CHINESE FOREIGN DIRECT INVESTMENT IN CENTRAL AND EAST EUROPE
CASE STUDY ON POLAND AND HUNGARY

THESIS

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MASTER IN SOCIAL SCIENCE
POSTGRADUATE PROGRAM
PARAHYANGAN CATHOLIC UNIVERSITY
BANDUNG
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DECLARATION

I, Milica Vuković, hereby declare that this thesis with the title:

CHINESE FOREIGN DIRECT INVESTMENT IN CENTRAL AND EAST EUROPE: CASE STUDY ON POLAND AND HUNGARY

is my own work and that all the sources I have used or quoted have been indicated or acknowledged by means of completed references.

Stated in: Bandung

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ABSTRAK

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Dalam beberapa tahun terakhir, perusahaan-perusahaan dari Tiongkok mulai mengembangkan bisnis mereka dengan mengakuisisi aset-aset secara strategis, membangun anak-anak perusahaan atau terlibat dalam perusahaan gabungan *(Joint Venture)* di Eropa dan Afrika. Namun karena proses ini masih dalam tahap awal, sampai saat ini belum ada penjelasan akademis yang berkaitan dengan alasan dan tujuan mengapa perusahaan-perusahaan dari Tiongkok tersebut berkeinginan untuk melakukan investasi di pasar yang telah disebutkan di atas. Di saat yang bersamaan, kita dapat mengamati kehadiran dari ekonomi Tiongkok di Eropa Tengah dan Timur. Arus kedatangan investasi yang terjadi saat ini diperkirakan akan meningkat lebih lanjut karena beberapa perkembangan politik yang ada saat ini, seperti pembentukan *"Belt and Road Initiative"* dan perkembangan intensitas perdagangan dengan beberapa negara.

Tujuan utama dari penelitian ini adalah untuk menganalisa dan mengidentifikasi faktor-faktor yang memotivasi perusahaan-perusahaan dari Tiongkok untuk berinvestasi di Eropa Tengah dan Timur. Untuk menjawab pertanyaan penelititan ini, saya melakukan studi kasus di dua pasar terpilih di Eropa Tengah dan Timur untuk merumuskan faktor-faktor yang menjadi alasan perusahaan-perusahaan dari Tiongkok untuk berinvestasi di wilayah ini. Studi kasus ini mencakup analisis dari undang-undang dan kebijakan-kebijakan investasi, hukum dan kebijakan-kebijakan fiskal, pasar

tenaga kerja, situasi makroekonomi dan mikroekonomi, politik dan ketersediaan sumber daya beserta isu-isu yang berkaitan dengan investasi. Selama penelitian, saya lebih memberikan perhatian pada faktor-faktor penarik yang menjadi dasar perusahaan untuk berinvestasi di negara-negara Eropa Tengah dan Timur. Secara khusus saya menganalisa pasar dari Polandia dan Hungaria.

Kesimpulan terakhir saya adalah bahwa investasi Tiongkok di kawasan ini didorong dan dimotivasi oleh kepentingan ekonomi, namun memiliki latar belakang politik dan konsekuensi pada perkembangan politik bahkan ketika investasi tersebut tidak datang langsung dari pemerintah RRC.

Katakunci: FDI, China, CEE, Case Study, MNE

ABSTRACT

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Chinese companies have in recent years started expanding their businesses by strategically acquiring assets, creating subsidiaries or engaging in Joint ventures in Europe and Africa, but as this process is still in the beginning phase there is a lack of academic knowledge on motives for Chinese companies to invest in above mentioned markets. At the same time, we can observe rising Chinese economic presence in Central and Eastern Europe (CEE). Investment inflows are currently expected to increase further due to recent political developments, such as creating Belt and Road Initiative, while the intensity of trade has been growing too, especially with certain countries.

The primary purpose of my research is to analyze and identify factors that motivate Chinese companies to invest in Central and East Europe. In order to answer my research question I conducted a case study of two selected markets in Central and East Europe to formulate factors that motivate Chinese companies to invest in this region. This case study included case study analysis of investment law and policies, fiscal law and policies, labor market, macro and micro-economic and political situation, resource availability as well as other investment related issues. During the research I put my focus more on pull factors to determine what motivates companies to invest in CEE countries. In this specific case, I analyzed markets of Poland and Hungary,

respectfully.

My final conclusion would be that Chinese investments in this region are driven and motivated by economic interest, but they have political background and consequences on political developments even when the investment is not coming directly from the PRC government.

Keywords: FDI, China, CEE, Case Study, MNE

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I must express my very profound gratitude to my family and friends for providing me with unfailing support and continuous encouragement throughout my years of study in Indonesia.

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I. INTRODUCTION

1.1 Background of the research

Since the fall of the Bretton Woods system in the early 1970s credit (bonds and loans), investment and money now flow more freely across the world than commodities.

Outward foreign direct investment has been studied by many researchers in the last years, both to develop and developing countries. It is the dynamics and effects of the latter in the home country and the host country that has received the greatest attention. It is a fact, however, that these emerging countries are starting to become investors and they are growing at a fast rate. The trend is likely to continue growing and it is expected to change how we viewed the world until today.

The presence of BRIC countries has attracted a lot of interest and they are thought to have created 6% of the jobs in Europe in 2011, only behind Germany and the US.[1] Although Brazil appears to be a greater investor in the region, China's presence is becoming increasingly dominant in the last years. This is the reason why the issue has started to gain a greater interest in the scholar world.

Increasing globalization levels have led to a number of measures, such as lower trade barriers and higher international integration, which have created the institutional and economic conditions for a growth strategy of firms from developed and developing countries. This measures expended to government investment policies which created special investment programs for foreign investors.

Presence in foreign markets is an important growth tool for companies, especially in the case of limited home market. This may happen due to lack of domestic demand, when the market is too small or the industry is to narrow, or due to the maturity either from the firm's action or from the

[1] Ernst & Young (2011). Beyond Asia: Strategies to support the quest for growth. http://www.ey.com/Publication/vwLUAssets/Beyond_Asia:_strategies_to_support_the_quest_for_growth/$FILE/Beyond%20Asia.pdf (Accessed on: 14th April 2017)

competitors. Going abroad represents an opportunity for companies to reach new customers in a much larger extent, but they also must face challenges like different political and economic scenarios, new competitors, new laws and regulations, and different quality demands.

With the global economy growing bigger by the day and the world consequently shrinking, companies start to look outward from the comforts of their local saturated markets and head to new territories to be competitive. Today Multinational Enterprises (MNEs) around the world are becoming increasingly more common and some of them come from emerging markets such as China.

1.2 Problem identification

Of all developing economies, China is the highest investor worldwide according to data from the UNCTAD.[2] Its influence in developing economies has attracted the attention of many scholars since the phenomena started, but little study has been done in one of the most important regions of the world: the European Union.

Only three decades ago, China would have been considered as a poor, underdeveloped economy. However, China has today reached a central role in the world economy due to the modernizing effects of globalization[3]. China has achieved remarkable success in attracting foreign direct investment (FDI) since the earlier 1990s. It became the top recipient of FDI among the developing countries in 1993 and have today become the top recipient in the world, by reaching a new record of $105.7 billion in 2010.[4]

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[2] UNCTAD Report (2000). The Competitiveness Challenge: Transnational Corporations and Industrial Restructuring in Developing Countries

[3] ALAN, T. (2010) "Institutional Analysis and the Determinants of Chinese FDI". Multinational Business Review, Vol. 18, No. 3, pp. 1 – 24.

[4] UNCTAD (2007) Rising FDI Into China: The Facts Behind the Numbers [online] Available from: http://www.unctad.org. accessed on: 14.01.2016.

The Chinese outward foreign direct investment (OFDI) has risen 19 fold since 2000 following the Chinese governments launch of the ―go global policy, aimed at establishing the country‘s national champions as international players. This has resulted in a rapid growth of the Chinese business groups. The trend seems to continue as the Chinese investments abroad doubled in 2008 while the global foreign direct investment declined by 20 percent because of the world financial crisis.

The economic expansion of China is one of the most spectacular cases of today's global economy, where this Asian country is increasingly integrated through foreign direct investments (FDI) and rising trade flows. In the beginning Chinese companies have been building strong economic ties with Asia, Latin America and Africa where they were in search for markets and natural resources. Recently, developed economies of Europe and the United States also became their important targets, offering markets for Chinese products and assets Chinese companies are lacking.

As certain authors discuss, Chinese companies used to treat the region of CEE as a back door to European markets but recently their motivations have slightly expanded towards efficiency- and strategic asset seeking motives.[5]

This might be the case as recently many of CEE developed governmental bodies to support and facilitate future investment and adjusted their policies to ease inward investment. The crisis accelerated the Chinese companies' interest toward this region due to new opportunities for Chinese companies and increasing receptiveness from CEE side. Besides that, Central and Eastern Europe countries not only form a cooperative market, they also play a role in linking the European and Asian markets and help promote cooperation between the European Union and China. The rapidly growing cooperation between China and Central and Eastern Europe is expected to

[5] ANDREA ÉLTETŐ, ÁGNES SZUNOMÁR (2016). Chinese investment and trade – strengthening ties with Central and Eastern Europe. International Journal of Business and Management, Vol. IV(1), pp. 24-48., 10.20472/BM.2016.4.1.002

facilitate the construction of a Silk Road Economic Belt.[6] A detailed and objective assessment of the role Central and Eastern Europe will play in facilitating the construction of a Silk Road Economic Belt between China and Europe is of realistic significance. The "looking east" of CEE countries is intensifying and their wish to acquire more development opportunities from China is evident. CEE countries have unveiled measures aimed at enhancing cooperation with China and they are conducting frequent high-ranking exchanges. Even countries which previously had problems with China, such as the Czech Republic, are showing signs of improving bilateral relations. Relations between China and CEE countries are showing positive interaction, and Central and Eastern Europe is a new growth point for Sino-European cooperation.[7] Hungary and Serbia have also shown great interest in joining a Silk Road Economic Belt. Although there are a number of difficulties standing in the way of a rail link between China, Hungary and Serbia, efforts are being made to support the construction of a Silk Road Economic Belt in these and other European countries.

There are many challenges facing this Asian economy on her way to conquer Europe.

The shortage of goods on the return journeys leads to spikes in transportation. As the majority of trains from Europe to China have no goods to transport on their return journeys, it is usual for the empty containers to be sent back to China via sea transportation, which is a waste of both resources and capital.

Secondly, unhealthy competition has emanated from China's domestic logistics transportation mismanagement. To survive the competition, the various localities rely on the local governments to interfere in the market. Many provinces in central and western China have taken measures to

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[6] LIU ZUOKUI (2014), The Role of Central and Eastern Europe in the Building of Silk Road Economic Belt. China Institute for International Studies, http://www.ciis.org.cn/english/2014-09/18/content_7243192_2.htm, accessed on: 08.01.2016.

[7] Ibid

subsidize their respective logistics corridors to Europe. Although this is understandable, the excessively low prices offered by some provinces have seriously compromised the environment for fair competition and increased the subsidy burden on local governments concerned.

This has been influencing the trade in several ways. Since the various provinces have failed to unite they are competing against each other on price, which lead the foreign partners to lack of efficiency and putting high prices. The extra cost resulting from the foreign side, however, is borne by the Chinese side.[8]

The security situation in Eurasia is complex and the strategic and resources competition among powers is exceedingly tense. The political instabilities in region tend to have a negative impact on both the existing and proposed logistics corridors. With the crisis in Ukraine, the United States and Russia have intensified their rivalry, which has increased the risks in this area. Affected by the Ukrainian crisis, China's plan to invest in a deep water port in Crimea has almost evaporated and the earlier Ukrainian Logistics Center project by China is in flux.

These, among other factors, seem to be pushing China to pass from trade into higher level of economic activity such as direct investment into European region.

For this research I choose Poland and Hungary as two geographically and economically wise similar countries.

Since the beginning of the transition to a primarily market-based economies that took place in the early 1990s, Poland as well as Hungary have achieved a "very high" ranking on the Human Development Index, as well as gradually improving economic freedom. These two counties are democratic countries with an advanced high-income economy, a high quality of life and a very high standard of living. Poland is the sixth largest economy in the European Union and among the

[8] KLING, G., & WITZEL, U. (2011). The internationalization of Chinese companies: Firm characteristics, industry effects and corporate governance. Research in International Business and Finance, 25(3), pp 357–372

fastest rising economic states in the world. The country is the sole member nation of the European Union to have escaped a decline in GDP in the recent years. The country's most successful exports include machinery, furniture, food products, clothing, shoes and cosmetics. Poland's largest trading partner is Germany.

In 1991, these two countries became a member of the Visegrád Group and joined the North Atlantic Treaty Organization (NATO) alliance in 1999 along with the Czech Republic and Slovakia. Poles along with Hungarians then voted to join the European Union in a referendum in June 2003 and becoming full members on 1 May 2004. Both members of World Trade Organization, the Organization for Economic Co-operation and Development (OECD), European Economic Area, International Energy Agency, Council of Europe, Organization for Security and Co-operation in Europe, International Atomic Energy Agency, European Space Agency, G6, Council of the Baltic Sea States, Visegrád Group, Weimar Triangle and Schengen Agreement.

Both located in Central Europe, this countries have access to biggest European corridors.

Picture I.1 European Corridors Passing CEE

Source: ec.europa.eu/transport

The similarities between Poland and Hungary will allow us to see what influences Chinese companies to invest in this region. At the same time, differences in their state policies and several geographic characteristics will as well be crucial to conclude which factors specifically outweigh the bar on Chinese companies' decision making.

1.3 Research question

The primary purpose of my research is to identify and analyze factors that motivate Chinese companies to invest in Central and East Europe. More specifically, I tried to answer why Chinese companies, state or private, choose to invest in Poland and Hungary. In order to answer my research question I conducted a market case study of two selected Central and East European

countries, namely Poland and Hungary, to formulate factors that motivate Chinese companies to invest in this region. This case study will include case study analysis of investment law and policies, fiscal law and policies, labor market, macro and micro-economic and political situation, resource availability as well as other investment related issues. This study will as well include comparison of two already existing Chinese investment in this two countries. Moreover, I looked closely into the "One Belt One Road", also knowns as B&R Initiative, policy of Chinese government. I conducted this research starting from the hypothesis that pull factors that drive Chinese enterprises to invest in CEE region include more than just economic interest of China in this region. To withdraw conclusions, I tried to examine the pull factors in more comprehensive way and prove that there are more than economic reasons to invest.

Aim of my research is the fill in the gap in existing knowledge on Chinese investment in CEE region which lacks in explaining the motivation for investment in a more comprehensive way.

1.4 Theoretical framework

To approach this topic from the very beginning it is necessary to define first of all basics of international relations, economy and forms of investment. This terms will allow us to better understand further definitions and research flow in whole.

1.4.1 Liberalism and globalization

There are many definitions of International relations and a good deal of overlap between different theories but no consensus about what the term, 'International Relations', actually signifies. Its most obvious meaning is the analysis of relations between nations – more accurately, states, but this is the approach taken by realists and neo-realists and rejected or substantially qualified by exponents of competing perspectives, some of whom think the term 'global politics' or 'world politics' is a

better term for describing what the subject should study in the contemporary age.[9]

If we are talking about FDI and role of the state and MNCs in international relations, we need to turn to theory of liberalism in International relations.

In the light of this theory we can recognize multiple dominant actors in International relations. Unlike in realism, where the dominant actor is the sovereign state, liberalism includes non-state actors such as transnational corporations (TNCs), transnational classes and 'casino capitalists', international organizations such as the World Trade Organization (WTO), international non-governmental organizations (NGOs), new social movements including women's and ecological movements and international terrorist organizations.[10]

Theory of liberalism can also help us explain how economic and political interest can intertwine as liberalism looks on free trade as a peaceful tool of achieving national wealth because, according to the theory of comparative advantage, each economy would be materially better off than if it had been pursuing nationalism and self-sufficiency. Free trade would also break down the divisions between states and unite individuals everywhere in one community. Artificial barriers to commerce distorted perceptions and relations between individuals, thereby causing international tension. Free trade would expand the range of contacts and levels of understanding between the peoples of the world and encourage international friendship and understanding.[11]

For neo-liberals an open global market, where goods and services can pass freely across national boundaries, should be the objective of policy makers in all nation-states. This objectives will result in helping developing nations including them into the global marketplace where they can exploit their domestic advantage in cheap labour. This is the case in which we can recognize China's role

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[9] BURCHILL, SCOTT et al. (1965) Theories of international relations. Palgrave Macmillan, pp.12
[10] Ibid.
[11] Ibid.

in international trade and how this key principal brought China to its current place in global economy.

The globalization of the world economy has seen the spread of industries from developed to developing countries and vice-versa. TNCs are becoming increasingly adept at circumventing national borders in their search for labour, access to raw materials, new markets or R&D centres. The creation of new centres of production occurs wherever profit opportunities can be maximized because investment decisions are governed by absolute profitability. For liberals, this is nevertheless the best way of encouraging much-needed foreign investment in the developing world and establishing a trade profile for countries which might otherwise be excluded from world trade altogether.

The resulting increase in the power of transnational capital and the diminution of national economic sovereignty is perhaps the most dramatic realization of liberal economic ideas.

1.4.2 Defining capital

Number of theorists argues that the theory of capital is a basic question and the essence of political economy.[12] However, in economic theory, there is no single definition and explanation of the term “capital”.

Chances are, the word capital derives from the Latin word caput, meaning head, or from adjectives capitalist - chief. Although the wealth of some nations can really be expressed in livestock (heads, so maybe the English chattel emerged from caput). The word capital in modern sense first appeared in the Middle Ages with the expansion of commercial wealth and the emergence of financial loans. [13]

[12] DEWEY, D. (1965) Modern Capital Theory, Columbia University, pp.9
[13] Ibid.

Capital can be viewed in two ways: in terms of value and the real, physical sense. In developed market economies, these two aspects are inseparable, because modern economy functions only through capital value, which is equal to capitalized net yield. The capitalization rate is equal to the dividend rate. Accordingly, the value of equity V: V = D / r, where D is the annual net income (profit), and r capitalization rate.[14]

The process of capital evaluation takes place in the developed market economies daily. Evaluation takes place in the capital market, through the so-called effective exchange. There they are estimating the equity value of a company depending on the assessment of the annual net yield (D) funding and risk assessment. Since these are two subjective assessments, the value of capital fluctuates almost daily, even without any changes in real capital structure. Therefore it is justified to use the second approach to the concept of capital (real capital), which should show the real possibilities of the company to produce goods.

The ability to accumulate and invest, capital determines the production and overall the economic potential of an economy. The proportions of the distribution of the accumulation and consumption determine the possibilities of investment in a given period, and the establishment of these proportions is the key issue for intensity and dynamics of development, opportunities present and future consumption, and therefore in terms of development, this represents a social and political decision.

1.4.3 International Capital Flows

We can define international movement of capital as a transfer of real and financial funds from one country to another, without counter-transfer or no contra transfer for a certain time period of time,

[14] UNKOVIC, M. (2010) “Međunarodna ekonomija”, Univerzitet Singidunum, Beograd, pp .100-112

and in order to achieve economic and political interests of participants in the transfer. The more an economy imports and consumes on the basis of the use of foreign capital, in the future will need to export more and spend less, since it has to repay principal and earnings on foreign capital (1 + i), where i is the interest – profit or dividend. [15]

The economy of any country in the world cannot normally function unless it does not include the international movement of capital, both in use, and placement of capital. The liberalization of international capital movements increased world production, efficiency and competitiveness, and discourages speculators that harm the world economy.

International capital movement aligns the real and financial surpluses and deficits in some parts of the world economy.

Profits, interest, dividends, price and exchange rate significantly affects the motives of international investment. The company which holds the capital, while choosing the object it wishes to invest into, takes into the equation, usually, three indicators: profitability, liquidity and security.[16]

The efficiency of the capital market, rational investment and liquidity are essentially motives of international investment. Political, market and currency risks, especially illiquidity of the country, reduce capital inflows in that particular country. General view is that private equity is led by economic interest motives, and public capital on the basis of wider socio-political interests. Most of economic motives of private capital flows are to achieve high profit related to the level of growth rates in the country rank, followed by motives such as the expansion of the market lending, supply of raw materials, cheap labor, circumvent tariff barriers and many others. Capital goes to markets

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[15] UNKOVIC, M. (2010) “Međunarodna ekonomija”, Univerzitet Singidunum, Beograd, pp .120-127

[16] CANTWELL, J. (2014). “Revisiting international business theory: A capabilities-based theory of the MNE”, Journal of International Business Studies, 45(1), pp. 1–7

where taxes are lower, crime rate is on a low level (higher security and where the judiciary system is not corrupted. It is usual to expect if the foreign investment if a country has a strong legal system that guarantees property rights of foreign investors and creditors.

Investments are the basic fuel economic development. Foreign direct investment has a major role to play in the economic development of the host country. Over the years, foreign direct investment has helped the economies of the host countries to obtain a launching pad from where they can make further improvements. It has often been observed that the economically developing as well as underdeveloped countries are dependent on the economically developed countries for financial assistance that would help them to achieve some amount of economic stability. The economically developed countries, on their part, can help these countries financially by investing in these countries. This financial assistance can be channelized into various sectors of the economy. The channelization is normally done on the basis of the requirements of particular sectors.

It has been observed that the foreign direct investment has been able to improve the infrastructural condition of a country. There is ample scope of technological development of a country as well. The standard of living of the general public of the host country could be improved as a result of the foreign direct investment made in a country. The health sector of many a recipient country has been benefited by the foreign direct investment. Thus it may be said that foreign direct investment plays an important role in the overall economic and social development of a country.[17]

This trend has manifested itself in the last twenty years. Any form of foreign direct investment pumps in a lot of capital knowledge and technological resources into the economy of a country.

It should be noted that foreign capital can start development, but in the long run, the development must be led by domestic savings and investment, as foreign capital debt need to be returned.

[17] UNKOVIC, M. (2010) “Međunarodna ekonomija”, Univerzitet Singidunum, Beograd, pp .100-115

Foreign capital, if properly invested, has a positive effect on the basic economic indicators: economic growth, employment, inflation and balance of payments.[18]

1.4.4 Defining Foreign Investment

Newer theoretical explanation of Foreign Investment is based on the paradigm of "market imperfections". The global enterprise is seen as oligopolists who seeks to gain control of assets that is not available to competitive companies. These assets are largely of intangible nature (brand, authorship, knowledge) and allows differentiation of products that competitors cannot imitate. The existence of oligopolies with ownership advantage, not necessarily needs to include Foreign Investment.

Imperfections in the market helps to identify sectors in which the company is likely to expand its business locally or internationally, with access to global market. The company assumes that it has the necessary resources and knowledge for competing in the world of Foreign Investment. To successfully operate in foreign country company should have advantages over domestic companies.

Each national economy is entering into international economic relations across several forms of foreign economic transactions. These transactions can be very different and may refer to:

1. import and export of goods and services;
2. import and export of capital and money, as well as
3. certain unilateral transfers (economic aid, gifts).

Part of international funding, which is in the literature defined as "international capital flow" represents a transfer of real and financial resources between subjects in different countries, with

[18] UNKOVIC, M. (2010) “Međunarodna ekonomija”, Univerzitet Singidunum, Beograd, pp .127-141

countertransference deferred for a certain period, in order to achieve realization of economic and political interests of participants in the transfer.

The largest investors of international capitals are Multinational corporations, banks, states, stock exchange and investment funds. General differentiation on private and public capital that we find in literature almost always depends on capital exporter.

Private capital is placed by MNC's, banks and funds, while public is being invested by states, public funds and International Financial Institutions.

There are three forms of capital flow among countries:

1. Foreign Direct Investment
2. Foreign Portfolio Investment
3. Loans and Credits

Foreign Direct Investment represent type of investment where investor, a foreign entity, holds a possibility of control on the company in which he is investing in. In this case, it may include acquiring major shareholding rights that are allowed by investment law in respective country.[19]

Leaving aside the flow of loan capital, which was the dominant form of international capital flow after World War II, especially in developing countries, it is necessary to make a distinction between portfolio and direct investments because the difference between these two types of investment are often vague and it is difficult to draw a distinction between these two forms of foreign investment.

Portfolio Foreign Investment are the type of Foreign Investments where the foreign entity does not have intentions to acquire control on the local company, but only to achieve profit through stock market or other financial markets.

[19] HENNART, J.-F., (1997). "The Choice between mergers/acquisitions and joint ventures: the case of Japanese investors in the United States", Strategic Management Journal, pp.1–12.

As a basis for defining the difference between the portfolio and direct investments is the access to control and management of the company in which they invest.

If the investor on the basis of the investment in the company obtains the right of ownership, thus, the right to directly control and management the company, this investment is direct foreign investment. In contrast, if the investment does not provide the right of control and management of the company in which it is invested, then it is the case of portfolio investment.

Moreover, direct and portfolio equity investment can be accomplished in several ways:

1. By forming a company completely owned by foreign investor.
2. By forming a company in which foreign investor and his partner have sharing roles.
3. By recapitalization of the existing companies (increasing the volume of total capital and the acquisition of shareholders rights in the proportion that comes after recapitalization);
4. By conversion of receivable foreign loan to the investment in the share capital - Swap arrangements;
5. By purchasing equity stake in the company without its total increment ;
6. By purchasing of the entire domestic enterprises by foreign investors.

1.4.5 Foreign Direct Investment

We consider foreign investment as any form of one country's company investment in the company of another country. There are two categories of this type of investment: FDI (foreign direct investment) and portfolio investment. In this section we will focus on FDI only. The phenomenon of FDI can be viewed from two interrelated, but essentially different aspects: from the aspect of funding or macroeconomic aspect, and the aspect of industrial organization and microeconomic aspects.

From a macroeconomic point of view, FDI is a special form of capital flow beyond the boundaries

of the national economy, going from investors from the home country to the host country, and which are registered in the capital part of balance of payments. The significance of this flow of capital across the borders of the national economy is reflected in the increase of the capital stock in the host country, ie. the value of investments of the country of the investor in a specific company, which is controlled by foreign investors or in which foreign investor owns a percentage of voting rights. Microeconomic aspect is observed through explaining the motivation for undertaking direct investments abroad in terms of investors. Motives and consequences are essentially linked with controlling the affiliates of foreign investors and multinational corporation's capabilities to coordinate the activities of the parent companies and its affiliates abroad.

Definition of FDI, which is still in force, given by the International Monetary Fund (1993) and approved by the OECD (1996), ignores the idea of control in favor of a more unspecified concept. "Direct investment is the category of international investment that reflects the objective of a resident entity in one economy obtaining a lasting interest in an enterprise resident in another country (FDI enterprise or affiliate enterprise or foreign affiliation)." [20]

The realization of long-term interest indicates the existence of a long-term relationship, cooperation between the direct investor and the company affiliates, as well as significant degree of influence of investors on the management of the company which is a resident of another economy.

Such investments include both the initial transaction between the two entities, as well as all other transactions between them and among themselves over which affiliates have been established corporate governance concerns, but also those which are not under the control of the particular parent company.

[20] OSHRY, B (2006), Trade, FDI, and the Organization of Firms, Journal of Economic Literature, Volume 44, Number 3, pp. 589-630(42)

Although the FDI as a relative term, its practical application is more specific. "The company in which has been invested directly is defined as a stock or non-stock enterprise where foreign investor owns 10 or more percent of the ordinary shares or voting rights of the joint-stock company or equivalent in an appropriate non-stock company ....placed requirement of possession of at least 10% of the shares of the company gives investor the right to manage or participate in the management of the company, but is does not give one hundred percent (absolute) control to the foreign direct investor."

In recent years, the Ministry of Commerce of the United States has accepted definition of FDI approved by the IMF and the criterion of 10% as the limit for the control of assets.

However, the term person is defined broadly to include various types of organizations or even the combined group. The last category consists of "two or more persons exercising their voting privileges on a consensual way - exercising activities under the agreement or arrangement - with the aim of exercising influence over the company management."

1.4.6 Different types of FDI

Foreign direct investment are usually differentiated through a discussion that takes place on equity:

1. Greenfield ,
2. Acquisition and
3. Joint venture

and non-equity-based:

1. Export and
2. Alliance

modes of entry [21]

As cross-border trade and investment flows increase, firms are forced to strategize on how best to serve foreign markets, but at the same time markets are pushed to adjust to foreign investment. The level of control in non-equity-based methods of serving foreign markets are, therefore, typically much lower than equity-based approaches. As previously expounded upon, according to the internalisation theory, the relative fixed and variable costs experienced by firms when serving a foreign market will be internalised by the firm depending on the relative stage of product market development.[22] In this thesis the main focuse will be primarily Chinese equity-based FDI.

Greenfield investment is best defined as an investment strategy of building a new establishment while the acquisition mode of entry entails purchasing a pre-existing company[23]. The idea of joint ventures indicates that an organisation is owned by more than one firm. Joint ventures are seen to be advantageous over wholly owned ventures when local resources are not equally accessible to all firms or assets within an acquired firm are 'indigestible'.[24] Many forms of foreign investment are conduct through Joint Ventures. Joint Ventures in that sense can appear as investment of:

1. One or more foreign investors and one or more local investors or natural parties.
2. One or more foreign investors or/and naturals parties without local partners.

We define Contractual Joint Venture as a type of investment where the foreign investor, similar to Contractual Investment, does not acquires shareholder right in the company that he invested in.

As already mentioned, there are two main forms of international flows of investment capital: FPI

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[21] CANABAL, A., & WHITE, G. O. (2008). Entry mode research: Past and future. International Business Review, 17(3), pp.267–284. doi:10.1016/j.ibusrev.2008.01.003

[22] BLONINGEN, B. a. (2005). A Review of the Empirical Literature on FDI Determinants. Atlantic Economic Journal, 33(4), pp.383–403. Retrieved from http://link.springer.com/10.1007/s11293-005-2868-9

[23] Ibid

[24] SLANGEN, A., & HENNART, J.-F. (2007). Greenfield or acquisition entry: A review of the empirical foreign establishment mode literature. Journal of International Management, 13(4), pp. 403–429.

(Foreign Portfolio Investment) and FDI (Foreign Direct Investment), wherein the difference between them is based on the control and management functions. FPI implies investing capital in property, while the control functions are transferred to the managers. FDI refers to integrated functions of ownership, management and control that are in the hands of investors.[25] Consequently, due to the problem of mediation between managers and owners, project portfolio investments are managed less efficiently than direct project investment. More specifically, direct investors, who act as managers of their own projects, are more informed than portfolio investors in terms of changes in prospects of their projects. This information will allow them to more effectively manage their projects.

According to the investor country origin and the investment country destination, FDI can be divided into:

• Inward FDI or FDI in the observed economy, i.e. investments of foreigners in the company in the respective industry / country;

• Outward FDI or investments of resident companies abroad.

Inward FDI are counted as inflow of the capital in a country and outward FDI as outflow of capital from one country. In FDI we include: initial and subsequent investments by direct investors, in the form of equity, loans or reinvested earnings. When defining FDI we can also include investments of branches that belong to direct investor.

Regardless of the mode of entry, FDI is seen, on the whole, to provide myriad benefits to the both economies. Benefits may vary depending on the strategic intent of the investing foreign firm, but are generally seen to be increased employment, increased competition and positive knowledge

[25] ANDERSON-III, JOHN,ROBERT (2014) Foreign direct investment from China to developed economies: do extant conceptual and policy frameworks explain the cross-border investment behaviour of Chinese MNEs?, Durham theses, Durham University.

spillovers which culminate in economic growth for the host and country from which the investment is coming.[26]

1.4.7 Traditional Internationalization Theory

According to traditional theories firms internationalize when they reach competitive advantage that allows them to make enough revenue to cover the costs and risks of expanding abroad.[27] Dunning uses the Eclectic Paradigm to explain the reasons behind why firms choose to internationalize. The model is based on the belief that a firm is required to have advantages within the OLI-factors **ownership, location and internationalization** in order to make direct investment beneficial in a foreign country.[28] The author explains that a company engages in international production when three inter-related conditions, so called OLI factors, are present. Firstly, ownership advantages in the form of superior proprietary resources or managerial capabilities. These are firm specific factors that give firms competitive advantages in a foreign country.

Ownership advantage refers to some firm-specific assets or resources that are exclusively owned by a company.[29] According to Dunning, these assets could be intangible assets such as brand name, good reputation, technology or tangible assets such as technology, financial resources, marketing and advanced production processes. Ownership advantages are the core competences of the corporation. The greater the competitive advantage of the investing firms, the more they are likely to engage in foreign production.

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[26] BOBONIS, G. J., & Shatz, H. J. (2007). Agglomeration, Adjustment, and State Policies in the Location of Foreign Direct Investment in the United States. The Review of Economics and Statistics, 89(1), pp.30–43.
[27] BUCKLEY, P.J. and GHAURI, P.N. (1999) The Internationalization of the Firm: A reader, 2nd edition. London: International Thomson Business Press.
[28] Dunning, J.H. (2001) The Eclectic (OLI) Paradigm on International Production: Past, Present and Future. International Journal of the Economies of Business, Vol. 8, No. 2, pp. 173-190.
[29] Ibid

Secondly, location advantages in foreign countries which give company new opportunities to access markets with higher potential and to establish low-cost production facilitates. Location advantage determines which country will be chosen for an investment. Location advantages can be the factors such as the availability of natural resources, labor cost, transportation cost, cultural closeness, investment incentive policies and taxes, market size and growth potential, etc. These factors evaluate the potential cost and difficulties to operate in a foreign country.

Lastly, internationalization advantages can be achieved if the company can reduce transaction costs by investing abroad. A way to do that is to undertake transformation or supporting processes more effectively than it can be achieved through market transactions. Hennart explains that the reasons for the rise of multinational enterprises are due to the advantages offered by internationalization. Firms can achieve efficiency advantages through factors such as know-how, reputation, the value chain, and marketing.[30]

The internalization advantage determines what mode of entry the firm uses to penetrate the foreign market. It helps a company to decide if to exploit its ownership advantages internally or license them to another company. Furthermore, "by internalizing the firms will be able to exert more control over its operations and reduce the risks associated with property rights, brand image."[31] The specific characteristics of the transferred knowledge and the transfer cost are determinant elements for the company's strategy. Without internalization advantage, FDI would be replaced by other forms of international contracts such as export or license.

The table below is Dunning's summation of factors that determine OLI advantages in relation to a firm's motivation.

[30] HENNART, J.F. (2001), Theories of Multinational Enterprise', in A.M. Rugman and T.L. Brewer (eds.) The Oxford Handbook of International Business, pp. 127–149.
[31] DUNNING, J.H. (2001) The Eclectic (OLI) Paradigm on International Production: Past, Present and Future. International Journal of the Economies of Business, Vol. 8, No. 2, pp. 173-190.

Table I.1 Dunning's OLI advantages

Types of motivation	O advantages	L advantages	I advantages	Strategic goals of MNCs
Natural Resource Seeking (RS)	• Capital • Technology • Access to markets • Complementary assets • Size & bargaining strengths	• Possession of natural resources • Transport & communication infrastructure • Tax & other incentives	• Ensuring stabilities of supplies at right price • Market control	• To gain privileged access to resources vis-à-vis competitors
Market Seeking (MS)	• Capital • Technology • Management & organisation skills • Surplus R&D and other capacity • Economies of scale • Ability to generate brand loyalty	• Material & labour cost • Market size & characteristics • Government policy (e.g. with respect to regulations & import controls, investment incentives, etc.)	• A reduction in transaction costs • Buyer ignorance or uncertainty • To protect property rights	• To protect existing markets • To counter act behaviour of competitors • To preclude rivals or potential rivals from entering new market
Efficiency Seeking (ES)	• As for MS, as well as • Access to markets • Economies of scope and • Geographical diversification and/or clustering • International sources of inputs	• Low labour costs • Incentives to local production by host governments • A favourable business environment	• As for MS, as well as • The economies of common governance and • The economies of vertical & horizontal diversification	• To contribute to regional/or global product rationalisation and/or to gain process specialisation
Strategic Asset Seeking (SAS)	• Any of first three that offer opportunities for synergy with existing assets	• Any of the first three that offer technology, organisational and/or other asset in which firm is deficient	• Economies of common governance • Improved competitive or strategic advantages • Reduction in, or spread of risks	• To gain new product markets

Source: DUNNING, J.H. (2001) The Eclectic (OLI) Paradigm on International Production: Past, Present and Future. International Journal of the Economies of Business

Later in the research this table will be used as a tool to determine specific factors which push Chinese companies to invest in the CEE region.

Traditional Internalization Theory as well explains the terms of "push and pull" factors in

investment decision making. What is ‘pushing’ firms to internationalize is usually institutions and trends in domestic market, while home country promotional efforts ‘pull’ firms across borders. Push factors in the case of China, for example, ‘such as weak intellectual property rights (IPR) and inefficient legal frameworks discourage Chinese firms from pursuing R&D and innovation in China. Unable to domestically develop technology, they use OFDI as an alternative to acquire strategic resources not easily developed in China.[32] Furthermore, pull factors are described ad factors that attract the investor towards countries to invest. Push factors, on the other hand, are unfavorable factors in the home state of the investor that repel the investor from that country. Thus, push factors have the force to push the investor to opt for a favorable condition to invest in. Therefore, the investor will go to abroad to invest.

The following may be the pull factors for investors to invest in a developing country:

1. Market pull factors, among others include preferential tax treatment compared to a similar product originating from another region. For example, a product originates from Europe will get a preferential tax treatment in the same region than a similar product that originated from China. Market pull factors are the most important determinants of FDI especially in host economies.
2. Resources
3. Policy framework
4. Political and economic stability [33]

Although push factors make a great impact on investment decision making, in this research I looked closely into pull factors that motivate Chinese companies to invest.

[32] BOISOT, M. (2004) Notes on the internationalization of Chinese firms. Unpublished paper, Open University of Catalonia
[33] Ibid.

1.4.8 Rationale for Chinese Firms Internationalization

The main reason for Chinese firms going global is often to acquire **advanced technology and research and development** (R&D) capabilities and through this reach differentiation advantages. Some companies also have the need to develop global brands to secure their brand advantages. According to Nolan, when compared to firms from developed countries China is still weak in the competition although the country has had two decades of reform.[34]

Many Chinese companies decide to invest outside of Chinese boarders to avoid disadvantages that occur in the domestic market and not because of the use of a competitive advantage developed in the domestic market.[35] Boisot discuss other disadvantages of the domestic conditions, such as limitations to exploits economies of scale because of **regional protectionism** and prevention of investment in plants of optimal scale because of limited access to capital.[36] Other disadvantages in the domestic conditions are limitations of innovative technologies due to lack of developed intellectual property rights and not enough intervention taken to receive access to skilled human resources. Besides that, one of the main obstacles in the domestic market is increased transport costs due to poor local infrastructure, and regional markets that are fragmented by provincial and communal protectionism.

Previously, in above subchapter, we discussed some of the push factors that motivate Chinese companies to internationalize and invest abroad. Nevertheless, main focus of the following research will be pull factors that influence Chinese companies to invest in CEE countries.

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[34] NOLAN, P. (2001) China and the Global Economy. Basingstoke, UK: Palgrave MacMillan.

[35] CHILD, J. and RODRIGUES, S.B. (2005) The internationalization of Chinese firms: A Case for Theoretical Extensions?. Management and Organization Review, Vol. 1, No. 3, pp. 381-410.

[36] BOISOT, M. (2004) Notes on the internationalization of Chinese firms. Unpublished paper, Open University of Catalonia

1.5 Methodology

1.5.1 Choice of methodology

The choice of methodology is influenced by the research purpose and the research question. Choosing a suitable methodology greatly depends on the purpose of the research and the research question. As stated above the aim of this study is to determine the factors of Chinese economic presence in CEE countries focusing on investment and to fill in the gap in existing knowledge on Chinese investment in CEE region which lacks in explaining the connection between political and economic interest behind companies' FDI.

To answer the questions raised in this study, I intend to develop several phases of qualitative research. To conduct this study I choose qualitative method as main method of data collection would be case study.

The methodology chosen when writing this thesis is qualitative approach. The purpose of qualitative approach is to increase the understanding of the phenomenon and reveal new theoretical perspectives. Within the qualitative methodology, case study approach was taken. Case study allows combination of qualitative and quantitative evidence, and the data collection is not limited to a specific data collection method. John W. Creswell defines a qualitative research as follows: "*qualitative research begins with assumptions and the use of interpretive/theoretical frameworks that inform the study of research problems addressing the meaning individuals or groups ascribe to a social or human problem.*"[37]

The method also gives me the opportunity to present a theoretical analysis, statistical data to investigate which market characteristic are crucial during investment period.

As noticed by Pakpahan, qualitative research allows us to use sense of logic and give us the ability

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[37] CRESWELL, J.W. (2013) Research Design, SAGE publication 2nd edition

to recognize diversity as well as regularity, which is of crucial importance while researching dynamic categories as FDI.[38]

In the first phase I explained the background of my research, including the economic interest of both sides, introducing the aspects of existing market and exploring potential chances of expending business to CEE markets. This study will as well cover theoretical concept of Investment in general, Foreign Direct Investment and its variations. Following I gathered all the research available on investments of Chinese companies in Europe and related subjects and structuring it properly. Moreover, literature review will provide a complete platform to continue to phase two of the research process that incudes reading and analyzing all the research material gathered for this paper and formulating propositions. Above mentioned proposition of influencing factors will be formulated according to the data collected by analyzing investment climate in several European countries such as tax policies, labor policies, demographic data and investment incentives for foreign investors.

In the second phase, a comparative case study of Polish and Hungarian market will be conducted including the analysis of two already existing Chinese companies in these countries. This case study will be conducted within the OLI-factors (ownership, location and internationalization) to finally determine the factors that influence China to invest in this region and is there a connection between economic and political interest.

1.5.2 Data collection

The two main data sources used in the thesis are UNCTAD and MOFCOM. UNCTAD compiles data from national and international sources such as IMF and OECD when national data is not

[38] Ibid.

obtainable. UNCTAD is known as an accurate and reliable source, it reports figures that more comprehensively cover Chinese outward FDI flows. MOFCOM as a national source from Chinese official reports, is the most consistently used statistical evidence in academic research on China's FDI activity. However, before 2002, the data provides by MOFCOM was on an approval basis. Underestimation of the actual OFDI volumes might occur based on enterprises escaping the formal approval process. From 2003, the data from MOFCOM was based on a balance-of-payments basis, which is more accurate and reliable.

Secondly, data for comparative market analysis will be retrieved from official governmental bodies of CEE countries. Mainly investment agencies and relevant ministerial institutions.

Finally, to cross-check findings I observed behavior of existing Chinese companies in Poland and Hungary.

These strategies will be used to answer and conduct analysis on the research question.

1.6 Chapter Plan

The structure of this research will be divided into five chapters. The first chapter will cover introduction of the research and theoretical framework including definition of International relations, actors and foreign investment in general. Further, this chapter will cover different types of FDI following traditional internationalization theory and rationale for Chinese firms' internationalization.

This chapter will as well further explain methodology of the research and research methods.

Second chapter will cover literature review and introduce previous finding on the research topic.

In the Chapter 3 I presented an overview of Chinese OFDI Globally including the historic development of Chinese investment. Following I provided an outline of Chinese presence in countries of European Union and complete analysis of Chinese Outward FDI in selected countries.

Moreover, in the same section I focused specifically on EU investment policies and historical development of EU regulations on this matter. Bilateral Cooperation and contracts signed between China and EU will as well be analyzed in this section.

Chapter 4 will be the main focus of the paper as in this part of the paper the research question will be answered. After an overview of CEE countries and historic development of Chinese investment in CEE region, I conducted a case study analysis of markets and government policies in Poland and Hungary. This analysis will include a comparison through OLI Eclectic paradigm.

Finally, in Chapter 5, I concluded my research and present research findings.