Aalto University
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# Motives and Location Factors of Chinese Outward Foreign Direct Investments in a Small Developed Economy

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Master's thesis

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**ABSTRACT**

MOTIVES AND LOCATION FACTORS OF THE CHINESE OUTWARD FOREIGN DIRECT INVESTMENTS IN A SMALL DEVELOPED ECONOMY

**Objectives**

This study examines the motives and locational factors of the Chinese foreign direct investment in smaller developed economies. The target economies of the study are both Finland and Sweden in order to improve the generalizability of the results. In the academic literature, foreign direct investments have been studied extensively but the Chinese investment is a relatively new phenomenon which has not been studied much - especially in the small developed economies. In recent years, the Chinese have rapidly increased their foreign investments, so it is increasingly important to understand why the Chinese invest abroad and how the different factors affect their investment decisions about the destination countries. Purpose of this study is to provide additional information on these issues in the context of small developed economies.

**Research method**

The research method of the study is a qualitative multiple-case study which is supported by secondary sources. The secondary sources have been documents, archival materials and statistics, among others. For the study totally 38 Finnish, Chinese and Swedish persons were interviewed representing Chinese enterprises, chambers of commerce, investment promotion organizations, partner as well as other expert organizations. The interviews were conducted as semi-structured and open-ended theme interviews.

**Results**

According to the results, the Chinese invest in the studied small developed economies particularly because of market seeking and strategic asset seeking motives. Market seeking investments have been made mostly by the small family enterprises and high technology companies especially in ICT sector, while strategic asset seeking investments have been made by the advanced Chinese ICT and software corporations. Small developed economies do not possess location-specific advantages which are particularly attractive for the Chinese investments on a global scale. The cost level and taxation are high, natural resources scarce, markets small and the countries are distant from China both geographically and culturally. However, the clusters of the knowledge-intensive sectors attract the large and international Chinese companies. In addition, the Chinese investors are interested in the developed infrastructure as well as high level of education and research. Both the investment motives and location factors are mostly similar in the target economies of the study. The strengths of Sweden have been the active invest-in promotion, broader industrial base as well as long trade relations with China.

**Keywords:** China, foreign direct investments, small developed countries, investment motives, locational factors

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**TIIVISTELMÄ**

MOTIVES AND LOCATION FACTORS OF THE CHINESE OUTWARD FOREIGN DIRECT INVESTMENTS IN A SMALL DEVELOPED ECONOMY

**Tavoitteet**
Tässä tutkimuksessa tarkastellaan kiinalaisten suorien ulkomaaninvestointien motiiveja ja niiden sijoituspaikkavalintoihin vaikuttavia tekijöitä pienissä kehittyneissä talouksissa. Tutkimuksen kohdealueina ovat sekä Suomi että Ruotsi tulosten yleistettävyyden parantamiseksi. Suoria investointeja on akateemisessa kirjallisuudessa tutkittu laajasti, mutta kiinalaisinvestoinnit ovat verrattain uusi ilmiö eikä niihin johtavia syitä ole juuri tutkittu varsinkaan pienten kehittyneiden talouksien osalta. Viime vuosien aikana kiinalaiset ovat nopeasti lisänneet investointejaan ulkomailla, joten on yhä tärkeämpää ymmärtää miksi kiinalaiset investoivat ulkomaille ja miten eri tekijät vaikuttavat heidän päätöksiinsä investointien kohdemaista. Tämän tutkimuksen tarkoituksena on antaa lisätietoa edellä mainituista seikoista pienten kehittyneiden talouksien kontekstissa.

**Tutkimusmenetelmät**
Tutkimuksen empiirinen osa perustuu kvalitatiiviseen useamman tapauksen tapaustutkimusmenetelmään, jonka tukena on käytetty myös sekundaarilähteitä. Sekundaarilähteinä ovat olleet muun muassa asiakirjat, arkistomateriaalit ja tilastot. Tutkimusta varten haastateltiin yhteensä 38 suomalaista, kiinalaista ja ruotsalaista henkilöä kiinalaisyrityksistä, kauppakamareista, investointipromootio-organisaatioista, partneri- sekä muista asiantuntijaorganisaatioista. Haastattelut toteutettiin puolistrukturoituina teemahaastatteluina.

**Tulokset**
Tutkimustulosten perusteella kiinalaiset investoivat tutkimuksessa tarkasteltuihin pieniin kehittyneisiin talouksiin varsinkin markkinoiden sekä strategisten voimavarojen ja hyötyjen takia. Markkinahakuisia investointeja ovat tehneet varsinkin pienet perheyritykset sekä korkean teknologian yritykset erityisesti ICT sektorilla. Strategisia voimavaroja ovat näistä talouksista hakeneet varsinkin korkean teknologian ICT ja ohjelmistoalojen kiinalaisyritykset. Pienillä kehittyneillä talouksilla ei juuri ole sellaisia sijaintiin liittyviä etuja, jotka erityisesti houkuttelevat kiinalaisinvestointeja globaalissa mittakaavassa. Kustannustaso ja verot ovat korkeita, luonnonvarat vähäisiä, markkinat pieniä ja maat ovat sekä maantieteellisesti että kulttuurillisesti kiinalaisille kaukaisia. Tietointensiivisten alojen klusterit houkuttelevat kuitenkin näillä aloilla toimivia kansainvälisiä kiinalaisyhtiöitä. Tämän lisäksi kehittynyt infrastruktuuri sekä korkea koulutus- ja tutkimustyön taso kiinnostavat kiinalaisia investoijia. Sekä motiivit että sijaintitekijät ovat pääosin samoja tutkimuksen kohdemaissa. Ruotsin vahvuuksina ovat olleet aktiivinen investointipromootio, laajempi teollisuuskanta sekä kauppasuhteet Kiinan kanssa.
**Avainsanat:** Kiina, suorat ulkomaaninvestoinnit, pienet kehittyneet taloudet, investointimotiivit, sijoituspaikkavalinnat

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# 1 INTRODUCTION

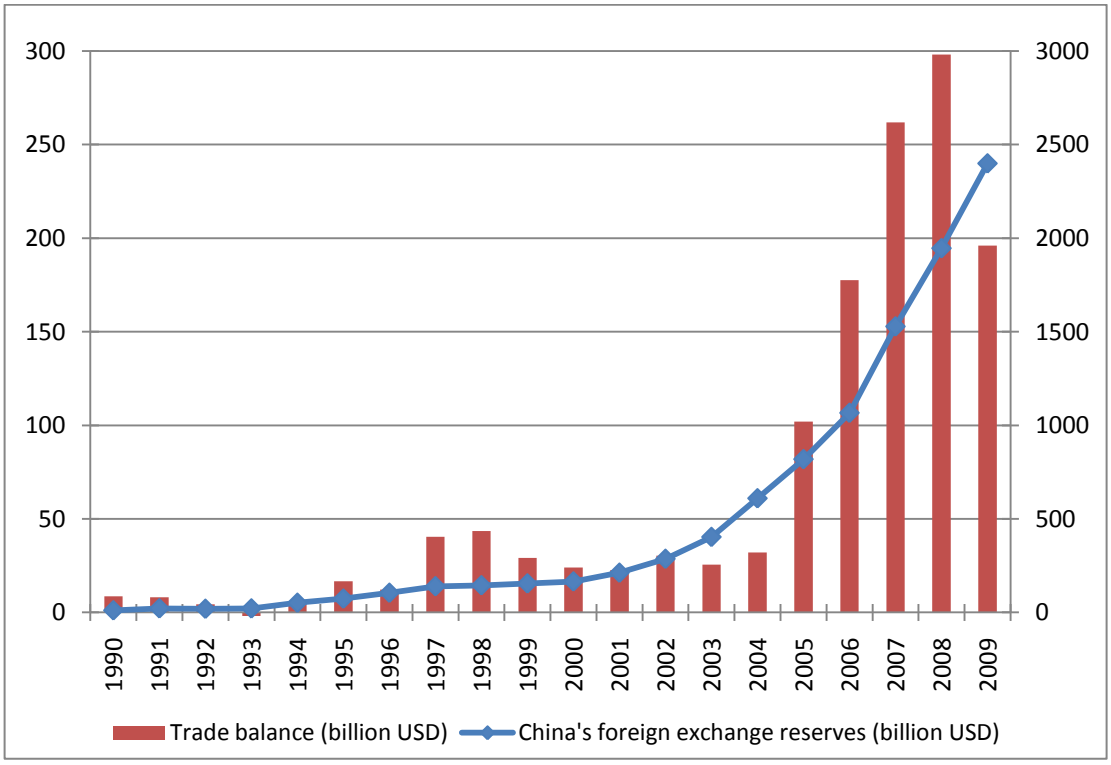
## 1.1 Background of the study

Since the beginning of China's Open Door Policy in 1978, its economy has developed astonishing rapidly from a poor developing country and minor player of international trade to one of the greatest economic powers whose continuously strengthening influence appears globally, also in the form of foreign direct investment (FDI). According to IMF statistics (2010), in 1982 the gross domestic product (GDP) of China was only USD 281 billion in current prices (USD 277 per capita). Since then China's economy has grown annually between 3.8% and 15.2%, and in 2009 GDP was already USD 4909 billion (USD 3678 per capita). Bloomberg (2010) reported that its GDP had surpassed Japan and China became the second largest economy after the USA during the second quarter in 2010 and in January 2011 Xinhua reported that GDP grew totally by 10.3% in 2010. If China's GDP is counted by purchasing power parity (PPP) it is already approaching the two largest economic centers of the world, EU and the USA. Furthermore, recent global economic crisis seemed to confirm the global position of China since its economy and investment activities abroad have suffered considerable less than the world average. Actually China nearly doubled its outward FDI in 2008, while global total FDI plunged by around 20% (Davies 2009).

During last three decades, China's enormous economic growth has been based largely on its opening economic policies along with cheap production costs, supported by obviously artificially cheap currency level of Chinese yuan, which have attracted a huge amount of foreign investment to the country and made it "the factory of the world" (Kettunen et al. 2008). This has boosted China's foreign trade and it increased 67-fold from 1980 to 2008 (National Bureau of Statistics of China 2009). By its exports, China reached the number one position in the world during 2009 and in 2010 the value of China's exports reached the all-time record, USD 1578 billion and trade surplus was USD 183 billion (China Customs Statistics 2011). According to CIA World Factbook (2011), China has had the largest surplus of current account in the world during the recent years. China has a huge

trade surplus with the USA, Europe and Hong Kong but it has an explicit trade deficit with many countries in East Asia, e.g. Japan and Korea (China Customs Statistics 2011). China's trade surplus turned to rapid growth in the middle of the 2000s and as the consequence also China's foreign exchange reserves have swollen greatly as the central bank of China (People's Bank of China) buys the foreign currencies (mainly US dollars) earned by the Chinese exporting companies and exchanges them for Chinese yuan (Figure 1). Thus China's foreign exchange reserves are the biggest in the world at the moment. They were USD 2399 billion in December 2009 and even USD 2454 billion in June 2010. Furthermore, China has gained substantial income from inward foreign investments and taxes from foreign companies (BOFIT 2009; SAFE 2011).

**Figure 1. Foreign trade balance and foreign exchange reserves of China in 1990-2009.**



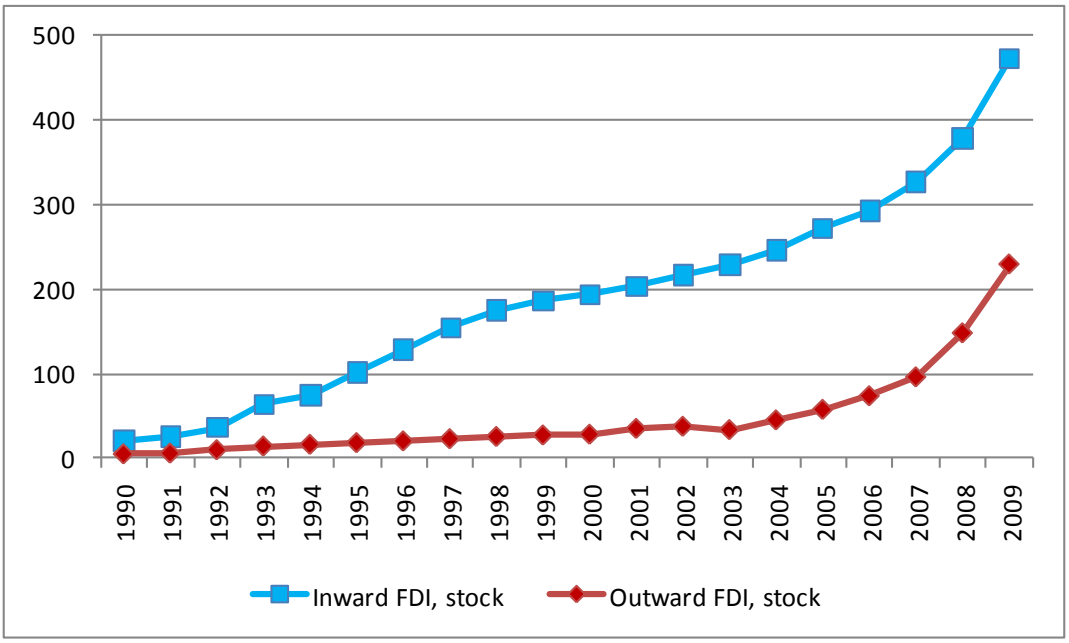

*Source: National Bureau of Statistics of China 2010; China Custom Statistics 2010; SAFE 2011.*

Chinese government has utilized its quickly growing incomes and foreign exchange reserves in several ways. It has gradually improved the well being of citizens, invested enormously in infrastructure - as even 60 % of fixed investment has been made in

infrastructure-related projects (National Bureau of Statistics of China 2010) -, imported raw materials for supporting of construction and economic growth, as well as established sovereign wealth funds (SWF) and investment companies for different purposes. The largest and most famous of those are China Investment Corporation (CIC), State Administration of Foreign Exchange (SAFE) Investment Company and CITIC Group. They have invested hundreds of billions of USD especially in foreign treasury bonds, e.g. U.S. Treasuries, and in large foreign companies. However, along with the recent bad performance of the US dollar and the Western companies, the Chinese government has shifted to back up substantially the internationalization and foreign investments of the Chinese enterprises.

Together with the liberalized outward investment policies of China and growing competitiveness of the Chinese MNEs, the government's support has clearly reflected in the amount of outward FDI which has skyrocketed since 2003. The growth has been particularly strong since 2007, despite the fact that meanwhile the world economy suffered from the global financial crisis. In 2009, the stock of the Chinese outward FDI was already USD 229.6 billion (Figure 2), and the same year inward investment flow in China was the second largest (USD 95 billion) and outward flow from China the sixth largest in the world (USD 48 billion). These figures were the largest among the developing countries (UNCTAD 2010). The figures reported by the Chinese authorities were slightly different, inward FDI flow USD 90 billion and outward FDI flow USD 56.5 billion (Invest in China 2010; MOFCOM 2010). Very recently, CIA (2011) estimates that the stock of the Chinese outward FDI was USD 278.9 billion while the stock of the inward FDI was USD 574 billion.

**Figure 2. Development of stocks of inward and outward FDI of China in 1990-2009.**




*Source: UNCTAD 2010.*

Europe has never enjoyed a special popularity among the Chinese investors, and by 2009 only 3.5% of the Chinese FDI had been focused on Europe (MOFCOM 2010). However, the latest statistics reported that the flow of the Chinese FDI has increased the most into Europe (alongside North America) and it almost trebled in 2009 (Xinhuanet 2010). This indicates the potential of the Chinese FDI to become a significant force and boost also in the European economy. By far Germany, the UK and Russia have received the most of the Chinese FDI in Europe, although the most of the Chinese FDI has been invested in the Asian side of Russia. Actually, the biggest amount has gone into Luxembourg which was in a special favour with the Chinese investors in 2009 and rose up to even China's fourth largest investment destination.

This is particularly due to the attractive tax regime for foreign holding and financing investments in Luxembourg (Deloitte 2010). In Northern Europe, Sweden has managed to attract the most of the Chinese investment, the tenth most in Europe in 2009 (in 2008 Sweden was even the fifth), but proportions of other countries have been insignificant (MOFCOM 2010).

Small developed countries with open economy (for clarity henceforth called 'small developed countries') are very heterogeneous as a group and amount of the Chinese FDI vary between the countries. Geographically huge and natural resource-rich Canada and Australia have received a considerable amount of the Chinese investments, as well as ethnically almost completely Chinese city state Singapore. In addition, China has invested moderately in some relatively small but traditional foreign trading countries, such as the Netherlands and Sweden. However, the majority of small developed countries such as Finland, Austria, Israel, Switzerland and Norway, have received only a handful of investments from China, although e.g. Switzerland is generally an important host country for FDI, and Norway has extensive oil and gas reserves (MOFCOM 2010). In line with the general trend of the Chinese FDI, their majority has been made into the small developed countries only in very recent years. Nevertheless, when the flow of the Chinese FDI is once opened, the trend in most countries has explicitly been growing, and there is no sign why this will not happen either in Finland or other similar countries.

Recently, Finland has also increased the support for the Chinese investments the both at the political level and public promotion of Finland as an attractive FDI destination. It is interesting to observe how these efforts will begin to bear fruit, and that is why it is important to find out what have been the motives behind the already existing Chinese investments in Finland, why they have ended up to choose Finland as their FDI location, and how they have experienced the Finnish business and investment environment. Moreover, for extending the outlook of the topic, it is also fruitful to chart the opinions of the local experts and to benchmark why there are so much more Chinese investments in Sweden than in Finland, despite the proximity and similarity of the countries.

## 1.2 Previous research and research gap

While there are extensive general studies of Western MNE's foreign direct investments as well as a growing number of studies concerning FDI into emerging economies, the academic discussion about FDI from emerging economies, such as China, has begun only relatively recently. Particularly little is known about the Chinese investments as well as

their motives and factors behind the FDI location choices in small developed economies, such as Finland, which are not rich by the natural resources, and are geographically as well as culturally distinct from China. In addition, relatively little researched information is available about how the Chinese face these host countries as an investment and business environment.

Nowadays, along with the growth of the Chinese outward investments also a growing number of studies and publications has been written by both the Chinese and foreign authorities introducing the general development and nature of Chinese FDI, for example the Chinese Yang (2003 & 2006) about the Chinese outward FDI as FDI from a developing country and the networks behind the Chinese FDI, Deng (2004) about motives and implications of the Chinese FDI and Li (2007) about the Chinese MNEs as latecomers in the field of FDI, as well as often quoted publications by Buckley et al. (2007 & 2008b) about trends of the Chinese FDI, Child & Rodrigues (2005) about the impact of the internationalization of the Chinese MNEs on the general FDI theories, Erdener & Shapiro (2005) about internationalization of the Chinese family businesses and Morck et al. (2008) about the common perspectives over the Chinese FDI.

However, general literature on the Chinese investments in small developed countries is practically absent, but studies focus on the Chinese FDI received by individual small developed countries. In Finland, only a couple of studies, articles and other overviews have been published about Chinese investments, e.g. Kaartemo's (2007) and Barauskaite's (2009) publications from Pan-European Institute (Turku School of Economics) about the motives of the Chinese FDI and trade relationships, although their focuses have been much broader covering the entire Baltic Sea region including both large and small countries. Little more studies and scientific articles have been published concerning the question of the subject matter in Sweden. These include, among others, Abrahamsson & Nyvall (2007) about the barriers for the Chinese MNEs to entry in Sweden, Englund, Merker & Ölund (2007) about the case of Fanerdun in Kalmar, Schölin (2007) about Fanerdun's impact to local development in Kalmar, as well as Nakamura & Olsson (2008) about the motives and pattern of private Chinese FDI to Sweden. All these focused in single Chinese investments in Sweden. In addition, Fromlet

(2006) from Swedbank has published an analysis of the impacts of the Chinese globalization in the Baltic Sea region.

Because of scarce research attention in the Chinese FDI in Finland, especially concerning the experiences of several Chinese investors particularly from the Finnish business environment, there is an evident research gap in this subject matter. Further research in this field is clearly beneficial for many stakeholders, such as the local and Chinese trade & investment promote authorities and organizations, the local and Chinese companies as well as scholars in the field of FDI research because the Chinese FDI is an emerging and rapid growing phenomenon in the global economy, and additional information from their performance in different geographic regions and business environment is necessary.

### 1.3 Research problem and research questions

Significance of large emerging economies and their MNEs have grown enormously within recent decades, especially in respect of China and Chinese MNEs. According to the traditional FDI theories foreign investment directed first to the neighbouring regions as well as to larger markets. This has been the case of China too, although commercial and political reasons have directed a growing number of the Chinese FDI also to more distant destinations, e.g. Africa, Latin America and Europe. The Chinese have mainly invested in geographically close countries, and in the countries of large markets or natural resources. This has been cleared up in many recent published studies about the Chinese FDI. However, it is still fairly unclear if the results of those studies apply also in smaller countries with developed economy and institutions. Furthermore, according to available data, the Chinese FDI have distributed rather unevenly between small and apparently similar countries such as Finland and Sweden. Thus, it is important to research if there are some distinctive motives and location factors that influence the investment decision of the Chinese MNEs particularly in small developed economies and therefore the research problem is the following:

*What are the main motives for the Chinese FDI and the main factors that affect the Chinese FDI location decisions in small developed economies?*

Next, the two first research questions are formed for answering the research problem using Finland as the empirical subject of the study. The last question is formulated in order to find out if the results of the preceding questions are generalizable also to other small developed economies besides the subject country by comparing them with another small developed economy, Sweden. Furthermore, at a practical level, the last question seeks to provide answers to the fact why the number of Chinese FDI has been varying so much between two, externally very similar, small developed countries.

1) *What have been the main motives behind the Chinese FDI in Finland?*
2) *What have been the most important location factors that affect the orientation of the Chinese FDI in Finland?*
3) *Are there differences in the motives and locations factors behind Chinese FDI in Finland and Sweden?*

The first question addresses the reasons why the Chinese MNEs have generally chosen to invest abroad, in this case in a small developed economy Finland. In some extent, push-factors of the Chinese MNEs to utilize FDI are discussed. The second question, in turn, is concerned with the reasons why Finland has been chosen (and also why not) the host country for the Chinese FDI, i.e. the pull-factors of Finland in the case of the Chinese FDI. Finally, due to the earlier mentioned scarcity of literature on the Chinese FDI in small developed economies, the results obtained from Finland can be only limitedly compared with the previous literature. Therefore, possibilities for comparison to similar countries and the generalizability of the results are improved by using Sweden as a benchmark.

In the next chapter, the key concepts of this study are defined, and after that relevant literature to the research questions is reviewed.

## 1.4 Definitions of key concepts

In this chapter the most important three key concepts of this study are defined in order to make clearance what they are and what they are not, as well as to provide some background information about each theme for the reader. Below the concepts are listed in order as they appear in the study, not in a priority order.

### Foreign Direct Investment

According to traditional definition, a foreign direct investment (FDI) means a physical long-term investment from an enterprise's (direct investor) domestic economy into another economy. FDI can be a transfer of the capital, managerial or technical assets and it is distinguished from, for example, international trading so that the investor owns or/and controls a foreign affiliate and facilities. The capital components of FDI are equity capital, reinvested earnings and other capital, mainly intra-company loans (UNCTAD 2002). In comparison, OECD (2008) determines direct investment enterprises (in host country) as corporations which either may be subsidiaries, where over 50% of the voting power is held, or associates, where between 10% and 50% of the voting power is held, or they may be quasi-corporations such as branches which are effectively 100% owned by their respective parents. Lower ownership shares and voting power are known as a portfolio investment.

### Multinational Enterprise

A multinational enterprise (MNE) is an enterprise that manages value-adding activities, such as production and services, or controls assets outside of its own country/economy. Other terms having the same meaning are a multinational corporation (MNC) and transnational corporation (TNC), although in some contexts the TNCs have more localized foreign functions while the MNEs do not have coordinated product offerings in each country. According to Dunning & Lundan (2008, 3) MNE is the result of previous FDI.

**Small Developed Economy**

Small developed economies (SDE) are often referred also to ‘small and open economies’ (SMOPEC) (e.g. Bellak & Luostarinen 1994; Laanti et al. 2009) and obviously there is no clear difference between these terms in the field of international business. Both terms also contain approximately the same frequency in the literature. Gammelgaard et al. (2009) define a small economy by the size of its GDP ”which is a proxy for the quantity of labour, capital assets, and natural resources bases”, whereas they define level of development by GDP per capita which is “estimate of social infrastructure such as life expectancy, percentage of urban population, and education levels”. Hence, small developed country possesses relatively small GDP but high GDP per capita.

Another definition (Dixit 2005, 248) of small developed economy / small open economy is that it participates in international trade, but because its smallness its policies do not affect world prices, interest rates or incomes. Thus these kinds of countries are so called ’price takers’. According to Laanti et al. (2009), SDE (or SMOPEC) are small countries that have opened their borders for international trade in competition with no or limited barriers. Usually, countries of this kind have higher export/GDP ratios than larger countries and FDI inflows have a bigger impact in smaller countries (Bellak & Luostarinen 1994, 3). However, the larger size of economy usually provides host location advantages (i.e. pull-factors) that determine the inflow of FDI, such as economies of size and scope in production as well as sales and distribution activities (Gammelgaard et al. 2009). Laanti et al. (2009) count Austria, Belgium, Denmark, Finland, Ireland, Israel, the Netherlands, New Zealand, Norway, Portugal, Sweden and Switzerland to belong the group of small developed economies. A broader definition can also include some other countries, such as Australia, Canada, Hong Kong, Singapore and Greece.

# 2 LITERATURE REVIEW

First in this chapter, the most recognised theories reasoning of FDI are briefly introduced for better understanding about the phenomenon. After that motives for FDI and the factors that determine FDI host country locations are discussed as they are the main subjects of the research questions of this study. Next, the literature of the Chinese FDI activities is reviewed in order to perceive their distinct features compared with the FDI in general, including definition of the advantages and disadvantages of the Chinese MNE in their FDI activities and internationalization process. Lastly, motives and location factors are discussed concerning the Chinese FDI.

## 2.1 Theories and determinants of foreign direct investments

Research history of foreign business operations and phenomenon of foreign direct investment is relatively short. In practice, the main theories for them have been generated only after the Second World War and particularly during latest four decades. One of the earliest explications for foreign business operations and trade, also partly explaining the possible reasons for foreign manufacturing, was *the Ricardian framework of comparative advantages* (Ruffin 2002) which was published already in the early 19$^{th}$ century, when international investments were still mainly an extension of colonial policy and made by chartered companies. In this framework the comparative advantage means that a certain country ought to specialize in production and export goods which it has production advantages over other countries and it also receives foreign investments in those sectors.

Later the neoclassical theories, such as *Heckscher-Ohlin framework* (Heckscher & Ohlin 1991) in the beginning of the 20$^{th}$ century, were mainly focused on international arbitrages. According to them, the capital tends to flow into such countries where the rate of return for investment is the largest. Nonetheless, although these early theoretical frameworks gave certain capable explanations for both general and the present-day Chinese FDI activities, they were still at very general level. They did not provide answers to the questions about micro- and company-level reasons for making foreign investments

instead of international trade, i.e. questions about foreign ownership and organizing. (Dunning & Lundan 2008, 79; Dreyhaupt 2006, 22; Moosa 2002, 24).

The breakthrough idea of imperfect markets and firm-specific advantages was firstly introduced by Stephen Hymer (1960 & 1976). He argued that company has to possess some monopolistic firm-specific advantages which are transferable to other countries, e.g. the economy of scale, product differentiation, technology and finance or intangible assets such as marketing, innovatory and managerial skills or famous trademarks and brands. With those advantages it is able to overcome the liability of foreignness, i.e. it is able to compete in foreign markets with indigenous companies which have benefits from their knowledge of local business environment and networks (Caves 1996, 3-5; Wilska 2002, 21; McCann & Mudambi 2004; Dunning & Lundan 2008, 84). Because there is not a perfect market, it is not possible to freely obtain these advantages by other firms without acceptance of the owner company. Thus the owner company possesses monopolistic asset-power advantages and is able to seek rents from them. In order to fully benefit from these advantages abroad, the company has to have a control and ownership over its foreign operations and thus it ends up carrying out a foreign investment instead of exporting or licensing (Caves 1996, 27). As discussed in the latter chapters, the Chinese companies have only a few, if increasing, amount of firm-specific advantages. However, certain special features behind the Chinese MNEs, mostly home country specific, provide them advantages that are compatible with the concepts put forward by Hymer.

In the 1970s and 1980s the global investment activity grew rapidly although even a larger leap occurred later at the beginning of the 2000s. Total flow of the global FDI increased 15-fold from 1970 to 1990 and the annual growth rate of international FDI was approximately 15% (Table 1). This development correlated also with the amount of new FDI theories during those decades. Hymer's ideas were supplemented with theories which combined market imperfections, transaction costs and internalization as FDI determinants (e.g. Buckley & Casson 1976; Dunning 1980; Rugman 1981). According to the theories, companies are able to circulate and avoid market imperfections, e.g. tariff barriers, by the internalization of their foreign operations. Furthermore, market imperfections can also be consisted of transaction costs. This means that a company

either buys information of market and business environment and outsources the means of production/sales/marketing/R&D etc. in order to participate in a market (external transaction costs) or it gathers knowledge by itself and internalizes the means within the company, which is not free either (internal transaction costs). Williamson (1975) discussed this as the 'market versus hierarchy' dilemma and Grosse (1985) calls it as the 'make-or-buy' decision. If a company has firm-specific advantages which need a tight control over them to maximize the profit and avoid risk dissipation (copying etc.) or buying of means is too expensive, impossible or uncertain, it internalizes the foreign operation. In other words, it applies FDI. Conversely it finds exporting and licensing a cheaper way to utilize the foreign market (Rugman et al. 1986). Thus a company internalizes foreign activities since the costs of further internalization is higher than its benefits. Hoever, in practice it is difficult to obtain relevant data of costs and analyze it thoroughly (Rugman 1986; Wilska 2002, 23; Dreyhaupt 2006, 34).

**Table 1. Volume and annual growth rate of global FDI in 1970-2005.**

| | Value at current prices (billions of USD) | | | | | Annual growth rate (%) | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1970 | 1980 | 1990 | 2000 | 2005 | 1970-1980 | 1980-1990 | 1990-1995 | 1995-2000 | 2000-2005 |
| FDI inflow | 13 | 54 | 207 | 1 398 | 959 | 15,0 | 14,4 | 10,5 | 32,6 | -7,3 |
| FDI outflow | 14 | 52 | 239 | 1 232 | 881 | 13,8 | 16,6 | 8,6 | 27,8 | -6,5 |
| FDI inward stock | n/a | 704 | 1 941 | 5 787 | 10 180 | n/a | 10,7 | 8,5 | 14,7 | 12,0 |
| FDI outward stock | n/a | 549 | 1 785 | 6 148 | 10 598 | n/a | 12,5 | 10,5 | 15,9 | 11,5 |

*Source: UNCTAD 2010.*

Dunning (1980) continued to develop the internalization theory by affiliating it to his *eclectic paradigm* (often referred also as OLI paradigm), which is a more general theory of the framework of MNE and FDI phenomena than a bare explanation of it with the internalization and transaction costs. In the eclectic paradigm Dunning combined asset ownership advantages (O-advantages), location endowments (L-advantages) and internalization advantages (I-advantages) on the basis of previous FDI theories. O-advantages refer to earlier discussed firm-specific advantages introduced by Hymer that enable a company to success abroad. L-advantages (FDI host country endowments) indicate those advantages or assets that are available to any company but exploitable only in certain locations, and include e.g. input cost advantages as cheap labour and affordable

natural resources, productive and skilled labour, large and/or growing markets, low taxation, good infrastructure as well as favourable political, legal, cultural, social and institutional environment. It should be also noted that locational advantages apply to both in home and host countries; at home they enhance the firm's ability to develop ownership-advantages and in host country they help the company to combine its ownership assets with local factors to gain higher benefits (Dreyhaupt 2006, 39). This is an essential consideration from the viewpoint of this study, i.e. what indigenous advantages the Chinese MNEs are able to exploit in small developed countries. Finally, by I-advantages Dunning means a company's ability to acquire and upgrade resources (McCann & Mudambi 2004), and internalize O- and L-advantages under organization's hierarchical control which reasons and benefits were defined earlier.

Nevertheless, recently OLI-paradigm has been questioned and challenged because it expounds weakly why the so called latecomer countries, such as China, and their companies have managed to internationalize and make substantial foreign investments despite their deprivation of O-advantages, especially 'dragon MNEs' from East Asia in the 1990s and 2000s (Mathews 2006; Li 2007). Therefore, so called *LLL-framework* (linkage, leverage and learning) has been proposed for a supplementary theory to describe the FDI phenomenon of the latecomer MNEs (Mathews 2006). However, Dunning (2006) has defended OLI-paradigm by access or/and augment based investments from developing countries (introduced further in the next paragraph) and different kind of competitive advantages of 'dragon MNEs' – either firm- or country-specific ones.

The last-mentioned advantages were earlier introduced e.g. by Rugman (Rugman et al 1985, 119; Rugman 1986) who has argued that OLI-paradigm can still be further condensed by combining O- and I-advantages under a term of firm-specific advantages (FSA) since he argues that "ownership-advantage (where there is a risk of dissipation) has to be internalized in order to be effective (to prevent dissipation)" (Rugman 1986). Furthermore, he called Dunning's L-advantage as country-specific advantage (CSA) with the same content, but CSA finally determines how a company is able to utilize its FSA in certain location, i.e. which foreign operation mode it chooses. As mentioned earlier, CSA could be benefited both domestically and in certain host countries. At home, CSA provide

companies extra strength to internationalize and success in the global competition, whereas CSA in a certain host country gives possibilities to either exploit MNE's own FSA or acquire new FSA. The domestic CSA behind the Chinese MNEs are undoubtedly strong and help them to internationalize quickly, which has been elaborated more in Chapter 2.4. One purpose of this study is to find out what the host CSA in small developed countries (here Finland and Sweden) possess which attract the Chinese investment. Aspects of location and matters affecting the choice of FDI locations are discussed in the following chapters.

## 2.2 Motives for FDI

It is generally assumed that the ultimate motive for companies' international expansion is the pursuit of growth (Caves 1996, 57). Because of this, a firm that possesses firm-specific assets and advantages enters a foreign market when it grows out the domestic market or there is an opportunity for more rapid growth abroad. It might also need to acquire means for further growth abroad, as in many cases in present China. At this stage, a firm usually formulates an international strategy which can lead to FDI but alternatively also to other foreign operation modes as explained earlier. Furthermore, also the motives of the firm affect the decision process of a foreign operation mode (Franco et al 2010).

### 2.2.1 Dunning's taxonomy of FDI motives

From this basis, many studies have been concerned with FDI motives but there are still few systematic theoretical categorizations between different types of motives. The most famous and quoted categorization of FDI motives is Dunning's taxonomy (1993) which is closely related to him earlier developed the eclectic (OLI) paradigm. In the taxonomy, he divided the FDI motives into four main types – resource seeking, market seeking, efficiency seeking and strategic asset seeking (sometimes also called knowledge seeking) motives. Three former are so called asset exploiting FDI motives since by them the MNE exploits some of its existing firm specific assets, and are thus in line with O-advantages

of original Dunning's eclectic paradigm. Unlike the above-mentioned types, the last FDI motive type, strategic asset seeking, is based on the acquisition of new assets that MNE has been lacking. Nevertheless, an asset seeking FDI requires resources and the investing company must be large enough, well financed or it has to enjoy certain domestic country-specific advantages, as the cheap financing in the case of the Chinese MNEs, for instance.

However, few investments drop only into a single motive type (Dunning & Lundan 2008, 68). Initially, most companies' motives are usually in the categories of resource or market seeking, but when their degree of international operations increases, they begin also to enhance the global market position by efficiency and strategic asset seeking investments. Dunning and Lundan have also elaborated that FDI can be aggressive, i.e. a proactive operation for advancing the strategic objectives, or defensive, i.e. a reaction to the competitor's move or act of foreign government, which calls for defense of prevailing market position. The Chinese FDI are usually proactive since the Chinese economy is so called latecomer economy and growth of the economy and the MNEs is fast.

*Resource seeking motives* are much based on traditional location advantages and it contains three main types (Dunning, 1993; Dunning, 2002, 409; Dunning & Lundan 2008, 68-69). The first type is a physical natural resource seeking - raw materials and energy sources that are inadequate in home country and are usually sought by the primary producers or manufacturing companies in order to minimize the costs and secure supply/import of resources. The second type is seeking well-motivated but cheap cost-efficient labour with possible poor or mediocre working skills. These investments are usually made from high labour cost countries to cheaper ones within labour-intensive industries. Nevertheless, the importance of this type of investments is gradually diminishing as the role of cheap labour is decreasing in value-adding activities of global companies. The third type is seeking technology capability and managerial, marketing or organizational skills and expertise, which are mostly available in developed countries, also smaller of them, but rather scarce in developing and emerging economies which drives their MNEs to invest into countries of the former kind. According to Gammelgaard et al. (2009), the demand for skilled labour is globally increasing which also increases the potential of high value-adding seeking FDI to small developed countries. However, two

latter types could as well be classified also in other groups of motives. In addition, Franco et al (2010) have elaborated alternative solutions and locational determinants for the resource seeking FDI. As alternative solutions to the resource seeking FDI they propose the use of international trading intermediates and outsourcing, especially when transactions costs are moderate and supply assured. However, if the exchange rate of the host country is particularly volatile, FDI is usually used for protecting the MNE from the exchange rate risk of importing. This has been the case e.g. in natural resource FDI in Africa. Finally, the locations of a resource seeking FDI depend on the real costs and absolute scarcity of the resource as well as the productivity of the labour (Franco et al 2010) which is obviously higher in developed than in developing countries.

*Market seeking investments* have been probably the most common type of FDI (Larimo 1993, 57; Dunning & Lundan 2008, 71). Also, according to the results of several FDI motive surveys in OECD countries from the 1960s to the 1990s, market-related motives had been more common reason for FDI than cost-related ones (Larimo 1993, 57-66). Market seeking investments are mainly based on strategic locational advantages and enhancing company's international, regional and local market power. They are often done in countries and markets where the investing company had earlier had e.g. exporting operations, but because of high import tariffs or large and/or fast growing market size has compelled or drawn it to involve in more permanent presence e.g. by a production or sales office investment. Market seeking investments could be also done to replace licensing or franchising if there is an increasing need for the higher control of the sales chains e.g. because of IPR or contractual problems. Franco et al. (2010) interpolate that if the products or technology can easily be imitated but it cannot be patented a company should utilize FDI, but if patenting works exporting and licensing are also relevant options. Market seeking types of investments are made to exploit new markets or protect existing markets, or, as Franco et al (2010) add, serve as an export-platform. This means that an investment in a certain country (with other locational than market advantages) is a platform from which products or services are exported primarily to surrounding countries, e.g. to other EU or NAFTA countries. Nevertheless, there is no unequivocal evidence that membership of the EU had directly increased the inward FDI flow to the smaller European countries (Gammelgaard et al. 2009). Besides above-mentioned market size or

growth as a market-oriented investment motive, the motive can also be a thrust to follow up company's main suppliers or customers to new locations and thus retain its business position, follow-up company's main competitors to their main market areas, adapting local culture, language and taste issues, the high cost of supply from probable distant home or other existing business locations, and so on (Dunning & Lundan 2008, 69-71).

The third type of FDI motive, *efficiency seeking*, contains two main reasons why MNEs end up to utilize them: "taking advantage of differences in the availability and relative cost of traditional factor endowments in different countries" and "taking advantage of the economies of scale and scope, and of differences in consumer tastes and supply capabilities" (Dunning & Lundan 2008, 72). The investments of this kind are done to arrange and rationalize existing the resource- or/and market-based investments in order to gain from common governance policy and hence often also benefits from the economies of scale and scope as well as risk diversification. Other possible motives are to gain, for example, from production factors/endowments, different cultures, institutional arrangements, economic policies and structures by adding them into company's governance policy, i.e. benefits from different locations. Usually, these kinds of efficiency seekers are relatively large MNEs with standardized and geographically wide processes and other operations (Dunning & Lundan 2008, 72; Larimo 1993, 59). Franco et al (2010) note that the motive of efficiency seeking is very similar to the resource seeking because it is often based on gaining from the fragmented production and cheap labor cost in developing markets, and thus would not count it an independent motive.

The goal of the last FDI motive type of Dunning's taxonomy, the *strategic asset seeking*, is to sustain or advance the company's global competitiveness by acquiring assets to supplement or increase the company's already existing assets. This is often performed by merging or acquiring assets of (or by cooperation modes e.g. a joint venture with) foreign corporations as a competitive strength in a new market (Dunning & Lundan 2008, 72), or by setting up a greenfield subsidiary e.g. near to R&D or supply cluster in order to gain the knowledge spillovers of agglomeration economies (Franco et al 2010). They add that if asset is not embedded in certain key personnel M&A is a more effective way to gain maximum benefit than capturing only the key personnel. The main target of strategic

asset seeking is to increase company's global portfolio with physical assets as technology, human skills (e.g. technological, managerial or organizational), but also intangible assets as brands, and thus to enhance its ownership-specific advantages, or weaken competitors' position. As the number of a strategic asset seeking type of FDI has increased rapidly, particularly in knowledge and information-intensive sectors, it has also increased the proportion of M&A as a modality of FDI (Dunning 1998). Due to their nature, most of the strategic asset seeking investments are focused on developed countries (Dunning 1998), but recently also the MNE of emerging economies are increasingly involved in the strategic asset seeking investments because of their apparent lack of O-advantages, e.g. the purchase of IBM's PC division by Chinese company Lenovo in 2005 as an example. (Dunning & Lundan 2008, 72-74)

In Table 2 types and motives of FDIs with some defining factors are introduced based to Dunning's eclectic paradigm and above mentioned motives for FDI.

**Table 2. Types and motives of FDIs with some defining factors based on the eclectic paradigm.**

| Types of advantages / Motives for FDI | Ownership advantages | Location advantages | Internalization advantages |
|---|---|---|---|
| Resource seeking | Capital, technology, access to markets | Possession of natural resources, transport and communication, goverment policy (tax & FDI incentives) | Control of markets, stability of supplies |
| Market seeking | Capital, technology, information, management skills, economies of scale, branding skills, R&D | Material & labour costs, market size and characteristics, government policy (regulations, FDI policy/incentives, tolls/import quotas) | Reduction of transaction & information costs, closer control over IPR issues |
| Efficiency seeking | As above, and access to markets, economies of scope, geographical diversification or clustering, international sourcing | Economies of product/process specialisation or concentration, labour costs, incentives for local production, favourable business environment | As above, and gains from economies of common governance |
| Strategic asset seeking | Any of above if creating synergy with existing assets | Any of above that offer needed technology, organizational etc. assets | Economies of common governance, enhanced competetive/strategic advantages, risk reduction or diversification |

*Source: Modified from Dunning & Lundan (2008, 104-105)*

### 2.2.2 Other types of FDI motives

Some authors also include political safety seeking investments in the list above (e.g. Korhonen 2005, 44). The reason for these investments is to reduce a risk of governmental interventions by undertaking investments in politically more stable countries and making divestments from more turbulent countries and economic circumstances, e.g. in cases of an unstable government regime or even war and civil strife. The recent examples of political safety seeking investments in the small developed economies are e.g. Hewlett-Packard's data centre investment in Vantaa and Google's server centre investment in Hamina, Finland, in 2008 and 2009. One of the main motives for these investments was safety and political stable conditions in Finland which they consider as one of the most secure locations for FDI at issue (Kauppapolitiikka 2009). Also in Sweden similar

reasoning has been used in order to attract suchlike data center FDI (Invest in Sweden Agency 2010). Political regulations can also be a reason for investments which Dunning and Lundan (2008, 74) call escape investments. They are made in order to escape restrictive legislation and macro-economical policies, or to gain from FDI incentive policy. One examples of this are the "circulated" or "round-trip" investments between Hong Kong and mainland China to exploit tax privileges and other incentives that are granted only to foreign investors.

Supplementary type of investment motive that Dunning mentions (Dunning 1993, 61; Dunning & Lundan 2008, 74-75) is the support investments, designed for helping and promoting the other MNE's activities in the host country or region. These subsidiaries are seldom profit makers themselves but their main contribution is to benefit other MNE's activities. Usually, they are sales and financial units that support and promote exporting of goods or services, after-sales maintenance and service units for clients, or purchasing unit to support MNE's sourcing in a foreign destination.

However, unlike explained at the beginning of this chapter, FDI are not always made for gaining growth and a high rate of return but a MNE has also to consider risks. Hence internationalizing by FDI can act as a risk reducer following Markowitz's classic *theory of portfolio diversification* (1959). Also e.g. Rugman (1976) presents that MNE is able to reduce its overall risk by the international diversification of the investment portfolio – not necessarily meaning portfolio investments but a wide variation of host countries and/or industries of its FDI. Furthermore, in case of a developing economy, such as China, a significant part of the new capital is likely to flow abroad since there are strong incentives to diversify domestic risks in areas of, for example, politics and IPR (Xiao 2004). It is obvious that the small developed economies offer a good location for reducing a risk of those issues.

Finally, although theoretically they are not concerned as FDI because of short-term perspective of their nature, also speculative foreign investments in real estate (land and property) are included in FDI data on national account calculations so they are worthy of mention in this context. The motive is mainly financial such as speculation about the

future expectation of real estate values, but sometimes also simply the ownership of foreign holiday apartments or second homes (Dunning & Lundan 2008, 76; Franco et al 2010). For example, in China sterner investment legislation was as a result from the loss of control over the state asset and leakage of foreign exchange especially to real estate and stock market speculation in Hong Kong in the late 1990s (Buckley et al 2007).

## 2.3 Determinants of FDI location

One of the earliest location theories to analyze the geographical patterns of foreign operations is Weber's *least cost location theory* which was initially published already in 1909 (translated into English in 1929). The theory, which applies predominantly at the country and industry level, suggests that the optimal location for industry is where the costs (general costs of transportation and labour as well local costs of market servicing, which usually are the lowest in agglomerations) can be minimized and thus the profits maximized. Hanink (1994, 203-204 & 217) noted, yet, that the least cost location theory applies the best to explain FDI from the so-called core markets (The USA, Europe and Japan) to the periphery and particularly in perfectly competitive product markets. However, international economy is rarely perfect since the monopolistic and oligopolistic characters of it, as well as governmental interventions are often involved thus making the markets imperfect. In practice, the least cost location theory has applied best to the industries producing bulk goods and exploiting cheap labor in developing countries, such as garment industry. One good example of this is the vast flow of FDI from the developed economies into emerging China in the 1990s and 2000s.

In the post-WWII era, a commonly used explanation model of location decision of MNE was Vernon's *product-cycle model* (1966). He argued that at country level innovations and sophisticated technology save labour costs, and thus the user value of those is the highest in the countries with high labour expenditures. That is why innovations are concentrated in high-income countries with a good supply of scientific and engineering resources. When innovated products and processes develop and large-scale production becomes feasible and cheaper, the domestic competition becomes more intense since

imitators appear in the market. In order to exploit home country advantages abroad this urges on to either export the products or/and transfer the production and technology to other countries, usually first to other developed countries and then to developing countries where production expenses are lower. However, similarly to the least cost location theory, the product-cycle theory has been generally based on center-periphery reasoning, and has not explained resource-based, efficiency-seeking or strategic-asset-acquiring FDI. (Dunning & Lundan 2008, 85-86; Yang 2006, 35-36; McCann & Mudambi 2004). At first glance Vernon's theory cannot be reconciled with FDI made by the Chinese but along with the rapid accumulation of their innovations the Chinese MNEs have had increased opportunities to seek profits also in developed markets. This has reflected in the increased Chinese investment in the USA and Europe during very recent years that have also impugned the traditional division of center-periphery in the world economy.

Contrary to the product life cycle theory, *the Uppsala model* has discussed more at the company level about MNE evolutionary and their internationalization processes, i.e. "the internationalization theory" or "stage theory" (Johanson & Wiedersheim-Paul 1975; Johanson & Vahlne 1977). According to the theory, the internationalization process of a company develops through the gradual acquisition of knowledge about the foreign markets and business operations. By increasing its size, knowledge and experience, the company is able and more willing to have stronger resource commitment - usually from export and licensing to FDI - in the foreign markets and geographically further areas (also Welch et al. 2007, 344-345). The theory predicts that at the first phase of its internationalization the company prefers physically, as well as culturally, the closest countries because of growing transaction costs from close to distant countries. With business operation experiences gathered from the physically close countries, the company is able to develop organizational routines for reducing the costs of collecting further information about the markets where its facilities are already located or the markets that it is going to penetrate in the future. Thus it can reduce uncertainty in their foreign investments and thereby enhance its ability to invest in distant locations.

### 2.3.1 Location factors

When it comes to the attractiveness of particular locations, Dunning and Lundan (2008, 324) summarized that literature in the 1970s and 1980s emphasized three main points: 1) costs and quality of given factor endowments, 2) size, nature and growth of local markets, and 3) policies of host government which have an affect on both factor endowments and markets. For example, Hood and Young (1979, 58-59) discussed about four main categories of locational factors: 1) labor costs including immigration costs as well as language and cultural barriers, 2) marketing factors (above mentioned added by the local competition and development level of market), 3) barriers to trade (quotas, tariffs and product standards), and 4) government policies including investment and general business climate as well as regulatory framework. Rugman et al. (1986, 101-102) explained the location specific factors with the previously introduced term country-specific advantages (CSA) which consist of three environmental variables: economic, non-economic and governmental. In the simplest model economic variables contain only labour and capital, but it could also be added by technology, natural resources and management skills or human capital. Non-economic variables refer to a wide set of the political-cultural dimensions of each nation that impose conditions, risks and opportunities that foreign companies have to perceive when operating in the country. Finally, both home and host governmental variables affect the MNE. In every country governmental interventions have their impacts in MNE's business and the environment at several levels, such as investment, trade and employment regulations.

Currently, along with the globalization development and increased number of free-trade areas, such as EU and NAFTA, more attention has been paid to country-specific incentives and their enforcement affecting inward FDI. Caves (1996, 55-56) found out that in most empirical studies exports and FDI are jointly determined because MNE evidently pursue value-maximizing and transaction-cost minimizing in their location choices (different costs and demand-side factors), particularly when exporting turns to investments because of higher tariffs. It is also apparent that large export and FDI flows occur between same countries, such as between China and USA or Germany, or similar

countries with bilateral affinities as similar income level or language and culture, e.g. between China and Singapore or the USA and Western European countries (Appendix 2).

### 2.3.2 National competitive advantages of countries

Perhaps the most thorough presentation of location factors that affect FDI and other international operations is Porter's *national diamond* model of countries' competitive advantages (1990). Although the model has been developed mainly from the standpoint of the competitiveness of domestic market in the international competition, it is also applicable in the discussion of FDI location because the investing foreign MNEs also try to benefit from the national competitive advantages. The model consists of four attributes of a country which together create the environment that promotes or impedes formation of competitive advantage, i.e. which either attracts or withhold foreign business activities, e.g. FDI. According to Porter, the attributes are a mutually reinforcing system so that they have to be systematically organized to be fully effective, and they are 1) factor conditions, 2) demand conditions, 3) related and supporting industries, and 4) firm strategy, structure and rivalry. (Porter 1990, 72; Dunning & Lundan 2008, 324).

The first attribute, factor conditions, includes available natural resources and locally created capabilities such as skilled labour, knowledge and capital resources as well infrastructure that are necessary to compete in particular industry. The first three can be mobile between different locations and countries, and thus they are somewhat more fluid and available for purchase out of the country. Furthermore, basic factors as natural resources, climate, geographical location, a number of unskilled labour and debt capital are passively inherited, whereas advanced factors, for example IT infrastructure, highly educated personnel and R&D facilities, depend on the level of development of the particular country. Respectively, the lack or uncompetitiveness of these factors reduces the attractiveness of a country as an FDI destination. (Porter 1990, 74-77; Dunning & Lundan 2008; 324). Small developed countries tend to have 'location-disadvantage' in capital resources and a number of unskilled labour thus making the basic production more

expensive and less attractive for foreign investors, whereas usually their strengths are in the developed infrastructure and trained workforce.

The second attribute, the demand conditions stand for the nature of domestic demand for the products and services in the particular industry. From the standpoint of a foreign investor, the most important characteristics are the composition of demand (i.e. the nature of buyers' needs) as well as the size and growth of demand. Demand conditions are often highly dependent on cultural and lingual similarities between the host market and foreign MNEs. Moreover, a developed consumer market can act as a platform or test bed for companies with new products because of its anticipative nature to forthcoming global hit products (earlier e.g. Japan for electronics or robot devices). One influential factor is the segment structure of demand because every nation has its own demand priorities. This might make a small developed economy an attractive niche market if local demand in a certain segment is large but internationally it is relative small.

The third attribute of the national diamond, and a potential attractiveness factor for small developed economies, is a presence (or absence) and international competitiveness of suppliers and related industries, especially clusters and agglomerations of them (Porter 1990, 100-107; Ledyaeva et al. 2010). Advanced downstream industries provide an access to the most cost-effective inputs to foreign companies. Benefit is the largest when there is a close process of innovation and upgrading between local world-class suppliers with international positions and the industry, i.e. a cluster where R&D and market information, new ideas and solutions and innovations are accessible for present companies. Again, a company can share activities in value chain with players in related industries when competing, or which are involved in complementary products that enhance company's competitive position (e.g. computers-software or mobile phones-networks). These also provide extensive information flow and other interchange between competitive domestic companies and foreign investing MNEs.

Finally, the extent of inter-firm rivalry as well as innovatory and competitive strategies of local companies have their own impact on business environment for foreign companies, i.e. what is the level and quality of the rivalry (e.g. the number and vitality of global and

domestic competitors in the market) and how orientated local firms are toward global competition and international demand (Porter 1990, 107-124). Tough competition usually lower prices, improve quality and service as well as create new innovations. It also often means that markets are not stiffen or distorted by governmental interventions, although this is not always the case, for example in the present China.

In addition to above mentioned four attributes, Porter (1990, 126-129) mentions several ways how the host governments can influence positively or negatively in each of above-mentioned attributes, and thus the FDI host country environment. It can shape factor conditions through subsidies, policies toward capital markets, investing in research and education etc. In demand conditions effects governmental policies are more indirect, e.g. product standards and regulations that steer buyers' needs, but government and public companies could also be substantial buyers of many products themselves and thus affect greatly in prevailing demand conditions. Furthermore, government can influence the related and support industries e.g. by regulations of supporting services, and firm strategy, structure and rivalry by taxation, capital market regulation, antitrust law or requirements for a certain level of domestic-content of sold products (Caves 1996, 35). Other governmental actions that affect strongly the investment and business environment are, for example, incentives for foreign investors or foreign exchange policy, e.g. an attempt to hold the value of local currency down in order to lower the cost level and thus improve competitiveness. Nevertheless, in a long-run it reduces domestic companies' pressure to develop, which has clear effect on FDI flows if rate changes are expected to be long-lived (Caves 1996, 55).

### 2.3.3 Dunning's location advantages

Next, earlier introduced L-advantages of Dunning's eclectic paradigm have been elaborated more in-depth and how each kind of location factors affects each motive type on Dunning's FDI motive taxonomy. Dunning divides host country determinants (L-advantage) of FDI in three fields: 1) general policy framework (economic, political and social stability, good governance, competition & M&A policies, IPR, industrial policies

and cluster development, trade policy), 2) policies specific to FDI (bilateral investment agreements, investment incentives and services, social amenities as the schools, quality and safety of life etc.) and 3) economic determinants by a type of investment motives. These economic determinants are further classified into factors which affect FDI location decisions in Dunning's taxonomy of FDI motives in Table 2. (Dunning, 1998; Dunning 2002, 418-424; Dunning & Lundan 2008, 323-327).

**Table 3. Factors affecting FDI location decisions classified by FDI motives.**

| FDI motive | Location factors |
|---|---|
| Market seeking FDI | - market size & growth<br>- income level<br>- local consumer preferences<br>- structure of markets<br>- physical and cultural distance between home and host country<br>- access to regional and global markets (importance growing) |
| Resource seeking FDI | - cost of land and property, raw materials and components<br>- availability and cost of both unskilled and (increasingly) skilled labour |
| Efficiency seeking FDI | - above mentioned costs compared with their productivity<br>- transportation and communcation costs<br>- membership of a regional integration agreement (e.g. EU or eurozone<br>- quality of market-facilitating institutions |
| Asset seeking FDI | - competition and M&A policies<br>- technological, managerial and other created assets<br>- physical infrastructure<br>- Innovatory, entrepreneurial and educational capacity |

*Source: Modified from Dunning & Lundan 2008, 325-326.*

As Porter earlier, also Dunning and Lundan (2008, 326) emphasizes the crucial role of host country government reflecting FDI locational factors. Most national and regional governments are nowadays eager to attract inward FDI because they are sources of capital and employment as well as a possible offering of new technologies. In other words, the greater their local value added, the greater is the contribution to local society (McCann & Mudambi 2004). For enhancing inward FDI the government has to offer functional institutions and institutional support which the foreign MNE needs. Investment

promotion policies (including “invest-in” functions at home and abroad) are important as well as regulations and incentives that are directed to nurture entering foreign companies and their investments. In addition, there are several other location advantages that do not directly appear in Table 2 but form the environment for foreign investors. One of the most significant is the openness of country, which includes several features such as the multiculturalism and tolerance of different religions and ideologies, the number of immigrants, level of cross-border commerce and number of foreign companies operating in the country. Thus, here the term ‘openness’ is broader than the definition of the small and open economy in Chapter 1.4. The others are level of economic, social and institutional development, and pattern of governance (e.g. freedom of speech and human rights).

### 2.3.4 Networks affecting FDI location decision

One of the less discussed but strongly FDI location channeling factor is international networks of a company and people. Chen & Chen (1998) argue that firm-specific advantages, the availability of local resources and the possibility for network linkages interact with each other to produce the final decision on FDI location. According to the network approach, FDI means a link made between domestic and foreign networks. In the today’s world technology development is faster and product life cycles shorter than earlier. In addition, the costs of organizing and monitoring market transactions are high, thus companies increasingly need for cooperation. Moreover, nowadays it is perceived that foreign market penetration and business expansion is almost impossible without building relationships and networks with private and public organizations and individuals. It is discovered empirically that especially smaller companies try to benefit from the local personal networks and economies of scale and scope through the networks, whereas larger companies make more independent investments and utilize global field-specific networks. Organizing company’s economic activities internationally through a market or within a firm is expensive, difficult and resource demanding. This is why the organizing is more and more often made via networks, so that a company is able to reduce transaction and governance costs, especially when foreign networks are alike with

MNE's home networks (Chen & Chen 1998; Wilska 2002, 28; Yang 2006, 63-64). The important and sometimes crucial dimension of networks is a sense of trust and mutual dependence between the human actors in a relationship. Especially in complex, different or distant markets this sense of trust is vital for the company's decision makers so that they are willing to highly commit in a more or less unknown country or market. Ready networks help a potential investor to join in these foreign networks, in other words agglomeration and clusters increase FDI into area because of their existing networks (Chen & Chen 1998). Accessible networks also help a company to progress in its internationalization process rapidly, e.g. in cases of 'born global' companies which managers usually have both technological expertise and experience of international business with ready contacts and networks abroad which impact in investment location decisions (Welch et al 2007, 38-39).

Particularly when international networks are alike as at home the adaptation is easy and transaction-costs decrease. Networks have also noticed to be especially useful when a company is entering into 'primitive' markets because lack of advanced market institutes Chen & Chen (1998) demonstrated that network linkages are important determinants of investment locations because, for example, the Taiwanese companies have been good at compensating their internal shortcomings by networking. Meanwhile the networks lessen the risks of internationalization without having to use only exporting and international licensing for risk reduction. The Taiwanese have successfully invested in mainland China and Southeast Asia partly because of similarity of local business communities with the Chinese ones. On the other hand, if SMEs lean only on local networks in its internationalization process it clearly reduces their number of possible choices between different locations and investment modes (Chen & Chen 1998).

In sum, it seems clear that the most important factors that affect FDI location decisions are macroeconomic environment, general economic infrastructure and socio-political stability, and the most important single factors are market size as well as development and prospects of it (e.g. in China and India), price-level, quality and price of labour, level of technology and already existing companies and industries in the target country, natural resources, favourable legislation and taxation, and access/supply of capital and financing

(Wilska 2002, 39; Welch et al 2007, 345). As the Chinese FDI is a relatively novel phenomenon, the explanatory power of the older FDI theories, such as least cost location and product-cycle theories, is rather negligible. On the contrary, FDI location factors introduced e.g. by Dunning and Porter in his national diamond seem to be relevant also in the case of the Chinese FDI but the importance of some factors are obviously different for the Chinese investors than for investors in the traditional investment countries. This conclusion can be made by observing the destinations and business sectors of the Chinese FDI, as well as special factors that affect FDI decision making in China. These special characteristics of the Chinese investment are discussed in the next chapters.

## 2.4 Special features of the Chinese outward FDI environment

Chinese outward FDI is a relatively new phenomenon both in the global economy and general FDI literature. Amount of literature about mainland Chinese foreign investments was especially scarce until the late 1990s. Overall, during previous decades the FDI literature paid only a little attention to FDI from developing countries, Lall (1983) and Wells (1983) as rare examples. Since then the number of publications about developing country MNE and FDI has gradually increased along with the fast growth of the outward FDI from developing countries within the latest decades. The Chinese FDI have increased dramatically since the turn of the millennium, which has increased both academic, economic and political interest in them considerably. In fact, in the 2000s China's share of the total outward FDI from developing countries has grown so large - 20.9% of flow and 8.5% of stock in 2009 according to World Investment Report 2010 (UNCTAD 2010) - that it has gained a more prominent and influential position both in the literature of FDI from developing countries and even in the general FDI literature.

In many respects, Chinese foreign investment activities have been seen rather similar to other developing countries but there are also divergences from the standard model of emerging country FDI (e.g. Buckley et al 2008b). As mentioned earlier, the OLI paradigm explains the FDI phenomenon mainly in such a way that it is a vehicle for MNEs to exploit their ownership advantages and firm-specific assets abroad. However,

usually this is not the case of MNE of developing countries that possess only limited ownership advantages to exploit so their FDI tend to be acquisitions of the needed assets, and this has been the case also with the many Chinese FDI (Athreye & Kapur, 2009). On the other hand, several authors (e.g. Taylor 2002) have perceived that the growth rate of China's outward FDI has been faster than in other similar developing countries, and, for instance, China has proceeded in Dunning's introduced *investment development path (IDP)* quicker than it would be expected of the overall economic development in China (Dunning & Lundan 2008, 330-336; Dunning et al. 2008, 164; Zhang 2009). Thereby the recent boom of the Chinese outward FDI has called into question, how well the traditional FDI and MNE theories are able to cover the phenomenon and what are the factors that have enabled such a rapid growth (Zhang 2009).

Buckley et al (2007) have highlighted three themes that are specific for the Chinese FDI in contrast to general FDI theories and in some extent also to the theories of FDI from other developing countries. These themes are capital market imperfections, special ownership and country advantages of Chinese MNEs as well as institutional factors.

*Capital market imperfections* affect the Chinese investment in many ways. Since the bank system in China is largely controlled by the state and the largest commercial banks are state-owned, many Chinese companies have been able to borrow below market rates (Warner et al., 2004). Besides the banks, also a state-owned conglomerate China International Trust and Investment Corporation (CITIC) and China Investment Corporation (CIC), a sovereign wealth fund with allocated assets from the enormous stock of foreign exchange reserves of the Chinese government, have extensively supported the Chinese companies' 'conquest of the world' (Antkiewicz & Whalley 2007; Gugler & Boie 2008). Especially large state-owned enterprises (SOE) and some private 'national champions' have benefited from cheap capital and other support from the government, while one of the main reasons for private companies to make FDI have been to secure their domestic foreign exchange e.g. from sales profit or by raising finance from international sources, particularly from Hong Kong (Wu & Chen 2001; Buckley et al. 2007; Buckley et al. 2008b; Gugler & Boie 2008; Zhang 2009). In addition, the Chinese government has protected above-mentioned 'national champions' from competition on the

domestic market and granted them (e.g. for Haier, Sinochem Group and Shougang Group) special permits to set up financial companies, to acquire a majority of local banks and to establish joint ventures with foreign insurance companies to ensure the funding of foreign activities (Liu & Li 2002; Child & Rodrigues 2005; Buckley et al. 2007). Secondly, the inefficient banking system also admits risky low-interest loans and other subsidies for potential conglomerate investors, often pressured by the local government and the party (Child & Rodrigues 2005; Antkiewicz & Whalley 2007). Buckley et al. (2007; 2008a) have noticed that the Chinese MNEs are not too political or economic risk-aversed in their FDI and they do not benefit from international trade and investment agreements as much as the foreign investors in general just because of the political and financial support from the Chinese government. In addition, the Chinese family businesses typically receive cheap capital for foreign investment from the family members (Erdener & Shapiro 2005). Finally, capital market imperfections along with the governmental support have apparently facilitated especially Chinese natural resource seeking and strategic asset seeking investments, latter particularly in North America and Europe (Taylor 2002). One example of this was Lenovo's acquisition of IBM personal computer business in 2005 when Chinese government possessed 57% proportion of the company (Buckley et al., 2007).

*Special ownership advantages* are typical for a MNE from developing countries having FDI in other developing countries because unlike many MNEs from developed countries it has indigenous experience to operate in a developing country context (Buckley et al., 2007). This is relevant also in the case of the Chinese MNEs although Yang (2003, 36) notes that a large portion of the Chinese FDI has been invested in developed countries. Basically, MNEs from developing countries have been found to be strong in other developing countries because of their apparent experience and capability to offer appropriate goods and services to smaller markets with low purchasing power per capita, i.e. downscaling technology by making manufacturing more labour-intensive or using local raw-materials, or cope with weak and corrupted governance (UNCTAD 2006, 104 & 117; Zhang 2009). Similarly, also Chinese companies are well adjusted to a poor institutional environment with corruption and governmental interventions and thus are

often more successful in developing countries with demanding business and political environment than their western rivals (Morck et al. 2008; Kolstad & Wiig 2009).

*Institutional factors* are crucial either as a conducive or constraining factor for FDI. Bureaucracy and cumbersome permit application processes have been clearly reducing the amount of foreign investments in comparison with the wealth and investment potential of China, but they have also been reflected in the illegal and informal investments abroad (Taylor 2002; Buckley et al. 2007). In China, the government affects companies' investments, their orientation and companies' foreign strategies significantly e.g. through the application processes and control of foreign currency exchange. Furthermore, foreign acquisitions, for instance, are still approved on a case-by-case basis and thus they are strictly examined before the approval (von Zedtwitz 2005, 64). The application process of FDI permit goes through the examinations by National Development and Reform Commission (NDRC), State Administration of Foreign Exchange (SAFE), Ministry of Commerce (MOFCOM) and state owned banks. Also the State Council as well as Ministries of Finance and Foreign Affairs may intervene in the process (Gugler & Boie 2008; Buckley et al. 2008b). Relational framework between the leaders of the internationalizing companies and the institutions is crucial, and the leaders commonly negotiate about strategic choices with representatives of the institutions, although this is in commonplace in many Western countries as well (Child & Rodrigues 2005), e.g. between companies and Tekes or Finnvera in Finland.

In addition to the above-mentioned advantages from capital market imperfections and special ownership advantages, Chinese MNEs also possess other *country- and some firm-specific advantages (CSA and FSA).* Several Chinese MNEs are successful because of country's huge reserve of cheap labor and production process capabilities which provide cost competitiveness for their products and services compared with their foreign rivals (Rugman & Doh 2008, 201; Gugler & Boie 2008). Second, as latecomers some Chinese enterprises have gradually managed to create their own firm-specific advantages as a result from cooperation with advanced foreign companies in China, i.e. they have undergone "*inward internationalization*" (Child & Rodrigues 2005). They have managed to imitate and adopt new technology, to acquire foreign business and distribution contacts

as well as experience in foreign business practices. Third, competition in China's domestic markets is fierce which has forced especially private firms to foster their cost effectiveness (Child & Rodrigues 2005). Moreover, in recent years the Chinese government has significantly increased its spending on R&D, although less at basic research, which also have visible results in the success of Chinese companies, such as Huawei's rise to the world's largest company in number of patent filings in 2008 (Gugler & Boie 2008; Xinhuanet 2009).

However, besides institutional factors the Chinese companies have also other disadvantages which have yet reduced their ability to make even a more substantial number of FDI or caused failures in the existing FDI cases. According to Wu & Chen (2001), still in the 2000s the Chinese often make their foreign investments on the basis of very small information and they do not have a clear plan why to invest abroad as well as where and how to develop foreign markets. The government urges the Chinese SOEs to grow large international players with a tight schedule and consequently they have often made rather hasty foreign investments. Gugler & Boie (2008), in turn, remark that the Chinese companies are lacking of knowledge-based advantages. According to Rugman (2008, 96-97), most of the Chinese companies still lack a system integration skills, which are typical of successful Western MNEs, and therefore the acquired assets cannot be maintained. The Chinese MNEs have difficulties in integrate and maintain the benefits from M&A in the firm because of weak internal management, strategy and branding skills, and unlike natural resources, for instance, only a few Chinese MNEs have managed to acquire particular advanced and useful technologies. In general, the Chinese governmental agencies assess that even 75% of the acquisitions have failed (von Zedtwitz 2005, 63). Nevertheless, the fact that the Chinese acquisitions in Europe have largely targeted in poorly performed companies might have its own influence in above-mentioned difficulties (Athreye & Kapur 2009). In addition, the Chinese have lacked a strategic vision and experience of a cross-border coordination of their business activities, which is one reason that companies have suffered losses abroad although the situation is improving nowadays (Child & Rodrigues 2005).

Rugman lists (2008, 97) that "the Chinese firms are protected, resourse-based, labor-intensive, low technology and inefficient", and that the potential and effective Chinese SMEs seek cooperation rather with the foreign MNEs than the Chinese SOEs, which are inefficient and not accustomed to business competition because of their domestic dominant monopoly position. In addition, few SOEs compete seriously in the international market, but their objectives are usually more in home country. Child & Rodrigues (2005) also take into account that a product differentiation by the Chinese companies has not developed far enough to enable them to compete effectively in consumer markets. Furthermore, they see that other weaknesses of the Chinese MNEs are excessive insistence on the behaviour of Chinese culture and organizational models which is a burden in different cultural contexts from China and East Asia, i.e. they suffer problems from a liability of foreignness. Also, many Chinese companies may even be too dependent on the support of the government and the Chinese networks, and thus they may be unable to compete in areas where this support is small or absent. Ignorance of international and local commercial laws as well as local governmental policies has noticed to be the weakness of the Chinese investors (Taylor 2002). Finally, China is still the fastest-growing major market in the world so for most of the domestic enterprises there is still little incentive to leave the country for less growing and more saturated markets, such as those in small developed economies (von Zedtwitz 2005, 66).

## 2.5 Motives of the Chinese FDI

In the literature, the motives of the Chinese investment FDI have been mostly discussed through the Dunning's taxonomy of FDI motives that is introduced earlier in Chapter 2.2. In this chapter, besides the motives of Dunning's taxonomy also some other FDI motives are elaborated that are typical for the Chinese investors.

According to the FIAS/MIGA/IFC/CCER survey on China's outward FDI in 2005, where 150 Chinese MNEs were interviewed, the most common motive for the Chinese FDI was market seeking (85% of the respondent firms regarded it as an important motive for their investments), then strategic asset seeking (51%), resource seeking (40%) and finally

efficiency seeking (39%) (UNCTAD 2006, 153 & 167-168). Also, in Deng's survey (2009) market seeking was found as the most frequent motive for the Chinese FDI although he found that strategic assets and efficiency seeking were almost equally common motives. However, the monetary value of Chinese FDI does not spread the same way between different investment motives as numerous small Chinese companies make a lot of small-scale market seeking FDI, and resource seeking FDI are usually made by fewer but larger investors. According to Gugler & Boei (2008), the three largest Chinese outward investors are all in the industry of natural resource. In the public discussion, the biggest attention has been paid to the Chinese resource and strategic asset seeking FDI, not least because they are often performed via foreign acquisitions (Deng 2009). As a difference from other developing countries, strategic asset seeking has a more visible role in the Chinese FDI scene (Gugler & Boie 2008).

### 2.5.1 Chinese FDI motives in Dunning's taxonomy

China possesses rather the limited extent of domestic natural resources, except the rich deposits of certain materials e.g. coal and iron ore. Besides other natural resources, also sources of energy have found to be inadequate for supporting country's rapid economic growth and consumption of raw materials and other inputs over last decades (Buckley et al. 2008b), although it has the largest resources of hydropower in the world (CIA 2010). Thus China has made large natural *resource seeking FDI* especially in Russia, Africa as well as East and Central Asia, e.g. in copper mining in Zambia (Buckley et al. 2008b), and in gas pipelines and oil refining in Kazakhstan and Turkmenistan to ensure a supply of resources for increasing domestic needs (The New York Times 2009). This indicates that those investments are not driven by the regional proximity but availability of assets (Gugler & Boie 2008). As mentioned earlier, most of resource seeking investments have been made by large Chinese state-owned companies, such as China Natural Petroleum Corporation (CNPC), China National Offshore Oil Corporation (CNOOC), Sinopec and Shanghai Baosteel, along with remarkable aid in development and favourable loans to the host countries by the Chinese government. Taking this into account it is not surprising that there has been a strong dispute if the aid has been granted mainly to ensure market

access and exploitation of natural resources for Chinese MNEs (Buckley et al. 2008a, 133; Buckley et al. 2008b).

In addition, MNEs from developing economies have supposed to make chiefly knowledge and technology oriented investments in industrialized countries, but China has also made substantially resource seeking investments in many developed countries, such as in the USA and Canada, and recently in Australia where mining sector counts over 85% of the Chinese investments (MOFCOM 2010). The latter two countries are sometimes considered to belong to the group of small developing economies, because of their relatively small populations. Otherwise it is apparent that natural resource seeking has not been the driver of the Chinese MNEs to invest in small developed economies, as their advantages are rarely in natural resources, and almost never in cheap labor. While the Chinese are quite interested in, for instance, mining acquisitions also in these countries, apparently the largest reserves and the least-utilized natural resources can still be found either in geographically large countries or developing countries. Furthermore, it is possible that for China as a latecomer foreign investor, it has better opportunities for natural resource investments mainly in poorly governed countries instead of developed countries with the established ownership of natural resources (Kolstad & Wiig 2009).

Chinese companies' international competitiveness rests largely on cheap domestic labour, hence foreign markets are served by exports. However, customs tariffs have forced many Chinese companies to make defensive *market seeking FDI* to dodge imposed tariffs or to reduce a risk of possible duties in countries and regions whereby China has a significant trade surplus, such as the USA and EU (Buckley et al. 2008b). The Chinese have also increased market seeking FDI in manufacturing especially in relatively cheap countries within a free trade area in order to serve as an export-platform for bigger and richer markets in the area, e.g. investments in Mexico to sell to the USA (NAFTA) and in Eastern European countries to sell e.g. to Germany and France in EU. The latter example has been used yet in a smaller scale, obviously because of a lower rate of market growth (Buckley et al. 2008b). Also small developed economies in Europe have been interested to have export-platform investments from China, mostly for hi-tech products with R&D

functions in the host country. These investments have been realized mainly when a Chinese MNE has a major corporate client in the host country.

Furthermore, one reason for market seeking FDI has been to acquire foreign distribution networks and diminish the dependency on intermediates, international agencies and foreign representative companies (Antkiewicz & Whalley 2007; Buckley et al. 2008b). Kaartemo (2007) found in his research that the Chinese MNEs have made this type of FDI also in small developed countries, i.e. their motive has been to internalize and supervise the operations in value added chains, such as sales. Also knowledge of the local markets has been an important driver for the Chinese FDI in those countries. Besides defensive FDI, a growing number of Chinese companies also make offensive market seeking FDI particularly towards large countries to develop foreign markets and improve brand awareness.

Nowadays they are increasingly competitive in international markets, also in technology-intensive sectors, and can afford to make large-scale market-seeking FDI. There are good examples in the electronics sector as Huawei, Lenovo, ZTE and Haier, for instance. These companies have managed to create global company image instead of negative 'country of origin' and 'made in China' notions which still harm many Chinese companies' business in foreign markets (Buckley et al 2008; Gugler & Boie 2008). Furthermore, the Chinese companies are also driven forward by the low profit margins because of the fierce competition at the home market, especially the firms without significant differentiation or/and brand advantage, and by their overcapacity in China, where the demand is possibly not large enough or average purchase power is low (Wu & Chen 2001; Child & Rodrigues 2005). Deng (2009) has found that market seeking FDI are popular particularly e.g. in steel, chemical, textiles, building materials, energy, transportation and household appliance industries.

As explained earlier, *efficiency seeking FDI* are usually done for reorganizing and rationalizing existing resource- or market-based investments regionally or globally to gain from common government policies and other standards, and thus benefits in production of scale etc. In case of the Chinese MNEs, these types of FDI are not

numerous yet because presently few of them have several foreign investments or other operations that need for reorganizing and if so, most commonly in South-East Asia where there are also able to benefit from the internal market of ASEAN (Buckley et al. 2008a, 115; Buckley et al. 2008b; Gugler & Boie 2008). Only the very largest Chinese MNEs with extensive service and sales networks have made efficiency seeking FDI in small developed economies, although their interest in this has been on the rise since the global value added chains have spread wider also into the small developed economies (Kaartemo 2007). On the other hand, normally Chinese companies do not need to seek production efficiency and cost minimization abroad as domestic labor costs are low (Deng 2004). Although manufacturing costs have increased in the coastal regions of China, the prevailing direction of the Chinese manufacturing site transfer is to the inland territories within the country although Vietnam, for instance, would have the same benefits of cheapness with better logistical accessibility (Gugler & Boie 2008).

As the international competitiveness and wealth of the Chinese MNEs have gradually strengthened, currently their focus on foreign operations is shifting from gathering of generic market information and foreign operation knowledge to connecting the knowledge with technology-intensive research, production and local market information (Buckley et al. 2008b). Thus *strategic asset seeking FDI* are rarely individual investments but rather hand-in-hand, for instance, with market seeking FDI where the acquired assets are utilized (Gugler & Boie 2008). The Chinese MNEs are making strategic asset seeking FDI, for example, by establishing or acquiring R&D oriented units in technologically advanced high-income countries with hi-tech clusters, especially in Europe and North America, in order to support their manufacturing of technology-intensive products in home country and exporting to foreign markets. R&D investments have been particularly made by electronic communications, electrical and chemical industries (Deng 2009).

Another motive for strategic asset seeking investments is global brands (Child & Rodrigues 2005). Few Chinese companies as Haier, Lenovo and Neusoft (software) have used their original Chinese brands also in foreign markets but most have ended up to acquire well-known foreign brands, e.g. Thomson and Alcatel by Chinese TCL and more recently Volvo by Chinese Geely Automobile in Sweden (BBC 2009). Brand and other

strategic asset purchases by the Chinese have increased because of their accumulated assets of foreign currency from grown sales and recently also because the global economic crisis has decreased the values of the acquired company and brand values. Cheap loans from large state-owned banks have also enabled remarkable purchases, just as in the above-mentioned case of Geely Automobile (The Wall Street Journal 2009).

Nevertheless, as discussed earlier, most of the Chinese have a little experience of managing intangible assets so it has been questioned if their companies are able to generate profits from the acquisitions, and furthermore, acquired companies have usually been in weak economic situation which possibly decreases the likelihood of success (Buckley et al. 2008). Third obvious motive for strategic asset seeking is to gain access to international capital markets as they are still rather inefficient, if emerging, in mainland China (Deng 2004). For instance, several large Chinese companies, e.g. banks, insurance, petroleum and telecom companies, have been listed on the Hong Kong stock exchange to finance their domestic parent companies in China (Buckley et al. 2008b). In his survey, Deng (2009) found that much the same industries have made strategic asset seeking FDI as make market seeking FDI, i.e. steel, building materials, energy, transportation and household appliances, but also postal service and finance industries.

### 2.5.2 Distinct motives of the Chinese FDI

Besides Dunning's FDI motive taxonomy, there are some other distinct motives behind the Chinese FDI as well. The minimization or avoidance of taxes is a motive for financially really substantial proportion of the Chinese FDI especially in Hong Kong, the British Virgin Islands, the Cayman Islands, Macau etc. although it is a relatively common motive for the FDI from other countries as well (Buckley et al 2008; Deng 2009). This kind of FDI might be made for obtaining venture capital and gaining status of foreign investment when reinvesting back in mainland China, or for reinvestments to third countries via tax-free holding companies or even for concealing wealth from the Chinese tax authorities. However, these money flows are difficult to verify because of a strong secrecy for FDI in those locations (Morck et al. 2008; Kolstad & Wiik 2009).

Furthermore, Wu & Chen (2001) assume that there is 'capital flight' from China in order to protect capital from the risk of inflation and exchange rate depreciation.

Next, according to Deng (2004) the Chinese government has supported large corporations, mostly trading SOEs with a monopolistic status at home markets, after Japanese and Korean trading houses to expand abroad in order to diversify their business and hence diversify the risk as well. This type of investments have been made e.g. by Sinochem (China National Chemicals Import & Export Corporation) and China Resources Enterprise, both state-owned companies. Behind governmental aid policies there have also been motives of promote domestic development, reassert the leadership of the current regime as well as support the objective of China's foreign policy (Morck et al. 2008; Kolstad & Wiik 2009). What comes in small developed economies, thus far there has not been discussion in the academic literature about risk diversification or politically oriented FDI by the Chinese SOEs in those countries. By contrast, one important but even generally little discussed motive to invest abroad is a possibility of enjoying the social benefits of the Western welfare states including smaller of those, such as Finland and Sweden, by gaining residence rights in them (Antkiewicz & Whalley 2007). The benefits could be e.g. legal protection, social security, free or cheap education and health care services, and safe and clean environment for family life (Deng 2004). This is a relevant motive particular to smaller Chinese family companies.

Finally, when discussing about investment motives it must be taken into account that there are several domestic push factors that force Chinese companies to channel their interest abroad. Like many foreign companies, also Chinese technology-intensive firms are suffering from the poor business environment in China and thus they are looking for more profitable and safer business operations abroad. For instance, weak IPR development spurs companies to prefer technology M&A utilization abroad (Athreye & Kapur 2009). Other push factors might be the lack and expensiveness of skilled human resources - especially management experts - in China, very low profit margins from overcapacity in many sectors, poor infrastructure especially outside of the tier-I cities that increases transportation costs as well as flaming competition with leading global companies and brands (Gugler & Boie 2008). For domestic non-government enterprises

there are also other shortcomings as domestic regional protectionism, non-secured raw material supply from home markets because of competition between the areal development (Wang 2002), limited access to capital as well as interference, unpredictability and corruption of local government and judiciary which both hinder and restrain business operations and raise transaction costs in domestic markets (Gugler & Boie 2008; Child & Rodrigues 2005). All these factors drive the Chinese companies to invest abroad as long as they are able and approved to FDI. Furthermore, the Western developed countries are obviously the most demanding FDI destination for the Chinese as a success there requires both resources as well as technological and management skills more than the other regions in the world.

In the next chapter, the Chinese FDI specific host country location factors are discussed. These factors are country specific advantages, i.e. pull-drivers that have been found to attract the Chinese investments into certain destinations.

## 2.6 Host country location factors of the Chinese FDI

Generally, the Chinese investments have been mainly directed by the same factors and location advantages, which have also been discussed within the general FDI location literature. Kolstad & Wiik (2009) found in their research that the Chinese FDI have been mostly attracted by tax havens (especially Hong Kong and offshore destinations in the Caribbean Sea), geographically close countries to China (East and Southeast Asian countries), resource-rich countries (e.g. Africa, Australia and the former Soviet Union countries), as well as large markets such as the USA and Germany. In other words, small developed economies and their location advantages have not been among the most attractive ones of the Chinese FDI. Buckley et al. (2007; 2008a, 130-138), in turn, found that the most notable factors for the location of the Chinese investment have been the size of the economy (particularly in OECD countries) and other demand conditions, factor input costs, the quality of infrastructure, the host country's economic development level compared with China as the Chinese have made a lot of market seeking FDI in other developing countries, the exploitability of natural resources, a degree of liberalization of

investment policy in a host country, host county's membership in WTO, cultural proximity to China and a number of the ethnic Chinese in a host country.

According to UNCTAD (2006, 156-157), the usual pull-drivers to the Chinese FDI as well as investments from other developing countries are market size, high purchasing power and liberal host government policies. These policies include not only incentives and tax-reductions, but also mature procedures as governmental transparency, protective IPR legislation, and cheap money transactions along with a developed banking system. Other macroeconomic pull-drivers include political stability, strong and stable currencies, or belonging to a common monetary area, such as the euro area. From the point of view of the small developed economies, the focal pull-drivers mentioned above are specific demand conditions (e.g. for cutting-edge hi-tech products) and high purchasing power per capita, the quality of infrastructure (both physical and telecommunications), liberal investment policy for FDI and developed legislation and banking systems, political stability and a safe environment, as well as stable currency probably in the euro area. Certainly other factors matter in those countries as well. Good geographical location and possible special natural resources affect positively the amount of the Chinese investment in small developed countries, as well as a large size of the ethnic Chinese minority, but they are general pull-factors that apply with host countries of all kind.

Next, Buckley et al. (2007) found that the exchange and inflation rates, the transparency of the host country market and the geographical proximity are insignificant host country location factors for the Chinese FDI, from which the latter one is inconsistent with the above mentioned results of Kolstad & Wiik (2009). However, the changing domestic exchange rate might become a push-driver for the Chinese investments as Child & Rodrigues (2005) presume that the probable appreciation of the Chinese yuan will increase the volume of outward FDI, just as occurred in Japan in the 1980s. In addition, apparently the large Chinese minorities and their networks in South-East Asia affect more an investment willingness of the mainland Chinese than mere geographical proximity. Finally, China's own exports to a host country obviously also increases the amount of the Chinese FDI in the country. Imports to China have the same increasing effect upon the

Chinese FDI in a host country, but weaker (Buckley et al. 2007). This trend is similar also in the small developed economies, as will be demonstrated in the Chapter 4.1.

### 2.6.1 Distinct features in the location factors of the Chinese FDI

The above mentioned factors are relatively common host country location factors both for the Chinese FDI and FDI from every country. However, there are also some distinct features in the location factors of the Chinese FDI. At the beginning of the internationalization process of China, the FDI were not located in the neighbouring countries (excluding Hong Kong), unlike the internationalization theory predicts, but in the 1980s and 1990s most of the investment went to the far-flung Western countries, especially in North America and Australia (Yang 2003, 21; Li 2007). Those FDI were partly politically inflected heavy industrial investments or they supported the SOEs' export activities in the countries with high purchasing power (Wang 2002; Buckley et al. 2008a SIVU; Buckley et al. 2008b). Later on the location choices of Chinese FDI have followed more the internationalization theory, i.e. internationalization starts from the nearest regions, especially by the smaller family enterprises (Erdener & Shapiro 2005). Asia has clearly been as the base for the Chinese FDI for the past two decades. In 2009, even over 75% of the Chinese FDI stock was invested in Asia (MOFCOM 2010).

Characteristically, the Chinese FDI directions are heavily controlled by the state and it supports investments to certain preferred countries and sectors to serve its needs according to current situations, not without political ambitions (Wang 2002; Buckley et al. 2008a, 107). Recently the foreign investment focus has shifted in the SOEs' FDI in the natural resources and acquisition of strategic assets, e.g. the technology and knowhow of international business management, while the private SMEs' investments have remained difficult to implement, especially from outside of the growth centers in China (et al., 2007). Another special characteristic of the Chinese FDI is that high political or economic risk level of host country has actually attracted the Chinese investments, against general expectations for FDI behaviour (Buckley et al. 2007). Nor do poor institutions or ethical problems seem to affect negatively the Chinese investment, as they

usually do to the amount of FDI from developed countries. This is partly explained by the institutional factors, i.e. the fact that the Chinese government has put in place risk management mechanism in high-risk regions, and the Chinese investments have also been supported by the political weight of China and its support in the host countries. Governmental support includes a direct financial assistance as well as financing of public infrastructure, industrial and agricultural projects (Taylor, 2002; Lum 2009). China has close political and economic relationships with many socially labile or non-democratic countries, e.g. with Sudan, Kazakhstan and Turkmenistan (The Washington Post 2004; Resource Investor 2009). In those countries, the political weight of China decreases the level of political and other risks.

As a consequence of the political and financial support from the Chinese government, the Chinese investors do not benefit from international trade and investment agreements as much as the foreign investors in general, and thus the impact of the agreements on the location choices of the Chinese FDI is low (Buckley et al. 2008a, 132-133 & 138). This is also the explanation for why investment agreements between China and small developed economies have hardly increased the interest of the Chinese MNEs to invest in those countries. On the other hand, the agreements strengthen the economic relations of the countries at the political level, which is particularly important with governmental led economies as China.

Third, a great number of the Chinese investments are channeled via access to networks and resources controlled of the ethnic Chinese, hence they often have a crucial role in the decisions of FDI location (Child & Rodrigues, 2005; Erdener & Shapiro, 2005). A widespread Chinese diaspora helps the Chinese investors, especially small companies with few firm-specific advantages, to invest and establish themselves abroad because in many countries the Chinese minority brings security and reduces transaction costs through a familiar language and culture (Child & Rodrigues 2005; Buckley et al., 2007). In addition, Tong (2005) has noticed that the ethnical networks have supported the Chinese investors particularly in countries with weak institutions, especially in Southeast Asia but also elsewhere in the developing world. Networks might also provide necessary market information for investors from the point of view of the Chinese type of businesses.

Thus the influence of the Chinese networks is important when considering the amount of the Chinese FDI in the small developed economies. Knowledge of these countries is not very high in China, especially compared with the knowledge about large developed countries, and networks are one of the main routes to the Chinese companies to receive information from them.

Finally, from the perspective of host countries the Chinese FDI are mainly welcomed and many countries have set up their own invest-in operations in mainland China. However, unlike the governments in the host countries have wished, the Chinese investments have not yielded significant amounts of new, but especially acquisitions have been followed by the cuts of personnel. Often newly acquired manufacturing activities are relocated to China because of cheaper labour costs while valuable but low employing distribution networks are maintained in the host country (Antkiewicz & Whalley 2007). Furthermore, the technology seeking acquisitions pursued by the Chinese do not bring to the host society as much new spillovers as technology-exploiting FDI although they do increase competition and hence productivity in the host country (Athreye & Kapur 2009). Many host country governments have been concerned the escape of the sensitive technology or control over natural resources by the Chinese acquirers which are often closely linked with the Chinese government. Also, those acquirers are not necessarily subject to the standard reporting required of OECD companies, which reduces the transparency of acquisitions. This concern has already led to several cases for example in Canada, Russia and the USA where the Chinese acquisitions have been blocked in the name of national security (Antkiewicz & Whalley 2007).

## 2.7 Summary and theoretical framework of the study

In the earlier parts of this chapter the relevant FDI theories to the research questions have been introduced with a brief of their historical background. First, the theories and frameworks that explain the phenomenon of FDI have been presented. The most important of them from the point of view of the modern and Chinese recently made FDI are Hymer's initial idea of firm-specific advantages, Dunning's Eclectic (OLI) Paradigm

and Rugman's grouping of firm- and country-specific advantages. These together create the framework from which to look for motives and location factors which have directed the Chinese investments to the small developed economies.

After this, the reasons that motivate companies to make direct investments abroad have been presented. Companies generally intend to seek the benefits from the already existing firm-specific advantages (i.e. ownership-specific advantages). In addition, FDI motives may also be a necessity to obtain various assets abroad which will improve the competitiveness of a company both domestically and internationally. Furthermore, as push-factor motives might be home country-specific advantages that facilitate opportunities for successful investment abroad or, on the other hand, the shortcomings and obstacles of the domestic market or operational environment that drive the companies to expand their activities abroad to ensure the competitiveness and growth. From this basis, the most extensive categorization of the different FDI motives is Dunning's taxonomy, where motives have been divided into resource-, market-, efficiency- and strategic asset seeking investments motives. In addition to those, other FDI motives that have been mentioned in the literature include political safety-seeking and risk diversification as well as supportive and speculative investment motives.

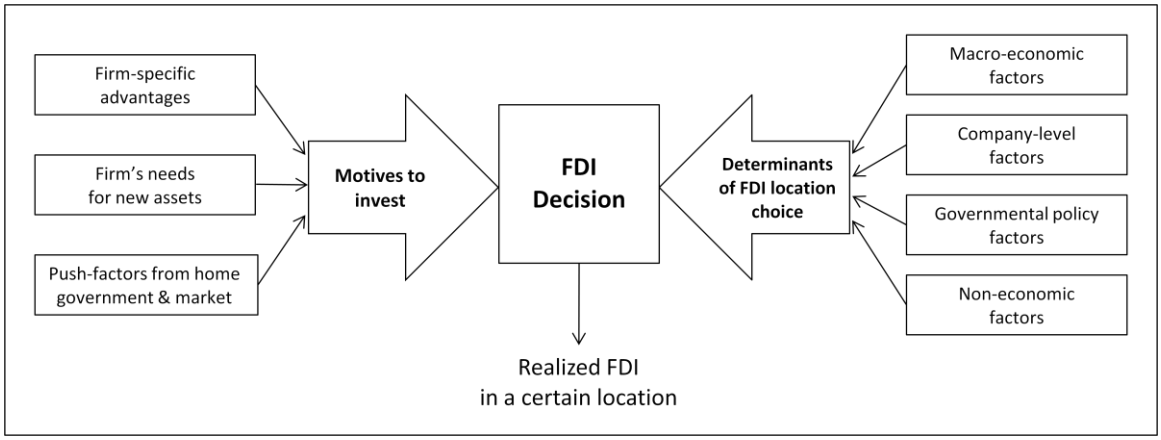
Unlike the theories and frameworks that explain FDI motives which mainly focus on the question why companies make foreign direct investments in general, the theories of the determinants of FDI location put forward the reasons why certain types of FDI are directed at certain locations, i.e. what are the so-called pull-factors of host countries for FDI. These location factors have been historically explained as the cost savings as well as product-cycles from the economic and technological centers to the peripheries, but the causes have been sought also from the company level, for instance, in the internationalization theory. In the literature, the most frequently mentioned factors funneling FDI locations have been the production costs, features of the foreign markets, trade relationships at both country and company levels, existing business and ethnic networks, memberships in free-trade areas, the policies of the host government including trade barriers, FDI incentives and promotion as well as language and culture similarities. FDI host country factors as an entity have the most clearly expressed Porter in his

national diamond model and Dunning as location advantages (L-particle) in his above mentioned eclectic paradigm.

Next, on the basis of the above-mentioned theories and frameworks one can draw the theoretical framework for this particular study (Figure 3). This study aims to examine on the one hand what motives, and on the other hand, which variables affecting on location have led to the decision of carrying out FDI in a certain host country location. According to some authors (e.g. Madhok 1997 and Deng 2009) the third factor that possibly influences on the investment decision is the choice of FDI mode. However, it has been excluded from the focus of this study as it relates more to the implementation phase of the FDI decision and less to the initial impetus to invest abroad than the FDI motives and location factors do. In most cases, the company has a FDI motive before it considers the questions of location, but they might also be, and often are, concurrent processes. In some cases, a business opportunity in particular location may even be an initiative trigger for performing FDI, for example, by utilizing business or personal networks.

As mentioned above, according to the previous literature the most important factors affecting FDI motives are firm- (ownership-) specific advantages, company's needs for new asset as well as push-factors from home government and market, i.e. their advantages and shortcomings. Motives for FDI decisions are generated on the basis of these. On the other hand, FDI location choice is affected by four factors, which are partly overlapping. Macro-economic factors include local and regional (host) market features, cost level, level of technology and labour skills, natural resources, the structure of industry and clusters, foreign trade etc. Company-level factors include company's earlier business relationships, e.g. supplier or customer relations, rivalry, the specific asset needed by the company, e.g. certain technology. Governmental policy factors include general legislative and regulatory environment, investment and capital market legislation, immigration policy, taxation etc. Finally, non-economic factors include, among others, human relationships, climate, language and culture environment and education (although governmental policy has a strong influence on it). Together, these are the reasons why a company invests in general and why into a specific location, and they vary company-, home country- and host country- specifically as well as in the course of time.

**Figure 3. Framework for the FDI motives and location determinants in the FDI decision**




In this study, the key subjects are the Chinese MNEs which have decided to invest in a small developed economy, Finland or Sweden. Thus the left and central parts refer to Chinese MNEs and their FDI, and the right side parts refer to a small developed economy in Figure 3. Academic literature of the Chinese FDI in small developed countries has been nearly non-existent so the literature review of this research has focused mainly on the general literature of the Chinese FDI phenomenon. Against this background, this study clearly provides novel research information on the subject.

When considering the general applicably of the research results, it has to take into account that the Chinese MNEs and China possess some specialties as a foreign investors and FDI home country, and thus it differs in certain extent from other developing economies and large economies as a FDI home country. Although the Chinese MNEs obviously possess special ownership advantages in less developed countries with weak institutions, at the general level they still have only a few firm-specific advantages so then tend to utilize more acquisitions of the needed assets than MNEs globally. This has been enabled by the strong support of the Chinese government as well as capital market imperfections in China. However, the institutional factors in China also set hindrances to the Chinese FDI and the government has a strong directing force in the FDI decisions of both state-owned and private Chinese MNEs. Chinese MNEs can exploit the home country-specific advantages abroad, such as cheap labor to product cost competitive products for exporting and political support from the Chinese government. In contrary,

hard domestic competition and poor IPR protection push companies to internationalize. Nevertheless, the Chinese MNEs suffer from poor technological and the managerial competitiveness as well as unfamiliarity of foreign markets, culture and legislation.

From Dunning's FDI motive taxonomy, most frequent motives for the Chinese FDI have been market seeking FDI mostly made by smaller private companies, resource seeking FDI made by large SOEs and strategic asset seeking FDI made by technologically and managerially advanced, wealthy or government-supported companies. Other visible motives for the Chinese FDI have been tax avoidance, risk diversification, political ambitions and domesticity issues.

Determinants of location choices in the Chinese FDI are mainly the same as in FDI from other countries, i.e. low taxation, geographical and cultural vicinity, amount of natural resources as well as market size and high purchase power. Chinese are also attracted by social welfare and liberal FDI policies although they are not too risk-sensitive in political and economic matters. International or bilateral investment agreements do not necessarily increase the Chinese FDI in a particular host country, but poor political relations between countries affect negatively the amount of investments from China. By contrary, ethnic and business networks have been found to affect strongly on location of the Chinese investment.

Empirical part of this study aims to compare how much the Chinese FDI motives and location factors in the small developed countries, here in Finland and Sweden, correspond with the general literature and are there certain special features in these countries. Before the empirical part, however, it is appropriate to present the methodology used in the study.

# 3 METHODOLOGY

In this chapter, the methodology used in the study is introduced. The chapter begins by introducing the methodological approach of the study. Next, the data collection method and study design are assessed. Lastly, the q1§qvalidity and reliability of this study are discussed.

Moreover, this study is a part of a larger research project of Center for Markets in Transition (CEMAT) at the Aalto University School of Economics. The research project is called "Finnish Chinese Business Communication" and it is funded by the Academy of Finland and the Chinese Academy of Social Sciences (CASS). The project includes five separate subprojects and this study is a part of the subproject "Chinese Investments in the Baltic Sea Region: Challenges of Intercultural business communication". Empirical data was collected by the research staff of CEMAT and the data has been in use of both the staff and writer if this study who was member of the personnel during the data collection.

## 3.1 Methodological approach

The research method of this study utilizes is a qualitative multiple-case study. A case study method is preferred when the research is going to answer questions such as "what kind of, how, why", and when the focus is on a contemporary phenomenon which boundaries with the surrounding context are not clearly evident (Yin 2003, 1). Certainly, this method is the best applicable to respond to the research questions because of the form of the questions. Furthermore, the object of a case study is typically to illustrate a comprehensive picture of the phenomenon with a use of different kinds of data, such as interviews, media reports and news (Velde et al. 2004, 79).

A multiple-case study is regarded more robust than a single-case study because the evidence from multiple cases is usually considered more compelling. This is particular relevant in this study where the case companies are highly different in their size and business fields. The target in this kind of research environment could be, for instance, to

have the subgroups of cases covering each type of conditions of the MNE. Moreover, a multiple-case method is used in the replication logic "so that the cases either predict similar results (a literal replication) or contrasting results but for predictable reasons (a theoretical replication)" (Thiétart et al. 2001, 165; Yin 2003, 46-47). In this study, the replication logic is particular suitable for assessing Finland as a FDI location for the Chinese, and equivalence of the results in Sweden. Also, even if contexts between the cases obviously differ greatly but there are still possibilities to draw common conclusions from them, the generalizability of the findings improves notably (Yin 2003, 53).

In addition to the above, it is worth to go through some relevant aspects of case study methods from the standpoint of this study. Firstly, in a case study the structuring of data and analyzing the results are necessary parts after the collection of data. Yin (2003, 151-155) introduces six case study structures: linear-analytic, comparative, chronological, suspense, theory building and unsequenced structures, of which Velde et al. (2004, 83-84) raises the four former mentioned as the most important ones. Linear-analytical is the standard approach when composing research reports. In it the earlier literature (and theory) is compared with the analyzed findings from the collected data. In comparative structure the same case study is repeated two or more times comparing alternative explanations with the same case. In chronological structure the focus is to describe or explore evolution and development in one or more cases. In suspense structure the outcome of the study is early presented and the rest part is to explain the results. In this study, the earlier literature of the Chinese FDI activities, motives and location choices in them is introduced, and the goal of the empirical part is to find and analyze how the findings from two small developed economies, Finland and Sweden, are reflected the general literature. Thus the most appropriate structure for the study is clearly the linear-analytic approach. Secondly, this study is based on a larger multi-method research, Finnish-Chinese Business Communication. Furthermore, the case interviews have been conducted for a more comprehensive subproject of Chinese FDI in the Baltic Sea Region. Thus, the questions and answers that are relevant to this study are picked out from the interview database, and analyzed and reported separately from the multi-method research on the basis of the theoretical framework introduced earlier.

Finally, there are some practical reasons in the research object to choose the particular method, a multi-case research. Firstly, the number of the realized Chinese FDI in the target countries of the study is too small for conducting a quantitative research reliable enough. Secondly, the phenomenon of the Chinese FDI is new, and there is relatively little information about motives and factors behind the location decisions especially in small developed economies, such as Finland and Sweden. Thus only using a qualitative research method enables to gain profound knowledge of the research problem. In addition, in order to draw a clear and generalizable picture of the phenomenon in the target region, also several other stakeholders, such as partner companies of the Chinese MNE and representatives of expert organizations were interviewed in Finland, Sweden and China.

## 3.2 **Data collection and study design**

As mentioned earlier, the strength of a case study is opportunity to use multiple sources of evidence which is called triangulation (Thiétart et al. 2001, 82; Yin 2003, 86 & 97). Also in this study, three kinds of data are collected – documentation, archival records and interviews (Yin 2003, 85-89). General picture of the phenomenon is drawn by using a desk study method, i.e. sources are news articles, websites, statistical publications, surveys, the media reports of the companies and organizations involved in the phenomenon etc. Another part of the study is conducted using a field work research method. In this part 38 semi-structured and open-ended theme interviews (Yin 2003, 90) were made in Finland (32 interviews), Sweden (4) and China (2) between December 2008 and October 2010. The time-span when the actual cases have been occurred is from the mid-1990 to present day. The interviews were either recorded and transcribed or careful notes were made in cases when the interviewee did not allow recording or felt uncomfortable with it. This followed Yin's (2003, 92) recommendations for a tape recording of interviews. Altogether 22 interviews were recorded, but from 18 interviews with the Chinese interviewees only 6 were recorded. This may be due to the unfamiliarity and mistrust of the Chinese towards academic study interviews, as well as due to the old wisdom "do not disclose your situation to the outsiders" in Sunzi's famous text 'Art of War' which is well-known and used to provide strategic views among the Chinese

businessmen (Sunzi 2005, 88-91). Therefore, which was essential in this study with respondents from the Chinese companies, fully anonymity was provided for the interviewees in order to achieve as high reliability of the results as possible. Most of the interviews were face-to-face discussions, three were made by telephone. The interview languages were Finnish, Chinese and English, and the interview situations were designed so that at least one native Finnish or Chinese interviewer was present in the interviews where those languages were used. English was used to seven interviews when the interviewer and interviewee did not have the same native language. The author participated in 30 interviews. Finally, every interview transcriptions and notes were encoded with NVivo software that is developed for a qualitative data analysis according to their themes. In this way, data was easy to handle in the analyzing phase of the study.

The respondents were representatives of the Chinese companies operating in Finland, the local partners of the Chinese companies, and expert or investment promoting organizations of Finland, Sweden and China. The interviewees represent 28 companies and organizations: eleven Chinese companies, six partner companies and organizations (Finnish, Swedish or international), four commercial chambers/investment promotion offices (Finnish, Swedish and Chinese), and seven other organizations of expertise, including two ministries and one university. Of the interviewed people, 17 were Finnish, 18 Chinese and 3 Swedish (Table 4). Two Chinese persons were interviewed twice during the research process due to the novelty of their operations in Finland and in China in time of the first interview. The number of Swedish respondents is small but also other respondents were interviewed about their experiences of Sweden if they had any. In the interviews was found out that several respondents had first-hand information about investments in Sweden as they had been operating also there besides Finland. The interview form was the same also for Swedish respondents, Finland had just replaced by Sweden in the questions.

**Table 4. Number of interviewed persons classified by nationality and type of company/organization.**

| **Nationality** / **Type of organization** | Finnish | Chinese | Swedish | **Total** |
|---|---|---|---|---|
| Chinese companies | 3 | 11 | 0 | **14** |
| Commercial chambers / Investment promotion offices | 3 | 5 | 1 | **9** |
| Partner companies /organizations | 4 | 1 | 2 | **7** |
| Other expert organizations | 7 | 1 | 0 | **8** |
| **Total** | **17** | **18** | **3** | **38** |

As mentioned earlier, this study is part of wider research of the Chinese FDI in the Baltic Sea region and the original interview form (Appendix 1) contained also other questions concerning issues outside of the focus of this study. The form was divided into seven themes: 'background information' (of company and investment), 'general information about the target country or region', 'relationship with the public sector', 'relationship with the local partner company' (if any), 'relationship with the companies and market', 'employees' and 'future'. The core questions for this study were under themes 'general information about the target country or region' and 'relationship with the companies and market'. The most of questions under the first theme were design to find out why Finland was chosen for the host country for the particular FDI and to compare Finland and its neighbouring countries as hosts for FDI. These are essential to answer the second and third research questions. Under another theme the core question was "what was the main motive to invest in Finland?" which refers straightly to the first research question. However, also many other theme area questions in the question form are important for this study because they shed light on the important background information about the Chinese FDI phenomenon and the reasons to invest in Finland. For example, the role of the public sector behind the FDI decisions is essential to know, especially in the case of the Chinese investments as was discussed in the literature review.

### 3.3 Discussion of the validity and reliability of the study

Validity and reliability of data collection and study design are usually more difficult to verify in a qualitative case study than in a quantitative study and therefore it should be prepared and presented with care. However, according to Yin (2003, 33-39) the validity and reliability of a qualitative case study can be measured using certain logical means and he introduces four tests to evaluate the validity and reliability of the case study. These are construct validity, internal validity, external validity and reliability. Test of internal validity can be used only in explanatory and causal studies, so it is not discussed in detail here. In general, validity refers to the ability of the utilized measurements to indicate correctly the researched phenomenon.

Construct validity refers to the establishment of the correct operational measures for the concepts being studied. It is particularly hard to attest in a qualitative case study research, as there are often suspicions that the researcher's operational set of measures are not sufficient and subjective judgments have been used in the data collecting (Yin 2003, 35). Furthermore, the interviewees usually have their personal perspectives and opinions about the events and the phenomenon that might be contradictory and not always very objective (Korhonen 2005, 164). Thus, the requirements for the objectivity could not have been particularly strict in this study, but the aim of it has been to collect as extensive data as possible by using multiple sources of evidence: documentation, archival records and 39 interviews. In this way it has been possible to gain a wide view over the phenomenon and often repeated views by different respondents, and thus the construct validity of the study has been increased.

External validity refers to the generalizability of the findings of a study. Once again, also this kind of validity is problematic in case studies, especially if it is a single-case study. However, a comparison of external validity between survey and case researches is tricky because survey studies use statistical generalization whereas case studies rely on analytical generalization. The latter means that the researcher is striving to generalize a particular set of results to broader theory (Yin 2003, 37). Still, generalizability often

requires that the theory is to be tested by repeating the study and collecting the findings also from other similar groups of respondents and observe if the similar results recur. In this study, the external validity is enhanced by interviewing a large proportion of the Chinese companies that have already invested in Finland - eleven of approximately 20 Chinese companies in Finland - and using Sweden as a benchmark for Finland. This way a fairly extensive overview of the Chinese companies' views related to the investment motives and FDI location factors has been managed to compile, and to compare the results with another rather similar small developed economy.

Finally, reliability means that operations of a study are able to be repeated with the same results, i.e. if someone follows the same procedures as described by the original researcher the same results should be occur. Thus the aim is to minimize the errors and biases in a study (Yin 2003, 37-38). Ensuring high reliability is possible only with careful documentation of the procedures used in a study that the readers can easily follow, e.g. by developing a case study database. In this study, the database is created as the documentation and archival records are collected from public sources and interviews have been encoded into the themes which have been discussed in the phrasing of the research questions of this study. However, as mentioned earlier, the respondents have been interviewed with full anonymity for improving the reliability of the study. Thus, the raw material of the interviews cannot be investigated by others than the author and the research team in CEMAT.

The empirical findings of this study are discussed in the following chapter and it is structured as follows. First, the Chinese FDI activities globally are briefly described and then focusing in small developed countries, especially in Finland and Sweden. Second, the motives and location factors of the Chinese FDI in Finland are discussed as they appeared in the interviews of this study. Lastly, the comparison of the motives and location factors of the Chinese FDI has been made between Finland and Sweden.

# 4 EMPIRICAL FINDINGS

As in the introduction chapter was sketched, the economic rise of China has been incredibly fast since the late 1970s onwards. Mainly because of the rapid rise and the centralism of the country, there are some specific features in the FDI activity of the Chinese that are presented in the chapter of literature review. Therefore, before introducing the Chinese FDI activities in the small developed economies and the findings from the case-study, it is necessary to have an overview of the Chinese FDI field in general.

## 4.1 Overview of the Chinese FDI

As in the previous chapters was mentioned, the investment activities of China have been widely directed by the government and the outward foreign investment have been exempted from the control gradually since the late 1970s from the "Open Door" policy. FDI of China began to grow particularly in the 1990s after Deng Xiaoping's southern tour of China that initiated to reassert the economic reforms. First grew the inward FDI and later also outward FDI have surged, especially since 1999 when the government-led 'Go Global' policy (in Chinese *zou chu qu*) was enforced. It provided a strong public support for an institutional environment that enhances outward investment to be absorbed by various governmental actors, and the Chinese government formalized the policy on its $10^{th}$ five-year plan in 2001 (Buckley et al. 2008b). The WTO membership in 2001 facilitated the activities of foreign companies further in China and competition in their domestic market intensified for Chinese enterprises. This forced more Chinese companies, particularly the private ones that lack of domestic political protection, to seek new markets and competitive improvements overseas.

Since the beginning of the 2000s, the approval system has been further unburden and decentralised to sub-national government authorities. The authorities are also moving a pre-investment approval procedure to a post-investment registration system. Foreign investments of private Chinese companies were finally fully allowed in 2003 (Buckley et

al. 2007). However, although Chinese private companies surpass SOEs by the volume and technological level of export goods, while SOEs are chiefly concentrated on the export of commodity products as steel, the field of outward FDI has still been dominated by SOEs (Studwell 2009). Until 2009, SOEs had accounted almost 70% of monetary value of non-financial Chinese FDI although their share of total amount of the Chinese FDI has been only around 5%. Also, every of top-10 companies by outward FDI stock and foreign assets are either directly state-owned companies or listed enterprises largely owned and controlled by the Chinese government. The largest foreign assets of privately-held companies are possessed by Huawei Technologies and Legend Holdings (Lenovo) (MOFCOM 2010). Government's strong role in the Chinese outward FDI has been explained by the fact that despite the liberalization began since the 1980s the SOEs still have an important role in the industrial sector and because the economy of China is export-driven the SOEs have begun to promote their exports and to secure access to raw materials from abroad (Athreye & Kapur 2009).

### 4.1.1 General position of the Chinese FDI

As usual in case of Asian and developing countries, also the Chinese FDI are still mainly intra-regional within East and Southeast Asia. Even nearly 68% of total flow of the Chinese FDI went either to Hong Kong or to ASEAN countries in 2009 (MOFCOM 2010). This is largely so because the firm-specific advantages of the Chinese companies are best suited to the surrounding regions and the networks of the ethnic Chinese have generated a lot of cross-border business operations within and outward from East and Southeast Asia since the companies of the overseas ethnic Chinese have strongly internationalized (UNCTAD 2006, 117 & 127; Buckley et al 2007; Rugman & Doh 2008, 178 & 198). Besides, very few Chinese companies are truly global or even internationalized as a clear majority, even 95%, of the sales of the large Chinese companies are still generated domestically, even though they have made substantial FDI at the same time (Rugman 2008, 96).

So far, most FDI have been made by three types of Chinese companies: large SOEs which mostly operate in the field of natural resources, medium-sized companies in mature industries such as light and heavy manufacture as well as electrical home appliances which have overcapacity at the home market (Deng 2009). According to Zhang (2009), the natural resources oriented FDI are made especially in the Middle East, Central Asia, Africa and Australia, manufacturing FDI in Asia, Latin America and Eastern Europe, and FDI of services, including marketing and trade- and export-supporting, in Hong Kong, Northern America and Western Europe.

According to MOFCOM (2010), in 2009 85% of flow and 81% of stock of Chinese FDI was non-financial and the rest was financial FDI (banking, insurance, securities etc.). By the end of 2009 almost 12,000 Chinese investing entities had established over 13,000 overseas enterprises in 177 countries and regions employing almost one million employees, including 438,000 foreigners. The Chinese government has spurred the state-owned and private companies to diversify geographically their overseas production portfolio and thus decrease of political and other risks (Buckley et al. 2008).

In 2009, regarding the stock of Chinese investments the ten largest FDI destination regions and countries had been Hong Kong, Cayman Islands, British Virgin Islands, Australia, Singapore, South Africa, the USA, Luxembourg, Russia and Macau. The same countries appear on the top of the list of Chinese FDI flow in 2009, but also Canada and Myanmar have reached the top-10 (Table 5) (MOFCOM 2010). If EU and ASEAN were counted as single entities, they would be the third and fourth biggest FDI flow, and the fourth and third biggest FDI stock destination, respectively. Hong Kong, the Cayman Islands and the British Virgin Islands often serve as intermediaries to forward Chinese investments to other destinations or back to China as "round-trip" investments. Hong Kong has this status because the Chinese companies are less restricted to invest first into Hong Kong (within 'one country, two systems' context) and then freely to other destinations from there, which is a much easier way to utilize FDI than directly from the mainland China to abroad. In the latter two companies enjoy benefits from their tax-free and offshore banking systems. So far there is no reliable statistical means to estimate where to and how much Chinese investments have been directed via these 'mediator

destinations' but Hess (2006) assumes that around 25-40% of all the Chinese investments have been round-tripping ones.

**Table 5. Ten largest host countries/regions of the Chinese FDI flow and stock in 2009, including EU.**

| FDI flow in 2009 | | | FDI stock in 2009 | | |
|---|---|---|---|---|---|
| **Pos.** | **Country** | **Million USD** | **Pos.** | **Country** | **Million USD** |
| 1 | Hong Kong | 35 601 | 1 | Hong Kong | 164 499 |
| 2 | Cayman Islands | 5 366 | 2 | British Virgin Islands | 15 061 |
| 3 | Australia | 2 436 | 3 | Cayman Islands | 13 577 |
| 4 | Luxembourg | 2 270 | 4 | Australia | 5 863 |
| 5 | British Virgin Islands | 1 612 | 5 | Singapore | 4 857 |
| 6 | Singapore | 1 414 | 6 | South Africa | 2 307 |
| 7 | USA | 909 | 7 | USA | 3 338 |
| 8 | Canada | 613 | 8 | Luxembourg | 2 484 |
| 9 | Macau | 456 | 9 | Russia | 2 220 |
| 10 | Myanmar | 377 | 10 | Macau | 1 837 |
| | EU | 2 966 | | EU | 6 278 |
| | Others | 4 779 | | Others | 25 918 |
| | **Total** | **56 529** | | **Total** | **245 755** |

*Source: MOFCOM 2010.*

It is instructive to note that several countries are both within the largest destinations of the Chinese outward FDI and also the largest investors into China (Appendix 2). Hong Kong dominated both top-10 lists of FDI flow in 2009 since it counted 59% of the total inward FDI to China and 63% of the total outward FDI from China. Other countries that appear in both top-10 lists are Singapore, the USA, Macau and Canada, as well as EU and ASEAN as single entities. Also the list of the largest foreign trade partners with China correlates moderately well with the main destinations of the Chinese outward FDI. Thus there are empirical evidences that trade and FDI volumes are relatively closely correlated also in the case of China. However, large Eastern and Southern Asian countries, such as Japan, South Korea, Taiwan and India, have been important trade partners but less important as outward FDI destinations for China. Also in Europe, China has been clearly more active in trade than investing operations, excluding Luxembourg which can be considered as a distinct case from other larger European countries. The lists of the ten largest investing countries into China as well as export & import partners are in Appendix 3 (China Custom Statistics 2010, Invest in China 2010, MOFCOM 2010). If the top-list of the Chinese FDI host countries is compared with the largest FDI destinations globally,

the difference is still relatively big. Globally, the main proportion of the FDI is still flowing to the Western developed countries although also Hong Kong enjoys a strong position globally, which nowadays is largely explained by the FDI from mainland China. The ten largest FDI host countries globally are illustrated by their flow and stock in 2009 in Appendix 4.

In China, the largest outward non-financial investment sources have been the province of Guangdong – particularly the city of Shenzhen – Beijing and Shanghai, as well as the provinces of Zhejiang, Shandong and Jiangsu in the eastern coast of China. In addition to these richest regions of China, also FDI from Liaoning – particularly the city of Dalian – and Hunan provinces increased rapidly in 2009. Nevertheless, FDI of the large SOEs that are approved by the central government are not included in these statistics (MOFCOM 2010). Again, these regions are also the most active in the foreign trade and largest destinations of inward FDI in China.

When it comes to the Chinese FDI by a sector, in 2009 the Chinese made overseas FDI particularly in leasing & business services (36.2% of total outward FDI), mining (23.6%), finance (15.5%) and wholesale & retailing (10.9%) sectors counted by monetary value (MOFCOM 2010). Regarding the stock of the Chinese FDI, the largest sectors are the same but finance comes before mining (Table 6). FDI had increased the most in mining, real estate as well as science research, services & geo-survey sectors from previous year, whereas the FDI especially in finance decreased substantially. However, most of FDI by a number was made in wholesale & retailing (36.6%), manufacturing (31.9%), construction (4.5%), leasing & business service (3.9%), mining (3.5%) and primary production (3.4%) sectors. It is notable that manufacturing sector has been clearly more important for inward FDI to China than for the Chinese outward FDI. Finally, Davies (2010) points out that there will be likely major shifts in the sectoral composition of the Chinese FDI in the upcoming years. FDI in leasing & business services might have been initially undertaken for supporting China's rapid growth in merchandise trade, but Davies inaugurates that the Chinese companies may diversify toward the manufacturing sector to service the markets of their global consumer goods more directly in the future.

**Table 6. Chinese FDI flow and stock by sector in 2009 (million USD).**

| Sector | Flow | Share-% | Stock | Share-% |
|---|---|---|---|---|
| Leasing & business services | 20 474 | 36,2 | 72 949 | 29,7 |
| Mining | 13 343 | 23,6 | 40 580 | 16,5 |
| Finance | 8 734 | 15,5 | 45 994 | 18,7 |
| Wholesale & retailing | 6 136 | 10,9 | 35 695 | 14,5 |
| Manufacturing | 2 241 | 4,0 | 13 592 | 5,5 |
| Transport, warehousing & postal services | 2 068 | 3,7 | 16 631 | 6,8 |
| Real estate | 938 | 1,7 | 5 343 | 2,2 |
| Science research, services & geo-survey | 776 | 1,4 | 2 874 | 1,2 |
| Others | 1 819 | 3,2 | 12 097 | 4,9 |

*Source: MOFCOM 2010.*

Leasing & business services, finance and wholesale & retailing sectors are dominating the Chinese FDI in Hong Kong which explains their standing at the top of the sector list of Chinese overseas investment. Chinese state-owned commercial banks have shown a growing activity abroad and they are extended their services in host countries to support non-financial investments from China. By the end of 2009, the Chinese state-owned commercial banks had established 50 branch offices and 18 affiliated institutions in 28 countries or regions. Meanwhile, China had established 12 financial institutions in the insurance sector abroad. (MOFCOM 2010)

Finally, it is important to note that evidently the official Chinese statistics are not completely transparent and definitions are not necessarily equivalent with international standards. Figures of Chinese outward FDI vary between the statistics of UNCTAD and those of Chinese MOFCOM and State Administration of Foreign Exchange (SAFE). An example of the figure differences between UNCTAD and MOFCOM was given in Chapter 1.1. Figures of MOFCOM and SAFE vary because SAFE records FDI from the reporting system of the national balance of payments. Thus it captures e.g. the large investments of the Chinese financial institutions and the SOEs approved by State Council as well as capital fund transfers by the Chinese parent firms to foreign affiliates, which are not registered as FDI by MOFCOM. Besides, as discussed earlier, the Chinese FDI data includes round-tripping investment flows to Hong Kong and the tax havens, which will be later reinvested back to China in order to exploit a beneficial treatment of foreign

investments in China (Gugler & Boie, 2008; Buckley et al 2008). It is highly important to pay attention to this possible statistical distortion because Hong Kong, the British Virgin Islands and the Cayman Islands together counted even 80% of the Chinese FDI stock until 2008, although certainly not all the Chinese FDI have been round-tripping ones in these destinations but also directed to other countries that Mainland China.

### 4.1.2 Chinese FDI in small developed economies

When compared the Chinese FDI in different small developed economies the amounts are very polarized and focused on certain countries. As mentioned earlier, the vast majority of the Mainland Chinese FDI is directed to Hong Kong. In addition, ethnically Chinese Singapore as well as geographically large and resource-rich Australia and Canada have received and are still receiving a significant amount of the Chinese FDI. However, the majority of small developed economies, such as Finland, have received the Chinese FDI worth only a few million dollars, and those figures are at approximately the same level with the less developed economies with a similar size in Europe and other continents. The values of the Chinese FDI in the small developed economies (defined in Chapter 1.4) in 2009 are illustrated in Table 7.

**Table 7. Value of the Chinese FDI in the small developed economies in 2009 (million USD).**

| Country | Inflow | Stock |
|---|---|---|
| Australia | 2 436,4 | 5 864,1 |
| Austria | - | 1,6 |
| Belgium | 23,6 | 56,9 |
| Canada | 613,1 | 1 670,3 |
| Denmark | 2,6 | 40,8 |
| Finland | 1,1 | 9,0 |
| Greece | - | 1,7 |
| Hong Kong | 35 600,6 | 164 498,9 |
| Ireland | -1,0 | 106,8 |
| Israel | - | 11,4 |
| The Netherlands | 101,5 | 335,9 |
| New Zealand | 9,0 | 93,9 |
| Norway | 3,6 | 13,0 |
| Portugal | - | 5,0 |
| Singapore | 1 414,3 | 4 857,3 |
| Sweden | 8,1 | 111,9 |
| Switzerland | 21,0 | 30,3 |

*Source: MOFCOM 2010.*

When comparing the Chinese FDI and FDI generally made in the small developed economies, the order is quite same but the differences between the economies are larger. For instance, the global position of FDI in Hong Kong, Canada and the Netherlands is high, as one can notice in Appendix 5. On the other hand, e.g. Belgium and Switzerland have attracted the Chinese investors significantly less that could be expected of their global inward FDI position. Still, if the Chinese FDI and foreign trade from China are compared with each other in the small developed economies, the results correlate with each other quite well. China both invests in and trades the most with Hong Kong, followed by Australia, Singapore and the Netherlands. However, it has to be noted that some countries, such as Finland, have received only a few Chinese FDI despite the fact that its trade with China has been quite extensive. (Table 8)

**Table 8. Foreign trade between China and the small developed economies in 2009 (billion USD).**

| Country | Exports | Imports | Total |
|---|---|---|---|
| Australia | 22,2 | 37,4 | 59,7 |
| Austria | 1,8 | 3,1 | 4,9 |
| Belgium | 14,9 | 5,3 | 20,2 |
| Canada | 21,8 | 12,7 | 34,5 |
| Denmark | 5,6 | 2,6 | 8,2 |
| Finland | 7,3 | 3,5 | 10,9 |
| Greece | 4,1 | 0,2 | 4,3 |
| Hong Kong | 190,7 | 12,9 | 203,6 |
| Ireland | 4,3 | 2,7 | 7,1 |
| Israel | 4,3 | 1,8 | 6,0 |
| The Netherlands | 45,9 | 5,3 | 51,2 |
| New Zealand | 2,5 | 1,9 | 4,4 |
| Norway | 2,6 | 2,1 | 4,7 |
| Portugal | 2,3 | 0,4 | 2,7 |
| Singapore | 32,3 | 20,2 | 52,5 |
| Sweden | 5,1 | 5,0 | 10,2 |
| Switzerland | 3,9 | 7,4 | 11,3 |

*Source: National Bureau of Statistics of China 2010*

According to MOFCOM statistics (2010), the Chinese made remarkable FDI especially in business services, finance, wholesale & retailing and electronics in Hong Kong and Singapore, in business services and manufacturing in the Netherlands, in business services in Ireland, in wholesale & retailing in Sweden, as well as in mining in Australia.

When it comes to the particular focus countries of this study, Finland and Sweden, the difference between these two countries is relatively large. By 2009, Sweden had received the Chinese FDI worth more than 12-fold compared with Finland although the gap narrowed considerably from the previous year (Table 9). If compared with other small developed countries in the region, Sweden has received clearly most both the Chinese FDI and FDI generally and it seems to be the base of business establishment for many foreign MNEs in northern Europe, while Finland has managed to attract far less foreign investment than its neighbouring developed countries. Nevertheless, the Chinese FDI activity in Sweden is a fairly new phenomenon as well and actually it did not begin earlier than in the mid-2000s. In this respect it seems that Finland is about five years behind Sweden in the development of the inward Chinese FDI.

**Table 9. Chinese FDI flow and stock in Finland and Sweden in 2003-2009 (million USD).**

| | Flow | | | | | | |
|---|---|---|---|---|---|---|---|
| | **2003** | **2004** | **2005** | **2006** | **2007** | **2008** | **2009** |
| Finland | - | - | - | - | 0,01 | 2,66 | 1,11 |
| Sweden | 0,17 | 2,64 | 1,00 | 5,30 | 68,06 | 10,66 | 8,10 |
| | **Stock** | | | | | | |
| | **2003** | **2004** | **2005** | **2006** | **2007** | **2008** | **2009** |
| Finland | - | - | 0,90 | 0,93 | 0,94 | 3,59 | 9,04 |
| Sweden | 6,07 | 6,44 | 22,46 | 20,02 | 146,93 | 157,59 | 111,89 |

*Source: MOFCOM 2010.*

In addition, Sweden is clearly ahead of Finland in the number of individual Chinese investments. While hardly 20 Chinese FDI have been realized in Finland (if the Chinese restaurants are not included), Invest in Sweden Agency (ISA) reported already in September 2009 that it has helped almost 190 investments from 160 Chinese enterprises since it established mainland China headquarters in Shanghai in 2002. Moreover, ISA estimates that it supports approximately 25-35 Chinese investors to invest in Sweden annually (China International Fair for Investment & Trade 2009). ISA's arrival in China occurred in the same period when the Chinese FDI in Sweden began to increase rapidly, which unlikely is a coincidence. However, the profile of the Chinese FDI is rather alike in both countries. The investments are concentrated mainly in the sectors of trading & importing and IT, electronics, software & computers. For instance, Chinese ICT giants ZTE and Huawei have invested both in Sweden and in Finland, but Sweden has received a more diverse set of Chinese investments as there have been several Chinese FDI also in the fields of tourism & aviation, logistics & shipping, metal & forestry industries as well as in service industries (ISA 2010b). In addition, many Chinese provinces have opened their representation offices in Sweden. These include, for instance, Shanghai's office in Gothenburg, Changxing's office from Zhejiang province and Wuxi's office from Jiangsu province in Kalmar as well as Henan's office in Gävle.

In Finland, the earliest Chinese companies were established already in the mid-1990s, when e.g. one of the largest shipping companies in the world, state-owned China Ocean

Shipping Company (COSCO), established a joint venture Cosfim Oy with John Nurminen Oy. Also Air China has had a presence in Finland already for several years. However, most of the current investments have been done within the last few years and they have been either greenfield FDI or acquisitions. With few exceptions, the FDI have been made by private Chinese companies although the largest of them receive domestic government support in their foreign operations as already mentioned in the earlier chapters.

The number of Chinese companies in Finland is still small, but it has increased quickly particularly since 2008 and the same trend will apparently continue for the next few years. According to the Economic and Commercial Councellor's Office of the Embassy of P.R. China, there are some 5-6 Chinese companies which are about to invest in Finland within the next couple of years. In June 2009 the governments of Finland and China signed an agreement to establish China-Finland innovation platform in the Helsinki Capital region in order to support the Chinese R&D-intensive companies to establish their operations and cooperation with the local companies in Finland and Europe (GHP 2009). Later on the platform has become concrete by opening two premises, one in Espoo, Finland, and one in Shanghai. Furthermore, the city of Vantaa is about to open a Finnish-Chinese cooperation center in the Aviapolis area, near Helsinki-Vantaa Airport (City of Vantaa 2008). Currently, Vantaa is looking for some 20-30 Chinese companies to verify their entrance on the center before it is ready to notify the opening of the center. The China Development Bank (CDB) is contracted to be one financer for the Chinese companies, and the bank nibbles at financing also Finnish companies and infrastructure projects in Finland. CDB plans to open an office in the Helsinki capital region in the near future. Economic & Commercial Counsellor's Office of the Chinese Embassy has supported some smaller companies' FDI with small amounts and helped with immigration procedures. According to interviews for this study, the larger companies have not received monetary support from the Chinese government.

Furthermore, a couple of acquisitions of Finnish companies have been made by the Chinese MNEs during very recent years. For instance, in August 2009 Chinese Neusoft acquired a mobile phone software development and test unit of Sesca Group (as well as

its branch in Romania) which organization was under rearrangement, and in late 2010 a Chinese medicine company Naton bought a biotechnology company Inion which had been in liquidation before the acquisition. In the near future, the number of the Chinese hi-tech investments in Finland is expected to grow by a new Sino-Finnish innovation center Golden Bridge. It is a service platform for the Chinese hi-tech companies willing to invest in R&D activities and in market expansion through Finland to access European and Russian markets (Golden Bridge 2011). Golden Bridge is a reciprocal project for Finnish Innovation Center FinChi in Shanghai and Shenzhen has also been strongly involved in the project development. Another Chinese city has been active in Finland, as Wuxi opened an office of Wuxi Oversea Station in Tampere in August 2010. In sum, the number of Chinese investments is this low but the penetration speed of new FDI is quickening, likewise in Sweden some 5-6 years earlier.

On the other hand, Sweden has received approximately 200 Chinese investments by more than 150 Chinese companies. Invest in Sweden Agency (ISA) listed 71 Chinese investments that have been made in cooperation with ISA since 2001 and were still active in 2008. ISA has invested a lot in China and it has three representative offices in Beijing, Shanghai and Guangzhou. Many of the Chinese FDI have been made in Stockholm and Gothenburg regions and southern Sweden, particularly in Kalmar, although Kalmar's China Center (Fanerdun Group) changed its owner after a stoppage of its operations since problems and a dispute between the initial investor and the Chinese authorities. Obviously, the Chinese government did not accept the capital transfer to Sweden because of a fear of bad news headlines about suspicious FDI in Kalmar. The project had also controversies with the Swedish government over the minimum wage level of the construction workers in the centre. However, the Kalmar's case gained a lot of publicity in China and may generate more Chinese interest toward Sweden in the future. Chinese ICT giants Huawei and ZTE have R&D sites in Kista science city, near to Stockholm. The vast majority of the Chinese investments have been greenfield or acquisition types but also some strategic alliances have been created between Chinese and Swedish partners. So far, the most famous Chinese acquisition in Sweden occurred in 2010 when a Chinese car manufacturer Geely Automobile bought the passenger car division of Volvo.

The following three chapters consist mainly of the results of the interview material. The external information from the interviews has been marked with the source references.

## 4.2 Motives of the Chinese FDI in Finland

If the Chinese FDI in Finland are classified according to Dunning's taxonomy of FDI motives, the investments are concentrated on the categories of market, efficiency and strategic asset seeking motives. Chinese resource seeking investments have not realized yet although there are prospects for them.

### 4.2.1 Resource seeking investments

Resource seeking motives have not prompted the Chinese to invest in Finland, although especially the Chinese state-owned natural resource companies appear to be rather interested in the Finnish mines and natural resources. Yet, there has been very little to buy in the sector while most of the mines are already in foreign ownership. Apparently there has been only one Chinese investment in that sector in Finland, the fourth largest nickel producer in the world, Jinchuan Group, purchased a share of Finnish Nickel Ltd owned by Canadian Belvedere Resources Ltd. One term of the deal was that the Chinese part is able to buy nickel at certain contract price. The situation may change with new more efficient enrichment technologies that both increase the value of the existing mines (i.e. possibly raise the price offered by the Chinese) and open up opportunities to establish new mines. Anyhow, the exploitability of the mines is still in the study phase. Another basic resource, cheap labour, is non-existent in Finland so the Chinese have not set up manufacturing in Finland that would be based on the resource seeking motives. All the interviewees had a consistent opinion of this.

### 4.2.2 Market seeking investments

Most of the Chinese FDI positioned in Finland have had market seeking motives, one way or another. Some small family-owned companies have come to Finland mainly to sell China made products at competitive prices. Originally, some of these types of companies were planning to store and sell their products from Finland to the Chinese dealers that are operating in Russia and make large orders. Nonetheless, the labile border formalities of Russia have made this kind of business unprofitable. The Finnish market has proved to be fairly small for retailing by the family businesses and they have neither managed to create supplier relationships with the large Finnish retail chains because those already have their own supply networks in Asia. Thus the future of the small Chinese family businesses does not look too bright in Finland, unless they have specific niche products to offer. On the other hand, one Chinese interviewee told that the competition is very intense between family business retailers in the larger European countries (e.g. in Italy) where there are thousands of Chinese retail enterprises and wholesale centers. According to a Finnish investment expert, small Chinese family business investments abroad, e.g. in Finland, are part of a very long-term strategy for the future to strengthen the international network of the family and to seek 'bridgeheads' in the developed countries, where the family and its business has possibility to grow. However, one Finnish China specialist thinks that there is not a suitable business environment and enough large Chinese population in Finland so that family businesses of this kind could thrive and multiply on a large scale.

In the case of larger companies, Nokia and many companies in the ICT cluster grown around Nokia are important customers for the Chinese companies and these customer relationships have usually been formed initially in China. According to the interviews, Nokia has been the biggest single reason for Chinese investments in Finland. Presence in the Nokia-led cluster or in the immediacy of it is both market and strategic asset seeking FDI, as customerships in ICT production chains are global and long-lasting. ICT software development requires close relationships with the client companies from design and co-creation phases up to after-sales services, which forces the Chinese companies to be physically present in Finland and possess some Finnish personnel with direct contacts with the client (usually Nokia) as well as knowledge of the local language and culture. In the ICT sector, the trend is currently moving in the direction where the sub-contractors

with ability to provide total packages - not only one or some components or services - to their clients are favored. Because of this, also the larger Chinese companies have been forced to acquire the missing pieces of the value chain in order to remain the preferred supplier of their main clients. Consequently, there have been acquisitions of ICT companies also in Finland made by the Chinese, and they are very likely to continue also in the future. The targets are typically smaller and/or economically weak sub-contractors or parts of a larger corporation of which the parent company wants to get rid of. According to a Chinese investment specialist, similar acquisitions are expected also in the sectors of health care, cleantech and biomedicine.

Again, some Chinese companies have come to Finland because of the difficult market and intense competition, or in order to exploit their competitive domestic brand. In mobile operator business Finland was the first country which implemented so called 'number portability' meaning that customer is able to preserve his/her phone number despite the changing of the operator. Because this is the global trend nowadays, the Chinese mobile companies wanted to come to Finland to learn how to cope and survive in labile and low-margin markets. Furthermore, almost every of global mobile operators are in the Western European market, which includes also Finland. The market represents 25% of the global mobile operator market, so a business establishment there is important both in terms of the sales and the global strategy of the company if it wants to be a large global player in the industry. Renown of the brand has been exploited by, for instance, ZTE, whose products are sold by Elisa/Saunalahti together with subscriber connections, as well as Huawei, whose mobile modems are sold together with Sonera's broadband subscriber.

Most of the market seeking investments has been made to serve a geographically larger market area than the just Finland. Only a few companies in the service sector, e.g. in health services, have invested only in the domestic markets of Finland, because of the nature of their products and fairly high purchasing power level of the private Finnish people. As mentioned above, many Chinese enterprises especially in the ICT sector are looking for clients from higher in the value chains than they used to do earlier. Those clients usually operate globally, just as Nokia. On the other hand, the Chinese companies might follow their Chinese global clients, such as Huawei, to Finland, like the Finnish

suppliers followed Nokia to China a decade earlier. For this reason, their investments in Finland are, in fact, investments for the global markets.

Furthermore, the Chinese investments in Finland often serve, besides Finland, also the markets of the Baltic countries, one company's office even Belarus, but also the Nordic countries in some extend as well as Western European markets in general. Particular Nordic headquarters the Chinese MNEs have not in Finland but they have been based mainly in Sweden or Denmark thus far. Most Chinese MNEs does not have their Nordic headquarters at all because their business in the region is so small-scale that there is no need for regional hierarchy levels. Russia is very seldom covered by the FDI in Finland which is somewhat surprising, but the finding is rather similar to the finding in the survey about American MNEs in Finland made by Deloitte in 2006. The importance of proximity to Russia did hardly emerge in the opinions of the American MNEs and the result is the same with the Chinese MNEs in Finland.

One interviewed Chinese branch office did earlier cover the Baltic countries, northwest Russia and Belarus, but the sales to Russia was dropped from the duties of the office in Finland by the establishing a representative in Saint Petersburg. The Chinese interviewees felt the boundary between Finland and Russia to be difficult and therefore have not considered it worthwhile to invest in Finland for serving also the Russian market. On the other hand, if the Trans-Siberian railway from China through Russia to Finland would begin to be competitive both in price- and schedule-wise, Finland would be logistically an interesting investment destination for warehousing and distributing the Chinese goods for the North-West Russian market. Anyhow, the current low reliability of the railway line does not suggest that it would be a potential transportation route, at least in the near future. According to one Finnish investment expert, the Chinese do not invest in Finland for the close Russian markets if they have a distinct strategy for Russia. China is also a neighbor of Russia and the Chinese are accustomed to do business with the Russians. In smaller scale logistic operations Finland would be a viable investment destination for Chinese companies, if the border to Russia worked better. Currently, the project of 'Baltic Pearl' (real estate, social services as well as hotel and trade center) (Barauskaite 2009) which is under construction and funded as well owned by the Chinese

investors, might increase the demand for logistic and retail services also from Finland in the future. This might tempt the Chinese to make market seeking FDI also to the Finnish side of the border. In addition, the Russian market for the construction materials has attracted the Chinese, for example, to export steel through Finland to Russia. An example of this was the plan to set up a joint sales company in Finland by Finnish Steelteam and Chinese Shougangin (Capital Steel). The joint venture would have sold the Chinese steel further to Russian and European markets (Steelteam 2009). However, the plan did not materialize but it displays the interest of the Chinese toward FDI in the commodity markets located in Finland.

### 4.2.3 Efficiency seeking investments

Similarly as in the other Western countries, the Chinese have made very few efficient seeking FDI in Finland, largely due to the small number of Chinese investment as a whole. The only case that rose from the interviews was a logistics company which invested in Finland in order to strengthen its global service network. The main reason to invest in Finland was the export traffic of the Finnish forest industry. However, the Finnish representative of the company suspected that in the future the company may terminate its office in Finland and centralize all its operations of the Nordic countries into Denmark where it has the branch office for Scandinavia. This arrangement would also have the efficiency seeking motives.

### 4.2.4 Strategic asset seeking

Besides the market seeking, the strategic asset seeking motives have been clearly the most common motive category behind the Chinese FDI in Finland and often these two motives have been combined in the same investments. Especially in the ICT sector the companies have come to Finland to strengthen their strategically important and long-lasting customerships by bringing relationships closer and expanding their supply for the main clients. Many companies at various sectors have invested in Finland and elsewhere

in Europe to make profit but especially to develop their strategic assets for global and often also for their domestic Chinese markets. One Chinese manager of a service company told that they came to Central Europe and Finland to strengthen their brand and to develop brand management as well as quality and reliability of their services. Another company in the field of testing and certification is planning to invest in Finland in order to learn international testing and auditing skills and knowhow.

Also the learning of new technology has been an important investment motive for the Chinese in Finland as well as in other similar high-tech countries. The companies are going to exploit those assets particularly in China where their business is still significantly larger than abroad and the learned technology is exploited mainly in the domestic manufacturing sites. One Chinese representative of an ICT company told that the company came because of the difficult high-end markets of Finland. The aim is to develop their operations to be quality enough for the discerning Finnish customers and if the aim was met, the operation will be competitive everywhere in the world.

One of the major strategic assets is a competitive educated labour which has been acquired in Finland especially by the ICT companies. Most of the Chinese ICT companies have only one or few Chinese employees in Finland and they have quite aggressively tried to recruit Finnish key personnel, such as specialist engineers, from the local companies. While the recruitment style has been criticized as 'purchasing of the brains of the local companies', is has not any special Chinese feature as such. Acquisition of the competitive human resource is a very common motive for many knowledge-intensive MNEs to make FDI and usually it is carried out by a buyout or direct recruitment. An example of this in Finland is the acquisition of the Sesca Group's mobile sector and its personnel by Chinese Neusoft. Through the acquisition it gained technical expertise as well as local knowledge and a wider surface with the main customer in Finland. Globally weak economic situation reflects also in Finland and provides opportunities for the wealthy Chinese MNEs to recruit the redundant skilled professionals. For example, Huawei managed to recruit engineers who had just been dismissed concurrently with the factory closure by Nokia Siemens Networks (Talouselämä 2009). In the spring 2010, another Chinese ICT giant ZTE announced to recruit the Finnish

network builders (It-viikko 2010a) and end of the same year the Chinese companies were reported to deliver 4G network systems for Finnish phone operators Finnet and Sonera (Digitoday 2010; It-viikko 2010b).

### 4.2.5 Other motives

Other possible FDI motives that came out in the interviews were the real estate construction and speculation, risk diversification and European Chemicals Agency (ECHA) which is located in Finland. Indeed, the last motive could be counted as a location factor as well. According to one interviewee, the Chinese have been very interested in large real estate and infrastructure projects in Finland, but they have not realized yet due to large cultural differences in project management and implementation. In other words, the Chinese do not know well enough the Western practices in the real estate industry, but the situation is likely to change in the future. Another Chinese interviewee, in turn, wondered the motives of the businessmen from the city of Wenzhou in eastern China who involved in a Chinese retail center business in Finland. According to him, the purpose was only to speculate about a possible increase of the real estate value. Apparently their objectives did not materialize and the speculators have left the project. The motive of risk diversification has been seen mainly behind the investments by the family enterprises. Representatives of SMEs told in the interviews that some of their family members are running business in other European countries and the interviewees came to Finland to expand their business networks in Europe. According to one Finnish investment specialist, also some SMEs that operate only in China have come to Finland in order to offset the risk because the markets are very different. China is a market of high profits and risks while Finland is more stable and safer. Lastly, European Chemicals Agency has attracted at least one Chinese consulting company to invest in Finland in order to support the Chinese chemical exporters in registration of their products in EU. FDI was made in the vicinity of ECHA so that information could flow smoothly between the Chinese companies and the agency.

## 4.3 Location factors of the Chinese FDI in Finland

Finland does not have any location advantage that the Chinese are particularly interested in and that are listed at the beginning of Chapter 2.6 – i.e. low taxes, geographical vicinity to China, natural resources and large markets. The market is small and rather saturated, natural resources are not abundant, taxes and especially personal taxes are relatively high and Finland is both geographically and culturally remote from China.

### 4.3.1 Factor conditions

If the location factors that emerged in the interviews are discussed according to Porter's national diamond model, Finland has advanced factor conditions. Finland has a world-class educated workforce which is not particular expensive in the European context and the Finnish education system was commended. Employees need only little or none further training after the recruitment. On the other hand, the Chinese interviewees wondered that the Finns do not want to work overtime or work on holiday or weekends, as the Chinese are used to do. Also R&D facilities and IT infrastructure in Finland received recognition, and they have been facilitating the Chinese FDI in Finland especially in ICT industry.

Basic location factors in Finland are either rather negative or neutral. Natural resources are scarce and their exploitability is not particular high in comparison with other resource-richer countries. The climate is cool and it is not attractive to the Chinese although neither an obstacle, because the buildings are of good quality. Due to its small population and high income level, Finland has not to provide a cheap labour. However, it is not an obstacle to the Chinese who usually do not invest abroad because of the cheap labour. Many interviewees, however, consider that the Chinese do not plan to make manufacturing FDI in Finland because of the high labour costs. One representative of a Chinese company told that they came to Finland partly because the company had previously invested in Germany and the same business model was easy to duplicate successfully in Finland because of the similarity of the countries.

The geographical location of Finland is rather weak and also good, the opinion depended on the interviewee. Some of them lamented that Finland is tucked away from the large European markets although it belongs both to the EU and the euro area, and its location is not pivotal even in the Nordic context. On the other hand, some interviewees found out its location to be good between East and West, close to the markets of northwestern Russia and the Baltic countries. Yet, the vicinity of the Russian markets has not attracted many Chinese MNEs to invest in Finland. According to one Finnish investment specialist, this is a consequence of the fact that the Russian market has not been marketed to the Chinese effectively enough and the favorable location of Finland has been overlooked. He added that it would be possible to develop huge logistics warehouses in Finland from where the products would be exported into the Russian markets while the Chinese companies could reduce the country risk of operating in Russia. One wholesale center has been established near to the Russian border, initially for serving the Chinese retailer in northwestern Russia, but the business has not flourished because the transfer of goods to Russia was felt to be too difficult and there are not enough customers in Finland. Several Finnish and Chinese investment experts and also a Finnish country manager of one Chinese enterprise considered it important that the shortest flight route from China to the EU goes through Finland. The country manager added that there are approximately the equally long flights to Beijing and New York from Finland, so the North European headquarters / office would be practical to establish in Finland due to relatively short flights. Nevertheless, the Chinese interviewees did not raise this issue and it appears that short flights to China have not affected the Chinese investments in Finland thus far.

### 4.3.2 Demand conditions

From the aspect of demand conditions, Finland is a small market with a moderate GDP and growth of it, as usual also in other small developed countries, which does not motivate the Chinese who are seeking a rapid growth. Size of the domestic market has attracted only smaller or service business companies to invest in Finland. Interviewed Chinese representative of a Chinese service firm expects that the sum that the Finns use in services will increase and consequently the market for services will grow in the future.

This is likely to attract also other Chinese companies in the field of services to come to Finland. Potential for this exists since the income level of the Finnish population is high. The markets of the Baltic Sea Region and whole the Europe are, by contrast, more interesting from the perspective of Chinese MNEs. For those larger markets, Finland has been seen as a fairly good "test-bed" to develop the offer of specific products and services, particularly in knowledge-intensive sectors. If the products and services are good enough for the demanding Finnish hi-tech clients, their prospects seem good for the European and the global markets. There have been practical examples of test-bed operations of this kind by the Asian companies in the 1970s when the Japanese automobile and consumer electronics manufacturers tested the European markets first in Finland before established themselves into the larger markets. One Chinese company told that the large Finnish telephone operator was their first large Western mainstream operator whereby the Chinese solved the technical problems related to broadband subscriptions. Furthermore, currently the Chinese company operates in Europe with great success. Furthermore, according to a Finnish investment specialist, also Chinese medicine companies could come to Finland to develop their products because Finland possesses and extraordinary large number of long-term data on the screened genetic population.

Culturally and linguistically Finland is certainly far from China. There is still a quite small Chinese minority in Finland although its size has grown relatively rapidly in the 2000s. In 2009 there were 5,180 Chinese citizens and, in addition, the number of the ethnic Chinese with the Finnish citizenship was around 1,500 (Statistics Finland 2011). Due to the smallness of the Chinese population, there has not been much demand for typical Chinese goods, such as groceries, and the Chinese ecosystem is still too small for the Chinese entrepreneurs who are accustomed to act in a "bazaar culture", as one Finnish interviewee called the Chinese type of business circles. The Chinese have not met language problems in the working life since English is widely spoken in Finland. However, there have been problems, for example, in shopping or dealing with the authorities because almost all the documents and texts are in Finnish. This problem concerns also the investment procedures and the Chinese investors cannot stay constantly up to date how the application and notification processes are progressing. For this, they have needed to employ local staff or outsourced assistance. Nevertheless, the language

barriers have not actually prevented the Chinese from investing in Finland but it may rather be regarded as a discomfort factor. Finally, both the Chinese and Finnish interviewees thought that the similar, diligence and pragmatic, temperament of the Finnish and Chinese people fits well at both personal as well as company level, which facilitates the integration in Finland and negotiations in the investment process.

### 4.3.3 Related and supporting industries

Regarding the related and supporting industries, the competitiveness and location advantage of Finland is clear. Nokia led, even globally significant, ICT cluster has attracted several large Chinese ICT and software companies to Finland (e.g. Greater Helsinki region, Tampere and Oulu) because they have supplier or other customer relationships with the major Finnish companies, mainly with Nokia or telephone operators. In that field there are also numerous smaller companies with whom the Chinese companies could collaborate, or from which they are able to purchase specific assets e.g. by acquisitions. The ICT cluster also provides research expertise of the Finnish universities, research and consultancy companies and other technology research and development organization, such as VTT (Technical Research Centre of Finland) and Tekes (Finnish Funding Agency for Technology and Innovation). Exploitation of the expertise usually requires the cooperation with the local enterprises and society. Other strong areas of expertise in Finland are, among others, cleantech, nanotechnology and biopharmacy, but there have been only a few Chinese FDI in those sectors although there are lots of operations between Finnish and Chinese companies and organizations in those industries.

### 4.3.4 Rivalry in Finland

Finally, as discussed already in the previous chapter, competition in Finland has been an attraction factor for some Chinese companies. Unusual tough competition of customers between the telephone operators serves as an experimental field for one Chinese ICT for

testing and developing of their competitiveness, and nowadays it holds a firm position both in Finland and globally. On the other hand, the smaller and service companies have been satisfied that the competition in Finland is not too fierce, especially with other Chinese competitors. The clientele for them is pretty small but it does not need to be huge, as long as companies offering similar products are not too many. According to the larger Chinese companies it is positive the government in Finland has not intervened in the competition by using protectionist measures, but the competition between domestic and foreign firms is free and fair. Finland is an export-driven country so the Finnish companies must take account of the international demand and competition. On the other hand, there are relatively few large or growing international companies in Finland, which does not support the interest of the foreign companies, including the Chinese ones, as consequently the number of business contacts is limited.

### 4.3.5 Political and regulative factors

The role of the government and its policies has been either positive or neutral as a location factor of Finland from the standpoint of the Chinese investors. According to the Chinese interviewees, the role of the state of Finland is positive and the administration is stable and transparent but it does not offer much practical support, such as incentives e.g. in a form of tax deductions, but the Chinese companies are treated similarly with the local companies. At the same time, during the 1990s and 2000s organizations, such as Invest in Finland and Greater Helsinki Promotion, have been established which provide free assistance for the companies that invest in Finland. Also several Chinese companies have benefited from the assistance. In addition to the above-mentioned support organizations also the openness of the society towards foreign companies, the cheapness and easiness of the business establishing, the lightness of the bureaucracy, the clarity of the legislation as well as the high level of education have been praised by the Chinese interviewees.

At the political level, there is no friction between Finland and China and relations have remained good since the formation of the Communist China. This was seen very important in the interviews. The agreement on scientific and technological cooperation

(TT) between Finland and China was signed already in 1987 and it was expanded to the economic, industrial and technical cooperation (TTT) agreement in 2005. However, as already mentioned in Chapter 2.6, such agreements rarely have an increasing impact on the Chinese investment and this seems to hold also between China and Finland. Finland's membership in the Schengen Area and EU Internal Market has been more important for the Chinese FDI than the membership in the Euro area, as reflected for example in the fact that the euro area, Sweden is not included in the Finnish attracted more Chinese investment. As an example of this is that Sweden which does not belong in the Euro area has attracted much more Chinese FDI than Finland. Instead, the exchange rate of euro to the US dollar and Chinese yuan impacts significantly in the Chinese companies. Most of the Chinese MNEs that operates in Finland are global companies that do business in several currencies, while there is a little difference if the currency is euro or not, but the exchange rate affect greatly what kind of business activity is beneficial at any given time. Cheap euro might encourage the Chinese to invest more in Finland. Smaller firms may benefit from the euro if its other European branches are also located in the euro area, when the branches can operate in the same currency. Otherwise the currency fluctuation risk may be too big for them. However, obviously not too many Chinese know that euro is used in Finland and thus do not take it into account when considering investments in northern Europe.

Chinese government's representative in Finland regrets that the investment information is fragmented between various organizations in Finland, and not all information is available even in English, not to mention Chinese. This has hampered the information search of the Chinese prior to possible investments. Thus the so-called one-desk system would be needful, from where the investors would be able to receive all the necessary information at once. The immigration policy of Finland has felt fair by the Chinese and the authorities are professional although one Chinese interviewee told that the applying for the residence permits in Finnish Embassy was a difficult and time consuming process. The trade union in Finland has praised to be stable but it has also hampered one Chinese company's operations in Finland. A Chinese manager of the company complained that he is not able to negotiate about certain dispute with anyone because the trade union does not agree to talk and thus the situation remains in deadlock. He was also surprised about the ability of

some trade unions to stop the export and import of Finland in full, which does serious harm to the country, its economy and the companies operating there.

The company taxation of Finland has felt to be reasonable, but the income tax to be high. For example, the Chinese who are working in a similar job in Germany has more for consumption after taxes and the consumer prices are generally cheaper than in Finland. According to one Chinese interviewee, the Finns have a lot of free services in payment for high taxes. These services improve their ability to purchase, but it does provide very little benefit for the Chinese who are working in Finland. To the Chinese interviewees, the Finnish society appears to be open, peaceful and safe, and the country is clean and environmentally friendly. The locals are honest and their attitude towards the foreigners is mostly good. Nevertheless, the number of foreigners and foreign companies is relatively small and there are not too many Chinese, which reflects e.g. in the narrow supply of the Asian groceries. Again, the food offering has expanded significantly during the recent years by the increased number of foreigners and nationalities in Finland. Also, few primary schools in Helsinki and Vantaa have begun to provide teaching in Chinese. Some Finnish investment experts believe it to be important for the Chinese family enterprises when considering of establishing themselves in Finland. Chinese teaching is also positive for the families of the Chinese MNEs' personnel in Finland.

### 4.3.6 Role of networks

Finally, when it comes to business relationship networks in certain location, a wide student society of certain nationalities has found to be as essential location advantage. According to the OECD statistics (2011), the number of the Chinese higher education students in Finland was altogether 1,859 in 2008. The figure is fairly large in comparison with the other European small developed economies. For example, in Denmark the figure was 1,789, in Norway 752, in Sweden 2,087 and in the Netherlands about 3,400 Chinese students in 2011. The figures are, of course, much smaller than in the large immigration countries, such as the USA (110,000), the UK (51,000) and Canada (36,000). Apparently, the Chinese students have been attracted by the good level and especially free tuition of

the Finnish education, but the problem has been the poor employment of the graduated Chinese students. Usually, they leave Finland for job seeking either back in China or larger western countries, while Finland loses not only a skilled and multilingual Chinese labour but also their contact networks between China and Finland, which does not affect positively in the prospects of the Chinese FDI in Finland. This problem is known, for example, among the interviewed Finnish experts but the local companies employ preferably students with fluent Finnish skills.

A Chinese business executive told that the service company of which he represents came to Finland almost entirely due to his activeness to the headquarters in China. He has firstly studied and then worked as a tourism entrepreneur in Finland. He managed to convince the Chinese top management to invest with his knowledge of the Finnish market and the country. Apparently there are relatively few this kind of Chinese-created contact networks in Finland, especially because the majority of the Chinese students leave the country after their graduation. According to the Chinese investment expert, it is very important for the Chinese businessmen that they would have a certain Chinese trusted person in the country who "pulls" their investment in the country. Generally speaking, usually an investing Chinese company has a ready contact in the country or representatives of it have visited there frequently before FDI. This has been the background of the several Chinese FDI in Finland as well.

## 4.4 Comparison of the motives and location factors of the Chinese FDI in Finland and Sweden

Finland and Sweden are very similar and geographically close countries. Sweden is larger than Finland both by its population and economy and it has a longer history of internationality. The inward and outward FDI stocks in Sweden have been roughly three times larger than those in Finland although the Swedish economy is only 1.6-1.8 times and foreign trade twice larger than the Finnish. The difference is especially immense in the numbers of the Chinese FDI in Sweden and Finland. However, the interviews and other background material of this study suggest that there are only little differences in the

motives and location factors behind the Chinese FDI in these countries. The difference in the amount of the investments is mainly explained by the strength of certain factors in Sweden and their weakness in Finland as well as by the facts that Sweden has made invest-in activities longer and with larger volume in China than Finland.

### 4.4.1 FDI Motives

The motives of the Chinese FDI in Sweden are largely the same as in Finland, but the implementation of the FDI is further in Sweden, while in Finland they are still mostly in the phase of talks and planning. By quantity, the most Chinese FDI in Sweden has made for the trade and services, i.e. market seeking ones, and they have been relatively small on average. Especially the Chinese whole sale center Fanerdun, which was built in Kalmar in the southeast of Sweden, attracted dozens of small Chinese trading investments, but currently the business in the center has been suspended by the payments difficulties of the property owner. In China, Sweden is seen as the center and leading economy of the Nordic Countries because its central location offers an easy access to cover also the other markets in the Baltic Sea region, such as Finland, the Baltic Countries, Norway and Denmark. Anyhow, a Swedish investment specialist supposes that the location of Finland is a more attracting if the target of the FDI is to cover particularly the Russian and Baltic markets. Sweden, such like Finland, is located in EU and the Schengen area, which facilitates the transportation and trade within Europe and attracts market-oriented FDI. In addition, in Sweden the considerable large Chinese community has attracted market seeking investments, because it provides markets for the Chinese type products. In some cases, the Chinese FDI have been made in Sweden in order to reduce a dependence on the local agent or distributor, or to strengthen the sales along with the remaining agents. These can be classified both as market seeking as well as efficiency seeking FDI.

Unlike Finland, Sweden has received a couple of resource seeking FDI from China, for example in the forest industry, although there have been also other motives behind those investments. One Chinese energy company came to Sweden to produce ethanol because the raw material (wood) is produced in Sweden. Nevertheless, the ultimate target has

been to develop and test the manufacturing method in Sweden - because of the industry know-how of the Swedes - and use the method mainly in China in the future.

As in Finland, the large Chinese ICT companies have been active also in Sweden. Kista ICT cluster near to Stockholm, the traditional giant Ericsson as its beacon, has attracted both Huawei and ZTE to invest and both have opened their R&D centers in Kista. In 2010, Huawei had already 300 employees in R&D and 100 employees in marketing departments, and the majority of Huawei U8300 Android smartphone has been developed in Kista. The company has clearly centralized its North Europe hub in Sweden (Computer Sweden 2010). Huawei's another R&D center in the small developed economies is located in the Netherlands. The Chinese companies have benefitted from customerships and cooperation with other companies in the cluster, such as Ericsson, but actually Huawei's initial FDI in Sweden occurred at the beginning of the 2000s when Ericsson was facing deep trouble. In those days, Ericsson had to reduce its staff drastically and consequently there were many unemployed engineers in the labour market from which Huawei was able to acquire the strategic asset from a competent workforce. Ever since the size of Huawei personnel has increased in Sweden while Sony Ericsson has cut its staff. The largest transition to Huawei was experienced a few years ago when Sony Ericsson closed its entire R&D function in Sweden. As discussed in the earlier chapters, there has been similar Chinese FDI also in Finland during last three years, albeit their size has been notably smaller than in Sweden. One manager of the Chinese ICT company told that they have been rather careful with Nokia and did not want to irritate it too much by coming earlier and more strongly into the Finnish market. Apparently, Nokia has hold a stronger global market position and status in the industry than Ericsson, and it has hindered the Chinese ICT companies to establish themselves in Finland more than in Sweden.

In Sweden, there have been Chinese strategic asset seeking FDI in cleantech sector as well. Thus far the most significant Chinese strategic asset seeking FDI in Sweden has been the acquisition of Volvo by Geely Automobile. There have been Chinese acquisitions also in the other industries, such as bioscience, metallurgy, retail, tourism

and other service industries. The motives have been both market and strategic asset seeking.

In addition to above mentioned motives, in the interviews of the Swedes raised a few specific motives for the Chinese investments in Sweden. According to some interviewee, in some industries the Chinese MNEs uses their branch in Sweden in international bidding contests - e.g. in East Europe and Africa - instead of the parent company in China in order to have more creditability and acceptability for their offers. If the company wins the order, the particular delivery is done, in most cases, from the parent company. In other words, the function of many Chinese investments in Sweden is to acquire new customers for the parent company in China, not only in the emerging markets but also in Northern and Western European countries. In the earlier mentioned project in Kalmar one main motive for the smaller investors was legal immigration to the EU and even residence permits were promised for the owners and employees of the Chinese companies which invest in the center. Previously, the relatively lax immigration policy of Sweden has plainly increased the interest of the Chinese towards immigration motived FDI in the country. The initial motives behind the Kalmar project itself were the speculation on the potential growth of the real estate price and a desire to benefit from the small Chinese companies' wishes to internationalize and access into Europe. For the original investor was enough that he managed to sell the shares to the Chinese entrepreneurs in Sweden. In fact, the actual success of trade in the center was not important to him.

### 4.4.2 Location factors

When compared the location advantages between Finland and Sweden, many factors were found in the interviews that have brought clear benefits in favour of Sweden and explain why the Chinese have been more interested to invest there instead of Finland. According to the interviewees, geographically the countries have only a little distinction. Sweden is more central in the North Europe context and Finland closer to Russia, but obviously these facts have not been the key factors in the FDI decisions of the Chinese MNEs. The Chinese, Swedish as well as Finnish interviewees believed that the general

level location factors which are stronger in Sweden than in Finland are open society, i.e. the Swedes (both people and companies) are more internationally oriented, Sweden has more immigrants and the number of the Chinese is more than three times larger than in Finland. According to Swedish Immigrant-institutet (2010), in 2009 there were 21,200 registered Chinese in Sweden and some Swedish interviewees told that those Chinese are well-networked with each other. In addition, at least six Chinese law firms operate in Stockholm and their staff speaks both Chinese and Swedish. As already mentioned earlier, the Chinese usually find their way to the regions where there already are their fellow countrymen. The first Chinese people moved to Sweden already in the 1780s.

The Chinese interviewees think that Swedish is an easier language to learn and understand than Finnish, and there is more information available in English in Sweden. Still, some interviewees have experienced that the language is a problem for the Chinese both in Finland and Sweden. The Chinese who have lived both in Finland and Sweden told that there is a wider selection of food and other consumer products in Sweden and the prices are cheaper because of the more international competition. Also, travelling abroad is easier and cheaper from Sweden. However, one of them told that it is still nicer to live in Finland, perhaps because of the fact that there still are no major problems with a large number of immigrants, so she thought that the foreigners, at least the Chinese, are treated kinder in Finland than in Sweden. Another Chinese interviewee praised that although the Chinese community is smaller in Finland, the spirit of it is closer and warmer than in Sweden. Yet, one Chinese thought that the Finns do not like foreigners and are ethnocentric.

When it comes to educational factors, one Finnish interviewee supposed that the researcher cooperation between the universities has been wider and has a longer history between China and Sweden than between China and Finland. This cooperation has obviously generated new Chinese enterprises more in Sweden and also attracted the Chinese to invest from China. Unlike the OECD statistics indicated above, the Swedish Embassy in China reported that there would be up to about 5,000 Chinese students in Sweden (more than double than in Finland) and the number has increased steadily (Sveriges Ambassade Peking, 2010). However, currently the number of the new Chinese

students in Sweden is declining rapidly because Sweden introduced tuition fees for the students coming from outside Europe in the autumn of 2010 (Nyteknik 2011).

In addition to the location factors of the Swedish and Finnish societies, the advantage of Sweden is also its broader industrial base which creates more opportunities for trade and cooperation as well as acquisitions. Sweden has had continuous trade relations with China since the 17th century onwards. Furthermore, according to the Chinese, Sweden, Stockholm, the Swedish brands and especially consumer product manufacturers (e.g. Volvo, Saab, Ikea, Ericsson, Electrolux, Astra) are well-known in China. Among the Finnish companies, only Nokia's reputation reaches at the same level of renown in China. Because its familiarity, Sweden is generally regarded as the center of the North Europe in China and they invest in Sweden often intuitively without a deeper examination of the other optional locations in the region. Also, there are more Swedish than Finnish companies in China and Sweden has there a well-established chamber of commerce which was opened in 1998 and nowadays it has around 230 member companies, whereas the Finnish companies are only now setting up their own chamber of commerce in China. Nearly 500 Swedish companies have a local presence in China while the number of the Finnish companies is around 300. According to the interviewees, the companies and their established operations in China have had a clear positive impact on the interest of the Chinese MNEs toward Sweden. Finally, the Chinese know Sweden, for instance, of their royal family and good success in football which is very popular in China.

Regardless of their nationality, most of the interviewees think that the Swedes know how to market their country and businesses better than the Finns. ISA opened its office in China already in 2002, soon after China launched its "go global" policy. ISA's office was the second western invest-in unit after the UK in China. Nowadays ISA has altogether more than ten employees and a relatively high budget in China, which has been reflected e.g. in good visibility in the investment fairs. The strong presence of ISA has clearly yielded results and the Chinese MNEs have found their way into Sweden. Invest in Finland opened its branch in China relatively late, in 2010, and has now two local employees in the country. Apparently, the more centralized invest-in operations of Sweden have worked better than more decentralized template of Finland, in which also

local players visit and operate in China besides Invest in Finland. Some interviewees were concerned that because of this the resources are scattered and a common message and country brand may become vague. In short, the visibility of Sweden has been much wider than Finland and the contact networks of the Swedes are broader in China. The Chinese hardly know the countries and the differences between them in North Europe, so the country promotion is very important. The Swedes got a foothold and a good position in China just before the competition for the Chinese outward FDI was really about to begin. In this respect, Finland has clearly lagged behind, even though the opportunity is not completely lost yet, but the gap is long.

On the other hand, at the political level Sweden has not supported the business as strongly as the Finnish government in China and it has posed e.g. human rights issues more visible than Finland. Interestingly, this has proved to be only little or none negative effect on the amount of Chinese FDI in Sweden, or alternatively a positive impact on that in Finland. The Chinese think that taxes are high in Sweden, just like in Finland. As a result, the staff costs are higher than in China because the salary of the Chinese expatriate must be increased so that his/her net salary would remain at the same level as in China. Transparency of the governance has been perceived to be positive also in Sweden, but for some Chinese it is strange that they cannot negotiate with the authorities e.g. about the level of taxes or other statutory requirements as they do in China.

Finally, several Chinese and Finnish interviewees think that there is apparent fear in Finland, not only towards the Chinese FDI but also towards inward FDI in general. The country has traditionally focused more on exports and outward FDI while inward FDI is mainly “a necessary evil”. The interviewees told that this attitude is reflected even at the governmental level which appears e.g. as under resourcing of Invest in Finland. In addition, one interviewee thinks that the growth has not been sought from the foreign investments and new openings, but rather by supporting the old existing structures. Only during the very recent years the attitudes and efforts have been reviewed. In the future, the retirement of the large generations may open up new opportunities for Chinese FDI both in Finland and Sweden. Many small businesses are going to be without a successor while the former owner retires, and this could make them suitable acquisition targets for

the Chinese entrepreneurs and companies. For example, the Germans have already sought actively and successfully for investors and entrepreneurs from China to make up the shortage of entrepreneurs in Germany.

# 5 DISCUSSION

In this final chapter the findings of the study are discussed and then they are analyzed on the basis of the theoretical framework and setting introduced in Chapter 2. Next, the limitations of the study will be discussed and finally suggestions for further research will be proposed. Due to the nature of the research problem, the managerial implications are not discussed in this study.

## 5.1 Summary of the main findings

The empirical results were divided in three parts: the motives of the Chinese FDI in Finland, the location factors of the Chinese FDI in Finland and comparison of these between Finland and Sweden. However, before the results there was an introduction of the development of the Chinese FDI activity in general as well as the position of the Chinese FDI in the small developed economies. This was written for clarity of the subtext behind the research problem.

Chinese FDI activities have increased rapidly in the wake of the country's economic growth over the last thirty years, but the largest investments are still made by either SOEs or private corporations with a strong funding from the Chinese government. Most of the FDI have been made intra-regionally, particularly into Hong Kong, and most the investing MNEs are still only slightly internationalized while the bulk of their revenues come the domestic markets. The Chinese typically invest in the international tax havens, financial centers, resource-rich countries as well as large consumer markets. By sectors, they invest mostly in business services, extractive industry, finance and trade. The Chinese FDI usually support the imports of raw-materials and fuels as well as the exports of commodities, or they have been made for seeking tax benefits for round-trip or further investments. Chinese have invested very little in the small developed economies except the special cases, such as the resource-rich Australia and Canada, the above-mentioned Hong Kong and Singapore inhabited by the ethnic Chinese. If compared with the other remaining small developed economies, Sweden has received a fair amount of Chinese

FDI while Finland is among the last. Thus these two countries are relatively good examples of the "normal" small developed economies as the host countries for the Chinese FDI. Stock of the Chinese FDI in Sweden is 12 times bigger than in Finland, although also Finland has managed to attract the Chinese investment in a growing number during last few years. Anyhow, the figures have still been relatively insignificant in Finland so far.

The Chinese have not made too many investments in Finland and the most of the FDI have had either market or strategic asset seeking motives behind them. There has not been any resource seeking FDI and only one investment which can be counted as an efficiency seeking one in the logistics sector. Market seeking investors have mainly been small Chinese companies operating independently or in a wholesale center. However, apparently their success has not been too good in Finland since the market is small, there are not enough suitable customers and it has been difficult to sell to the neighbouring Russian market owing to the problematic border between the countries. Another group of the Chinese MNEs that have made market seeking FDI in Finland are ICT and software companies which have been attracted to invest by the Nokia-led ICT cluster. Nokia and other Finnish ICT, software and teleoperator companies are important customers for the Chinese MNEs globally and they have wanted to strengthen the business relationship by investing in the vicinity of the customer corporates' headquarters in Finland. The market seeking FDI are usually made for serving larger market area than the just Finland. These markets include neighbouring countries, such as The Nordic and Baltic countries, and on a larger scale even the European and global markets depending on the nature of the customerships. Surprisingly, the Chinese FDI have not made to serve the Russian market. Only one interviewed company has covered Russia by the FDI made in Finland and now it has also deducted from the area responsibilities of the subsidiary in Finland.

Many Chinese market seeking FDI also have had strategic asset seeking motives behind them, especially in above-mentioned ICT, software and teleoperator industries. In these, customerships are long-term and global, thus they are usually counted as strategic. The FDI have strengthened the position of the Chinese parent MNEs in the global competition with the stable customer relations. At the same time, the MNEs have successfully

developed and tested their products and services together with the local customer and partner companies as well as learned international business and management by operating in Finland. This has improved their competitiveness both in their home market and also in the international markets, which has been one of the initial reasons for the FDI decisions. The Chinese have sought new technology and knowhow also by acquisitions. With acquisitions they have managed quickly to gain new technology, customers as well as skilled labour. Top-level engineers have been tried to attract also from the local hi-tech companies which have had pressures to reduce their personnel.

Other motives that were raised in the interviews are real estate construction and speculation, risk diversification by the small Chinese family enterprises as well as European Chemical Agency (REACH) which is located in Helsinki and attracted the Chinese consulting companies to establish themselves in Finland to support the registering of the Chinese chemicals in the EU market.

As most small developed economies, either Finland does not have location advantages that particularly attract the Chinese investors. Taxes are high, natural resources relatively scarce, the market is small and it is far from China and Chinese culture. The number of the Chinese and Chinese students in Finland is minor although quite quick-growing. Because of this the awareness of Finland has been weak in China and the Chinese people do not feel attractive to come to Finland because they thrive in a society of countrymen which would also facilitate their businesses. Although only a very few speak Chinese in Finland the language has not been felt to be a problem as the most Finnish can speak English. Moreover, climate of Finland is not too pleasant and blue-collar labour costs as well as the general cost level are not attractive. Furthermore, the general price level of Finland has been noticed to be high even in European context, e.g. when compared with Germany. The geographical location of Finland is distant from the large markets but Russia, but this location factor has not pulled the Chinese into Finland although it has possible potential in the future depending on the development of the Russian border formalities. Neither has the shortest flight route from China to EU, which goes through Finland, attracted the Chinese – although this is considered an attractive factor for the Chinese investors in some Finnish circles.

Obviously the most important single location factor that has attracted the Chinese FDI in Finland is the ICT and software cluster led by Nokia. Cooperation with the companies in the cluster is important to many Chinese MNEs in the sector. Also developed infrastructure and the support from several institutions, such as universities and research organizations have facilitated the presence of the Chinese ICT companies in Finland. Furthermore, because of the developed technology, the demanding customer base and some special features in the Finnish teleoperator business, Finland has been appreciated being a good test-bed for developing products and service for the whole European market. Some Chinese ICT companies have made pilot projects with the Finnish customer firms and have been able to use these experiences also elsewhere. Also, Finland has strong location advantage in educated labour - especially engineers - that is one of the main factors that have attracted the Chinese MNEs to invest into the country.

Openness and stable administration system of Finland has been positive from the Chinese standpoint. The country is safe and clean and education is free, which is important especially for small Chinese businesses and expatriates' families. Supportive invest-in organizations, such as Invest in Finland, Greater Helsinki Promotion and Golden Bridge, have helped the Chinese FDI in establishing themselves in Finland but the number of these cases has been limited. In addition, the political relations between China and Finland have been good for long and there are several bilateral cooperation agreements. Anyhow, their impact on the Chinese FDI is rather ambiguous and apparent low. Also importance of Finland's membership in the euro area has been insignificant for the Chinese investors, meanwhile fluctuation of the currency rates between euro and dollar or Chinese yuan has been more influential for the Chinese businesses. Because of the saturated market, the growth rate of the Finnish economy is low but the average purchasing power is high which attract the Chinese service companies. They see good prospects for further service FDI in the future.

Finally, because of the smallness of the Chinese society in Finland and loss of the Chinese students to abroad after their graduation from the Finnish schools the crucial human networks between the Chinese in China and Finland have been sparse and

embryonic. Many Finnish and Chinese companies have solid trade relationships but these have not for one reason or another generated many Chinese investments in Finland.

In the final chapter of the empirical findings the motives and location factors of the Chinese FDI were compared between Finland and Sweden. This was done in order to find if there are some major differences between these two rather alike small developed economies and what are the reasons for multifold Chinese FDI in Sweden compared with Finland. Generally speaking, Sweden has made and received clearly more outward and inward FDI than Finland and this is particularly pronounced in the Chinese inward FDI. Nevertheless, the results of the study indicate that there are only little differences in the motives of the Chinese FDI and location factors in the countries. The main reasons explaining the larger number of Chinese investments in Sweden are the strength of certain location factors in Sweden and their more active invest-in operations in China.

Sweden has received quite many market seeking FDI from China and many of them are small trade and service investments. Especially the Chinese wholesale center in Kalmar attracted investments of this kind. Sweden, which is a member of EU and the Schengen Agreement, is perceived to be the central of the North Europe and it is easy to cover the whole market from there. Sweden has also attracted a couple of Chinese resource seeking FDI, e.g. in the energy sector. However, the innermost motives have obviously been strategic since the investing companies are meanwhile learning the novel technology of use of the raw materials and going to use it in China. As in Finland, there have been many FDI by the Chinese ICT companies in Sweden, but unlike in Finland they have already set up large R&D centers in Sweden to serve the parent company globally. Investments have been done rather simultaneously with the deep problems of the local giant Sony-Ericsson which suggest opportunistic motives to gain strategic assets, for instance, by hiring the personnel terminated by Sony-Ericsson. The similar development of the Chinese ICT activities has been observed also in Finland, albeit on a smaller scale. Strength of Nokia has apparently hindered the Chinese ambitions to expand in Finland until the very recent years. Besides ICT sector, Chinese companies have been active also e.g. in cleantech and automobile sectors where they have made several strategic asset acquisitions. Other distinct motives of Chinese in Sweden that have not found in Finland,

at least directly from the interviews, have been the use of FDI as a vehicle in international bidding contests as well as an access to a legal residence in Europe through an investment. However, there have been signs about the latter motive also in Finland in the case of Kouvola China Center.

On the location factors, Sweden has clear advantages compared with Finland that have facilitated the Chinese FDI. The Chinese society in Sweden is larger and has a much longer history than in Finland. The trade relations between China and Sweden have existed already for more than 300 years. In general, Sweden is more internationally oriented and the language is easier than Finnish which makes it easier to live for the Chinese. The high level of education is a location advantage of both countries, but apparently the Swedish-Chinese research cooperation between the universities is deeper and thus generated new investment opportunities. As a country, Sweden is better known than Finland in China, apparently because of its wide industrial base and several global brands of consumer goods. There are more Swedish companies with deeper cooperation with the local partners in China and they are well represented e.g. by the Swedish Chamber of Commerce. Moreover, Invest in Sweden Agency has operated perceptibly in China already for almost a decade and it has invested there more human and monetary resources than the Finnish invest-in organizations. This has probably had the largest single impact on the enthusiasm of the Chinese to invest in Sweden. Politically Finland has had apparently better relationships with the Chinese regime while the Swedish politicians have paid less attention to business issues and raised sensitive questions e.g. about human rights in China. Nevertheless, this has hardly had too negative influence on the Swedish-Chinese investment environment. Obviously the traditional lack of interest and even reluctance of the Finnish society and government towards the inward FDI has had a negative impact of the number of the Chinese FDI in the country. Very little has been devoted to attract the Chinese FDI which has clearly reflected in the results compared with Sweden.

## 5.2 Theoretical implications

The objective of this study is to explore firstly, what have been the main motives behind the Chinese FDI in small developed economies and secondly, which location factors / advantages of those economies have especially attracted the Chinese to invest. The case country has been Finland and it has then been compared with Sweden in order to find are the results similar in these two small developed economies.

Theories that discuss about FDI motives are relatively few and Dunning's taxonomy of resource, market, efficiency and strategic asset seeking motives (1993) is perceived to be the most comprehensive of them. Thus it has been utilized also in this study. Location factors and advantages that attract foreign investments into certain locations/countries have been discussed more in the FDI literature. In this study location factors for Chinese FDI in destination countries are mainly examined through Porter's national diamond model (1990) and L-advantages of Dunning's eclectic paradigm (Dunning, 1998; Dunning 2002, 418-424; Dunning & Lundan 2008, 323-327).

Since there is virtually no previous literature on Chinese FDI in small developed economies FDI, the motives and location factors affecting Chinese FDI - as well as the special features of Chinese FDI context - have been firstly discussed at a general level. However, this provides a valuable baseline to compare how much the research results of this study reflect the previous literature of the Chinese FDI and if the small developed economies possess some distinct features.

At general level, the Chinese FDI have mostly had either resource or market seeking motives, while also strategic resource seeking has recently become an increasingly important (Deng 2009; Gugler & Boie 2008, Buckley et al. 2008b). According to the results of this study, the main motives of the Chinese FDI in the small developed economies are market and strategic asset seeking. There are some reasons for the results. Although size and growth rate of the markets in the small developed economies are quite low, the market seeking is attractive because of high income level of the population, long

trading relations from China call for trade support investments and openness of the countries provides opportunities to use them as export-platforms to the larger markets. The Chinese have also established large wholesale centers in several countries but in most cases they have not bloomed, maybe because the ultimate motives of the founders have obviously been real estate speculations and rental fees from the Chinese small-scale manufacturing due to high production costs. This result is in line with Buckley et al. (2008b) that the Chinese utilize manufacturing FDI mostly in other low-cost countries near to the large and rich markets.

The high level of development in these economies usually means that a country possesses assets, i.e. advanced factor conditions (Porter 1990, 74-77), such as technology, educated labour and brands, as well as developed legislation and research institutions. All these facilitate the Chinese strategic asset seeking FDI and acquisitions of assets in those countries, such as in Finland and Sweden which were examined in this study. Access to the local capital markets has not been an important reason for the Chinese to invest into the typical small developed economies (excluding Hong Kong and Singapore) since their capital markets are rather limited and the Chinese investors have received their finance mostly from the Chinese banks if needed. This is inconsistent with the result of Deng (2004) and indicates the strengthening of the Chinese domestic financial institutions during the recent years.

Resource seeking FDI are rarer because of the sparsity of natural resources in the countries or the difficulties of acquiring them due to established ownership. Usually there are also other, more important, motives behind the rare Chinese resource seeking FDI in the small developed economies, such as strategic asset seeking. Chinese efficiency seeking FDI are also rare but potential in some small developed economies, especially in the logistics sector if the countries locate in a pivotal area for transportation. These kinds of small developed countries are e.g. the Netherlands and Sweden in the context of North Europe.

As mentioned earlier in this study, the small developed economies basically do not have the basic location advantages that attract the Chinese most and thus the amount of the

Chinese FDI in those economies has not been remarkable (e.g. Kolstad & Wiik 2009). However, their advanced factor conditions and demand factors, i.e. high purchasing power, open and transparent economies – also towards the competitions from abroad - , good governance and advanced legislation, high technological and R&D level, advanced consumer markets, educated labour and possible membership in special economic regions, such as EU, are seen positive for the Chinese FDI. These results are in line with, for instance, UNCTAD report 2006 (156-157) of Chinese FDI in general level. Therefore these countries have found to be suitable try-out fields to test and develop products, service and management before entering the bigger markets, particularly in Europe where larger markets are close to the Nordic countries and small developed countries in Western and Central Europe, for instance. Furthermore, the clusters of different industries are a very powerful attracting factor for the Chinese MNEs, among others. The findings of this study indicate that the strong ICT clusters in Finland and Sweden have been the most important single reason for several significant Chinese FDI in the countries. In other words, related and supporting industries has found to be the most significant attribute from Porter's national diamond model (Porter 1990).

The Chinese investors, especially the smaller companies and entrepreneurs, are also interested in the high welfare, social security, free or cheap education as well as safe and clean environment. To this type of investors an opportunity to obtain residence permits in the countries with high living standards, and possibly also in EU, is very attractive. Deng (2004) and Antkiewicz & Whalley (2007) had earlier come to the same conclusions. Apparently, the number of Chinese residents has a substantial influence on the amount of the Chinese inward FDI also in the small developed economies, similarly as at general level (Child & Rodrigues 2005). The results of this study from Finland and Sweden suggest in this direction as there are much more the Chinese residents as well as FDI in Sweden than in Finland. In the other hands, there is not unambiguous evidence that the number of the Chinese students is correlated to the amount of the inward Chinese FDI in the country. Obviously, it is more important how well the Chinese are employed after their graduation so that they would remain to create networks between the country of residence and China.

In China, many small developed economies are not too well-known so presence and focused country promotion are essential factors which directly affect the interest of the Chinese to invest, i.e. the host country governments' role is crucial in this sense as Porter (1990) and Dunning & Lundan (2008) also emphasized. The number of companies and their institutions (e.g. chambers of commerce) established in China is an important factor as well as how much certain country does invest-in promotion in China. The results of this study indicate that these factors influence greatly the development of relations and hence the awareness of the Chinese about the investment opportunities in a small and lesser-known country. However, merely the trade between the countries itself does not appear to increase the amount of the Chinese FDI in the trading partner countries, unlike in some studies indicate (e.g. Buckley et al. 2007). Only in the case of the Netherlands the trade may be the explanatory factor for the relatively high number of the Chinese FDI in the country, likely because of logistical reasons.

Finally, the political relations between countries are not very important for the Chinese FDI in the small developed economies, as long as they are at a tolerable level. The reason for this largely is that the Chinese has made only a few investments in natural resources in these economies. The investments of this kind are almost without exception made by the Chinese SOEs and because of that, the political relations are important behind the investments. In addition, The Chinese government also plays an important role as a financier and guarantor in the major M&A made by the Chinese MNEs. Also the small developed economies have experience of this, such as in Sweden in the acquisition of Volvo by a Chinese company, and the cases of this kind are likely to increase in the future for the growth and internationalization of the Chinese companies. All in all, the role of the Chinese government is lighter behind the Chinese FDI in small developed economies than it often is in many other destinations (e.g. Buckley et al. 2007 and von Zedtwitz 2005). However, by the increasing number of M&A its importance is growing at least as a financial guarantor for the Chinese MNEs also in the small developed economies.

## 5.3 Limitations of the study

The number of the Chinese investments in Finland is still rather small and it inflicted some limitations in gathering information because the pool of the Chinese interviewees was moderately small. However, many of the Chinese that were invited for interview agreed to participate and there were only a few refusals. The Chinese businessmen tend to be quite challenging to interview due to different language and the fact that they are not very familiar with the interviews and academic research. That is why in some interviews, especially with the older and more experienced Chinese managers in state-owned companies, it was demanding to express the question so that the necessary information was able to be brought out. Sometimes it was difficult to obtain a reliable perception of the underlying investment motives. This sometimes required quite long casual small talk in order to create a climate of trust.

The Chinese inward FDI is a very novel phenomenon in Finland, so particularly many Finnish investment experts had to speak about the motives of the Chinese largely in general terms without concrete examples, or with allusions to the future prospects. By contrast, they had relatively clear and quite similar views with the Chinese on the FDI location factors in Finland. Furthermore, the Finnish companies that are in cooperation, and especially in a customer relation, with the Chinese MNEs were not interviewed practice at all, but their information was collected mainly using the secondary sources.

The number of the interviews with the Swedes was small due to lack of resources for the study because they should have been done mainly in Sweden. In Sweden, totally only four interviews were made and one of them was with a Chinese person. In addition, the author of this study was not present in those interviews. Still, several Chinese interviewees in Finland had worked also in Sweden and they could provide valuable benchmark information between the countries.

## 5.4 Suggestions for further research

As the Chinese outward FDI are studied mostly only at the general level and the phenomenon is still relatively new, it should be studied more thoroughly in different type of countries, country groups and environments. This is both interesting and necessary because the amount of the Chinese FDI will undoubtedly continue its notable growth and China will be one of the largest foreign investors in the future. Therefore, it is good to have researched information about the motives behind the Chinese investments and how and why different kinds of business environments attract them. The latter knowledge is valuable because the Chinese investments will be - and in some host countries in Asia and Africa already are - an important and dynamic part of the domestic economy in most of the countries.

This study concentrated on two small developed economies, Finland and Sweden, and drew conclusions from this basis. However, it would be useful to test the generalizability of the results of this study by conducting further studies in the other small developed economies in other regions, such as New Zealand, Switzerland, Ireland and the Netherlands. Furthermore, as the number of the Chinese FDI in Finland has begun to grow not until very recent years this type of study could be done again within next five or ten years while the number of new Chinese FDI – and thus also the research population – has been undoubtedly increased.

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## APPENDICES

### Appendix 1

### Chinese Foreign Investments in the Baltic Sea region, interview questions:

**1. Background information**

- Line of business and company's size (turnover and number of employees)
- Main products and markets
- Share of foreign markets in the turnover
- Investments in foreign countries
- Role and importance of Finland and the Baltic Sea region for the company
- Has the company invested in several locations / countries in the Baltic Sea region?
- Value of the investment(s) (in Finland and/or other countries in the region)
- Other locations that were considered suitable
- Share of ownership and the owners (if the subsidiary or JV)
- Way of establishment (greenfield, acquisition, JV)
- Main operations of the subsidiary (e.g. production, sales & marketing, R&D etc.)
- How does the investment support company's strategic goals and global competitiveness?

**2. General information about the target country or region**

- What makes Finland / the region attractive for foreign investors?
- Did it/them impact on the investment decision?
- Is the location in the Euro-currency area important to the company?
- What are the major problems or hindrance to investment in Finland / the region?
- How has the business environment in Finland and Baltic Sea region developed and how has it affected company's operations in the area?
- Does investment in Finland service a bigger context, e.g. sales in St. Petersburg area or elsewhere in the Baltic Sea region, or supply-distribution chain?
- What kind of added value the investment generates for the company? Does it also benefit the home market, e.g. in creation or transfer of new technologies?
- Why Sweden and Denmark has managed better in their promotion for Chinese FDI than Finland? Why there are more Chinese investments in Sweden/Denmark than in Finland?

**3. Relationship with the public sector**

- Has the public sector subsidize you with any kind of incentive that impacted on the investment decision?
- Had the functionality / effectiveness of the public sector any impact on the investment decision?
- Have the relationship with the public sector been an important part of the investment decision and do they have any impact at the moment?
- What are the major problems/challenges related to the public sector?

- Are they any problem in taxation or legislation, e.g. visa and immigration policy?
- How the public sector and related organizations could develop Finland and the Baltic Sea region more attractive destination for foreign investments?

**4. Relationship with the local partner company (if any)**

- Does the company have a local partner company and how did the cooperation begin?
- What were the factors affecting the partner selection?
- How the cooperation works between the partners (distribution of work and the responsibilities)?
- Distribution of know-how, technology and innovations
- Role of personal relationships in the cooperation
- The major problems/challenges in cooperation

**5. Relationship with the companies and market**

- Did the company have any operation in the target area before the investment (exporting, licensing etc.)?
- What was the main motive to invest in Finland?
- What are the major competitive edges of the company and local companies?
- Had clusters or other company networks any impact on the investment decision?
- Has a previous partnership or business relationship with a Finnish company or with a company from the Baltic Sea region in China or elsewhere in the world led or affected the investment in Finland / the Baltic Sea region?
- Does the company have many supplier or customer in the region?
- Does the company have cooperation with local companies, and what kind of (R&D, technology transfer, co-marketing etc.)
- Has the investment contributed in gathering of market information and/or localization of products/operations?
- Is the company renowned in the target area and has the investment improved the situation?

**6. Employees**

- How big personnel the company has in Finland / the Baltic Sea region?
- How many of personnel are local and how many Chinese?
- What is the company's recruiting policy and is it easy to find skilled employees in the area?
- Is the employees' level / know-how one reason for the investment?
- How the Chinese employees' migration has been arranged (e.g. living conditions, permissions etc.)? Are those permits easy to be issued?
- Has there been any problem related work or organization culture?

**7. Future**

- How the business operations are expected to develop in the target area in the future? Will the number of Chinese investments/companies increase?
- Is the company planning to make new investments or expand the present investment in the future?
- Is the company planning to recruit more local or Chinese employees?

- What kind of cooperation with local public sector and companies do you expect/wish in the future?
- What are the major risks that threaten the region and investments there?
- What have been the major problems that the Chinese companies have faced in the region and have there been done some common mistakes among the companies?

## Appendix 2

**Ten largest investing countries into China by FDI flow in 2008.**

| FDI flow into China in 2008 | | |
|---|---|---|
| **Pos.** | **Country** | **Million USD** |
| 1 | Hong Kong | 41 036 |
| 2 | Virgin Islands | 15 954 |
| 3 | Singapore | 4 435 |
| 4 | Japan | 3 652 |
| 5 | Cayman Islands | 3 145 |
| 6 | South Korea | 3 135 |
| 7 | USA | 2 944 |
| 8 | Samoa | 2 550 |
| 9 | Taiwan | 1 899 |
| 10 | Mauritius | 1 494 |
| | EU | 4 995 |
| | Others | 7 156 |
| | **Total** | **92 395** |

*Source: National Bureau of Statistics of China 2009.*

## Appendix 3

**Ten largest export and import countries of China in 2009.**

| Export from China in 2009 | | |
|---|---|---|
| **Pos.** | **Country** | **Billion USD** |
| 1 | USA | 220,8 |
| 2 | Hong Kong | 166,2 |
| 3 | Japan | 97,9 |
| 4 | South Korea | 53,7 |
| 5 | Germany | 49,9 |
| 6 | Netherlands | 36,7 |
| 7 | UK | 31,3 |
| 8 | Singapore | 30,1 |
| 9 | India | 29,7 |
| 10 | France | 21,5 |
| | EU | 236,3 |
| | **Total** | **1 201,7** |

| Import to China in 2009 | | |
|---|---|---|
| **Pos.** | **Country** | **Billion USD** |
| 1 | Japan | 130,9 |
| 2 | South Korea | 102,6 |
| 3 | Taiwan | 85,7 |
| 4 | USA | 77,4 |
| 5 | Germany | 55,8 |
| 6 | Australia | 39,4 |
| 7 | Malesia | 32,3 |
| 8 | Brazil | 28,3 |
| 9 | Thailand | 24,9 |
| 10 | Russia | 21,3 |
| | EU | 127,8 |
| | **Total** | **1 005,6** |

*Source: China Custom Statistics 2010.*

## Appendix 4

**Largest inward FDI destination countries globally by flow and stock in 2009.**

| FDI flow in 2009 | | |
|---|---|---|
| **Pos.** | **Country** | **Million USD** |
| 1 | USA | 129 883 |
| 2 | China | 95 000 |
| 3 | France | 59 628 |
| 4 | Hong Kong | 48 449 |
| 5 | UK | 45 676 |
| 6 | Russia | 38 722 |
| 7 | Germany | 35 606 |
| 8 | Saudi Arabia | 35 514 |
| 9 | India | 34 613 |
| 10 | Italy | 30 538 |
| | EU | 361 949 |
| | Others | 370 059 |
| | **Total** | **1 114 189** |

| FDI stock in 2009 | | |
|---|---|---|
| **Pos.** | **Country** | **Million USD** |
| 1 | USA | 3 120 583 |
| 2 | France | 1 132 961 |
| 3 | UK | 1 125 066 |
| 4 | Hong Kong | 912 166 |
| 5 | Belgium | 830 101 |
| 6 | Germany | 701 643 |
| 7 | Spain | 670 550 |
| 8 | Netherlands | 596 669 |
| 9 | Canada | 524 938 |
| 10 | China | 473 083 |
| | EU | 7 447 904 |
| | Others | 5 264 734 |
| | **Total** | **17 743 408** |

*Source: UNCTAD 2010.*

## Appendix 5

### Value of global FDI in the small developed economies in 2009 (million USD)

| Country | Inflow | Stock |
|---|---|---|
| Australia | 22 572 | 328 090 |
| Austria | 7 051 | 168 550 |
| Belgium | 33 782 | 830 101 |
| Canada | 18 657 | 524 938 |
| Denmark | 7 800 | 157 627 |
| Finland | 2 551 | 88 441 |
| Greece | 3 355 | 44 927 |
| Hong Kong | 48 449 | 912 166 |
| Ireland | 24 971 | 193 302 |
| Israel | 10 877 | 71 258 |
| The Netherlands | 26 949 | 596 669 |
| New Zealand | 348 | 66 634 |
| Norway | 6 657 | 116 090 |
| Portugal | 2 871 | 111 272 |
| Singapore | 16 809 | 343 599 |
| Sweden | 10 851 | 304 504 |
| Switzerland | 9 695 | 463 799 |

*Source: UNCTAD 2010.*