brands and OEM operations. The TCL plant employs about 600 people, mostly local staff and has five production lines to make LCD and LED color TVs as well as DVD players.

"Despite the big costs primarily due to the cultural differences and unfamiliarity with the local laws in the first few years, TCL Operations Polska has helped us gain valuable experience in the construction and international management of projects outside China," he said. "The plant has set an example for other Chinese firms seeking to invest abroad." In 2012 TCL has outsourced all of the warehousing and line feeding processes in Żyrardów to ESA who continuously monitors the processes and optimises them wherever possible. ESA's particular focus is on continuous improvement and development in harmony with the Kaizen philosophy. ESA has devised numerous custom-made technical and organisational solutions in order to offer the customer the best possible efficiency, such as tailoring the reporting system to the client's needs and creating internal tools for precise KPI control based on its existing SAP system.

China Daily 10/24/2011 page11 and ESA website

Given the fact that gaining access to specific groups of customers would be difficult through Chinese companies' own efforts, many Chinese companies see European deals as a "short cut to a customer base". One case of a Chinese enterprise buying in Europe mainly to reach a new group of customers was the 2007 purchase by Northern Heavy Industries, a Chinese machinery company, of NFM, a leading French supplier of specialised tunnelling equipment to companies working around the world on underground railway projects (Marsh, 2011).

In addition to the access to specific customer abases, the M&As of Chinese firms in Europe has been also driven by the motivation to acquire European brands, especially in luxury and fashion industry. The take-over of Todd & Duncan in 2009 by Ningxia Zhongyin Cashmere Company which is the largest cashmere ‘dehairing’ and combing company in China and operations in Hong Kong, Japan, the US and Cambodia. Todd & Duncan was founded in 1867 and is considered as the leading producer of finest quality cashmere yarns for the world's most famous knitwear brands with sizable constant R&D activities for new textures and colours.
It is also interesting to note that in recent years, Chinese enterprises appear to be interested in taking over the original knowledge developed in their OEM partners, frequently related to design-intensive and high-quality productions. The linkages between Chinese and European companies in these cases have been likely “reversed”.

Due to the rapid growth of the Chinese market, its large size and their outstanding performance in exports, a number of Chinese manufacturing companies, especially those heavily engaged in the OEM production for western leading companies, have successfully built up strong manufacturing capacities and financial position. These companies have started to move up on the GVC and switched their position from local suppliers to global players. They have reversely acquired their former brand owners and adopted a more expansive strategy on the basis of their cost leadership position on the one hand and strengths of acquired branded products on the other hand (Case study 3).

Case Study 3. Moving up on the GVC: from OEM to OBM

League Company was established in 1997 in Hangzhou, has developed into the largest luggage manufacturing in China to supply OEM products for SAMSONITE, TARGUS, Delsey, CASE LOGIC and other world leading brands. The company has seven subsidiaries, of which four production facilities with annual output is 15 million PCS, while the annual sales amounted to USD200 million per year. League (Yunnan) Factory started its production in 2012 with a designed capacity to accommodate 10,000 employees.

Hedgren Creation is an Antwerp (in Belgium) based brand of highly functional bags and travel gear with high quality, eye-catching design and comfort. The company used to subcontract with League for its OEM production and its business focused on Europe. In 2011, League Co. acquired Hedgren as an important step in its restructuring strategy to develop companies from low-cost OEM producer to high value added OBM manufacturer (original brand manufacturer).

After the acquisition, Hedgren Creation quickly adopted a new strategy to generate high revenue through its global brand, while the distribution channels have been restructured from a large number of small distributors/shops to own flagship and large department stores. The internationalisation process has been accelerated through strengthening its presence in the North America and Asia. An office was established in 2011 in the Denver in the US, while the sales value in Asia was doubled during the last years, as compared to 30% in Europe.

The major challenges in this strategic move is to change the mind-set of the local management which used to operate as a small-sized family company with limited resources and less spread-out objectives and resisted to move into a new strategy. After the acquisition, the company has experienced a deep restructuring by a step by step approach and the mid management team has been reorganised and reengineered in order to be able to implement the new vision and new strategy of the company – which has been integrated in a much large structure and plays a key role in the GVC of its parent group.

Personal interview, July 2014
Yet, not all Chinese companies have been positively considered, especially less sophisticated small-sized enterprises in the textile and clothing subsector. They have often been considered as unfair competitors towards local businesses, when the decline of local traditional industries could result in job losses (Park, 2009, Ma, 2008). The concerns about unfair competition from Chinese small manufacturing companies have been especially observed in some South and Eastern European regions, such as e.g. Prato, Elche and Budapest, when Chinese migrant entrepreneurs have developed some manufacturing clusters in labour intensive industries (e.g. garments and fashion clothing, shoes, bags, etc.). The agglomeration of Chinese low-tech manufacturing activities on the one hand and the lack of linkages with local business communities often created tensions between the Chinese entrepreneurs and local business people (Johanson et al., 2009). Yet, from a long term perspective, the increasing integration of Chinese migrant entrepreneurs into local business communities and their upgrade from low-end market to higher value added activities might inevitably contribute to job creation in the local market.

2.3 Distribution and support services

Many Chinese owned service companies in Europe are active in less knowledge intensive market services, such as wholesale and retail trade. Given that wholesale trade involves low resource commitment and is relatively easy to set up, at least as compared to for instance production activities, it can also be considered as a first stage in the internationalisation process. In fact, the concentration of Chinese companies in trade and related supporting services reflects that most of these companies are still at the very beginning of their international expansion. Of course, the high concentration of Chinese owned enterprises in international trade is related to the high export orientation of the Chinese economy.

The Chinese wholesale and retail sector is highly concentrated in Eastern and Central European countries, especially in Hungary and Romania. In Western Europe, Chinese trade companies dominate in Germany and France. Yet, there is a clear distinction between Eastern and Western Europe with regard to the trade and distribution activities of Chinese companies. In West Europe, Chinese companies are more involved in trade with multiple and slightly more sophisticated products, namely, in order of importance, the distribution of machinery and equipment, clothing and footwear, electrical household appliances, pharmaceuticals, household goods, hardware, plumbing and heating equipment and supplies. By contrast, in Eastern Europe, the most important trade and distribution activities of Chinese companies consist of wholesale of clothing, textiles, fur, footwear and leather goods and the retail sale of clothing in specialised stores.

The nature of the trading activities of Chinese firms in Central and Eastern Europe has been substantially changed as compared to its early development. In the 1990s, wholesale and retail activities were organised in an open air market, i.e. Józsefváros in Budapest, also known as 'Four Tigers Market'. The early Chinese “traders” took advantage of shortages that existed in the Central and Eastern European markets and responded to the demand gap in these countries.

The agglomeration of Chinese companies in wholesale or distribution activities resulted in a number of large Chinese communities in the capital cities of some Eastern and Central European countries, while the emergency of overseas Chinese population has in return attracted new investors. This self-enforcement can be considered as an on-going process for the geographical concentration of Chinese FDI and migrant entrepreneurs.
Yet, this agglomeration trend is still quite “volatile”, as it depends on the immigration policy of host countries and their business environment. Over the years, the original “open air” and rather primitive markets for Chinese products in Central and Eastern European countries have been gradually replaced by trade and exhibition centres, which were established by Chinese entrepreneurs sometimes with supports from the host country and Chinese governments. These centres are specialised in the wholesale of Chinese products with showrooms and office space for Chinese and local distributors and wholesalers. Their target markets are upgrading from low end to branded products (Nyíri, 2003, Szabó, 2009, Wong and Primecz, 2011). As a result, the upgrade of Chinese trading activities have allowed these cities to keep their special position as regional distribution centres for Chinese and Asian products and contributed to the establishment of linkages with local business communities in logistic and retailing services.

However, lack of linkages with local business communities often created tensions between the ethnic Chinese entrepreneurs and local business people. This often resulted in the introduction of a stricter immigration policy and enforcement of business regulations by the host governments. The changes to a more regulated business environment and especially the emergence of certain mistrust and sometimes a hostile atmosphere in the local business community may even result in the relocation of migrant entrepreneurs and business activities as happened in some cities. For instance, after violent protests erupted at Elche in Spain against Chinese importers and distributors in the shoe business, the Chinese business community moved to Fuenlabrada in Madrid and a new distribution centre of Chinese footwear and clothing was established with about 700 companies active in wholesale (Financial Times, 2011).

It is widely recognised that entrepreneurship contributes to job creation, innovation and economic growth. Within the on-going globalisation process, the international entrepreneurs emerged as an important source of capital, knowledge, market information and business opportunities. While the Chinese ethnic communities brought a new dimension to the local economic development by bridging the cultural and other differences between their home country and the country of residence, this “bridging” role and their contribution still need to be sufficiently taken into consideration by local business communities and government institutions.
3. Specific characteristics of Chinese GVCs in the EU

The expansion of Chinese MNEs abroad is characterized by three relatively unique aspects: (1) the strong policy support of the Chinese central and local governments as an institutional force, (2) the challenge of going abroad in 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 (Peng, 2012). Overall, these three relatively unique aspects of emerging multinationals from China have significant impact on their FDI operations in the EU on the one hand and the nature of linkages with local SMEs on the other hand.

3.1 Types of Chinese investors

According to the ownership and corporate governance of Chinese enterprises, Chinese MNEs with direct investments in Europe can be divided into three groups (Figure 4).

**State-owned enterprises (SOEs)**

Most of China’s state-owned enterprises are large industrial and service groups belonging to SASAC’s central and local administrations. In addition, there are also sovereign wealth funds, state-owned insurance companies, venture capital firms, pension funds, research institutes and government departments and agencies. The expansion of SOEs in Europe has been strongly supported by the “go out” policy of the Chinese central and local governments as confirmed by a recent survey (EUCCC, 2013). Most of them often opt for the acquisition of key tangible and intangible resources and strategic assets, mainly through asset augmenting M&As.

**Private-owned enterprises (POEs)**

Chinese private-owned enterprises (POEs) have successfully developed into dominant players in the industries where the monopoly of SOEs was removed or waning, such as machine tools, consumer
electronics, telecom equipment, automotive industry and renewable energy. Due to the rapidly growing large-sized home market, these firms succeeded to acquire the capability to engage into large scale manufacturing activities based on state-of-the-art production facilities and cost leadership position. The direct investment of these private companies in Europe, either through take-overs of existing European companies or via greenfield establishments, is strongly driven by their search for new technology, well-known brands and efficient distribution channels.

**Individual and family investors**

Most of Chinese individual and family investors are small-sized companies mainly involved in cross-border trading activities. These individual and family investors can often be described as international entrepreneurs or “suitcase investors” who are searching for business opportunities abroad. Such investors do not necessarily have a strong business basis in their home country and most often lack sophisticated ownership advantages. The international development of Chinese entrepreneurs is clearly illustrated by the surge and expansion of Chinese private business in Central and Eastern Europe. Their establishment in Europe is driven by the desire to look and find opportunities of growth in foreign countries as a way to avoid the saturation of the Chinese market. Yet, some of these companies can be considered as “hidden champions”, as, despite their low profile in Europe, they are strong family businesses in China.

**3.2 Location patterns**

The UK, the Netherlands, Sweden, Germany and Portugal are the top five host countries of Chinese companies in the EU in terms of assets. All together, they host 85% of the total assets of all Europe-based Chinese companies. On city level, Chinese companies tend to agglomerate in a small number of cities and their surrounding areas, such as Bucharest, Budapest, Hamburg, Düsseldorf, Frankfurt, Berlin, London, etc.

In Eastern Europe, Chinese companies agglomerate around capital cities, which can be explained by the migratory road followed by Chinese entrepreneurs looking for lucrative business opportunities at the end of the cold war. Early Chinese cross-border traders were attracted to the capital cities by the well-established transportation and communication infrastructure as well as the opportunities in the market.

In Western Europe, Chinese companies are concentrated in regional hubs either with intensive industrial activities, strong logistic capabilities or financial centres, such as Hamburg and Düsseldorf in Germany and the Rotterdam area in the Netherland. Easy access to maritime transport facilities and strong hinterland industrial activities are the primary consideration. Financial centres, such as London and Frankfurt, have also attracted a large number of Chinese investors, especially for their headquarter activities.

Figure 6. Geographical distribution of Chinese enterprises in Europe per types of industries (number of firms), 2013
Different types of Chinese investors also show preferences to different locations, influenced by their investment motivations, strategies and competitiveness. Chinese SOEs prefer to choose Western and Northern Europe, whereas individual firms tend to agglomerate in Central and Eastern. The business environment and FDI policies in the host countries also cast influence over Chinese investors’ decisions.

Western and Northern European countries have attracted more Chinese companies in high-technology manufacturing and knowledge intensive services. In Eastern and Southern Europe, Chinese companies are attracted by its low manufacturing cost, such as TCL in Poland, Hisense in Hungary, Foxconn, Changhong in the Czech Republic. Their main products are electronic equipment like LCD screens and televisions. These firms do not produce under their own brand names, but work for western firms or operate as joint ventures with European partners (Nicolas and Thomsen, 2008).

It has also been noted that most Chinese SOEs, their subsidiaries and private corporations primarily engage in knowledge intensive services and high-technology manufacturing, while almost all individual and family owned Chinese firms are active in the less knowledge intensive sectors, such as wholesale and retail business.
3.3 Entry form and partnership

Wholly owned subsidiaries and majority owned joint ventures are the top two forms of entities for Chinese investors when considering of establishing themselves in the EU. Nearly half of the Chinese owned enterprises (44%) in the EU are fully Chinese owned companies with sole proprietorship. The other half consists of joint ventures with double or multi-proprietorship. About one third of Chinese joint ventures are majority owned joint ventures. For example, Chinese shareholders control more than 50% of the equity capital, while the so-called fifty-fifty or equally owned joint ventures and minority partnerships with a Chinese ownership between 10 and 49.9% constitute the other two thirds of Chinese joint ventures.

Chinese investors are heterogeneous in many ways. Therefore, numerous factors significantly affect their choices of the entry form in the EU market, such as their different sizes, available resources, strategic visions, investment motivations, ownership status and partnership.

Among three types of Chinese investors, individual and family owned Chinese companies are more inclined to set up joint ventures, whereas SOEs and large POEs prefer wholly owned subsidiaries and majority owned joint ventures. The higher propensity of corporate investors, especially SOEs and listed companies, for complete ownership and majority joint ventures reflects their financial or technological strengths and their attempt to acquire or maintain control of their overseas investment operations. By contrast, the choice of small entrepreneurial investors for minority owned and equally owned equity joint ventures may to some extent indicate a shortage of resources and the need to share the investment risks when entering European markets.

The cross-sectoral analysis reveals a number of interesting points. Usually, multinational enterprises favour wholly owned companies when they have sufficient knowhow to enter a new market and compete against the home-country’s companies. As high-technological activities and knowledge intensive services demand the concentration of high value intangible assets, such as technology, knowhow and R&D, multinational investors opt for exclusive or majority ownership to control those assets instead of risking the dilution of their advantages through the formation of a joint venture.

However, the preference of the wholly owned subsidiary and majority joint venture by Chinese multinational companies in Europe is to some extent different from that of western multinationals, as Chinese SOEs and private groups are asset-augmenting investors, for whom the overseas subsidiaries are often the result from the take-overs of western companies. Therefore, the choice of the sole proprietorship or majority ownership is to ensure the acquisition and control of foreign assets rather than the protection of their own technology.

With limited financial resources, Chinese companies in the less intensive service sectors and low-tech manufacturing have opted for a lower equity control. However, some of these small firms might rely on alternative control mechanisms than high equity shareholding, such as partnering with overseas Chinese and involving family members for the key management positions. Joint ventures with same ethnic entrepreneurs from the same region in China may lower transaction and coordination costs, as suggested by the literature on social networks and ethnic communities.

Setting up an international joint venture is complicated and a risky operation as it brings together firms and managers with possible different strategic and business priorities and unfamiliar corporate
cultures. Here are some common characteristics observed from the partnership patterns of Chinese joint ventures in Europe:

- Chinese SOEs and POEs tend to look for local companies in the European host countries to enter into joint venture partnerships;
- Chinese individual and family investors prefer to cooperate with investors in China to set up operations in Europe;
- Chinese international entrepreneurs and family businesses are more inclined to work with Chinese or overseas Chinese partners as a way to lower transaction and coordination costs;
- The lack of international experiences and skills in international business operations might also be a motivating factor to look for partners with a closer cultural distance;
- Chinese SOEs and POEs possess stronger ownership advantages that enable them to deal with the coordination costs;
- Chinese SOEs and POEs prefer to include European (i.e. non-Chinese) companies in their partnerships, as involving local partners can facilitate the access to the particular technology, marketing know-how or other intangible assets of the European company, especially in the case of M&As.
4. Conclusion: Linkages of Europe SMEs to Chinese GVCs

4.1 Opportunities and challenges for European SMEs

European SMEs can find different ways to link into Chinese MNEs’ value chains. Supplying goods or providing services is one of the common kinds of linkages, known as “backward vertical”. Other types of linkages include forward linkages with customers, linkages with technology partners, linkages with competitors and other spill-over effects (Smallbone, 2003).

Being a part of the GVCs of Chinese MNEs bring numerous new opportunities for European SMEs. Through supplying components, materials and service locally, SMEs will be able to build linkages with Chinese MNEs, ranging from arm’s-length market transactions to deep, long-term inter-firm relationships as indicated in Haier’s local programs.

For European research institutions and high-tech SMEs, they can link up with Chinese investors to transfer their existing production and technology, or cooperate with them in new technological ventures. For example, in the case of SAIC’s R&D centre, the investment of SAIC provided opportunities for local engineers and service companies to continuously upgrade and innovate in car designing technology and know-how.

Linkage with Chinese MNEs also helps introducing SMEs’ existing products and services to new markets. As shown in the case of Sany’s acquisition of Putzmeister in Germany, if the relationship could create successful forward linkages with the Chinese market, it can diversify and expand SMEs’ current customer portfolio. It could also result in adopting new corporate strategy, new business model or new management approach, which can generate rapid growth in size and in turnover, as in the case study 3.

However, European SMEs also need to tackle a number of major challenges in order to seize opportunities of creating profitable relationship with Chinese investors.

First of all, gaining a better understanding of Chinese companies’ management structure and decision making process is a crucial step. Compared to European MNEs and large companies, most of Chinese companies have a very loose organisational structure and diversified business portfolio. The opacity of their businesses, organisation and financing structure are quite difficult for western companies to understand and to cope with.

The complexity is also due to their unique management structure and decision making process. Chinese companies experienced rapid and radical changes in the management style over last 30 years, which is still under continuous adaptation and modification today.

The management system in different types of Chinese investors varies from one to the other. For example, the government has bigger influence over Chinese SOEs’ decision making process, whereas many private Chinese companies are still family business in nature. The on-going transition in their leadership teams from older entrepreneurial generation to the western educated professional management team is another factor to be taken into account.
The cultural and language barrier is another major challenge to be overcome, as SMEs often lack of international and cross-cultural communication and management skills. In addition, SMEs in service sector also face constant pressure of lowering costs and time compression from Chinese investors.

4.2 Recommendations

Facing the opportunities and challenges to link in to the GVC Chinese investors, European government institutions and business representative organisation could provide further support to their SMEs. Here are the recommendations:

- Raising awareness of local SMEs about the opportunities and challenges when linking up with Chinese direct investors;
- Developing special programs that facilitate networking and matchmaking opportunities for local SMEs and Chinese investors, or providing databases on suppliers and business alliance;
- Taking measures that encourage local SMEs to link into different stages of the GVC of Chinese MNEs and the knowledge creation stage in particular;
- Providing tax incentives for Chinese MNEs to localise their R&D activities;
- Promoting technology transfer between local SMEs and Chinese MNEs;
- Encouraging public-private partnerships between local research centres, universities and Chinese MNEs;
- Providing support for SMEs that wish to expand their international market through linkages with Chinese MNEs;
- Facilitating cooperation (e.g. SME consortia) for joint marketing or joint bidding in the procurement contracts of Chinese MNEs;
- Organising competency training and cultural awareness programs for SMEs that facilitate their communications with Chinese MNEs.
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The EU SME Centre assists European SMEs to export to China by providing a comprehensive range of hands-on support services including the provision of information, confidential advice, networking events and training. The Centre also acts as a platform facilitating coordination amongst Member State and European public and private sector service providers to SMEs.

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