Bachelor research proposal:
Analysis of increasing Chinese outward foreign direct investment in Germany – Are the motives changing over the course of time?

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Introduction
A recent OECD (2012a) report predicts China to surpass the US by 2016 as the largest economy in the world. Numerous studies in the past addressed the emergence of this developing Asian nation and have studied foreign direct investment (FDI) flows from developed into developing economies, such as China. With the rising importance of the Chinese economy, beginning in the 1990s the academic focus increasingly shifted to the phenomenon of outward FDI (OFDI) flows from developing countries into industrialized nations. Notably, OFDI from China into the Western world received considerable attention. Studies with a regional focus, such as Chinese OFDI in Europe, emerged and focused on particularities of regional bonded factors that attract Chinese FDI (see, for example, Schüler-Zhou, Schüller and Brod 2011, in Alon, Fetscherin and Gugler 2011). Germany as the leading export nation in Europe with large FDI flows to China has also attracted the largest share of Chinese OFDI flows to Europe in recent years. This phenomenon reached new heights in Germany in 2012. Considerable media attention evolved around the Chinese acquisition of one of Germany’s ‘hidden champions’, the Putzmeister Holding GmbH, a concrete pumps manufacturer, and the Chinese acquisition of stakes in the well-known Kion Group GmbH and Kion’s hydraulics business branch, a manufacturer of materials handling equipment. The significant increase in Chinese FDI flows leads to the question how sustainable these foreign direct investments are for the national economy of Germany. It further raises the concern of more exploitive FDI in high technology industries. Therefore, a central question is whether today’s Chinese investments in Germany are differently motivated than those of the past. The research may find that the primary motives remain strategic-asset seeking for Chinese FDI. The underlying motives, however, are presumed to have changed. In particular, institutional factors in both countries are likely to have altered the motivation behind foreign investments. Further, domestic market factors seem to play an increasingly important role for Chinese firms to pursue internationalization strategies and promote market-seeking FDI. This in part, might explain the increasing focus on exploiting or gaining firm-specific advantages by market-and asset-seeking investments in high developed industrial sectors, such as the automotive, industrial, machinery and equipment sector in Germany.

Research objective
Until today, only a limited number of studies and researchers have turned their attention to the topic of the recent significant increase of Chinese OFDI flows into the German economy. An in-depth analysis of the motives that Chinese firms pursue when conducting FDI in Germany, which may be both country and
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industry specific, is necessary. In particular the question whether motives for Chinese investments in Germany have changed over time needs to be investigated. This research will especially focus on institutional, market-specific and firm-specific factors that influence internationalization strategies as well as location decisions for OFDI. Potential differences or similarities of the drivers for FDI at certain points in time might subsequently help to explain the noticeable increase in Chinese OFDI.

The study of the motives behind Chinese OFDI shall be based on four in-depth interviews of firm representatives from four different Chinese acquired companies in Germany. Companies shall be chosen within one industry to allow for a meaningful comparison and analysis of the answers provided. Two firms shall be selected which entered Germany between the years 2002-2004 and two firms which entered the German market in 2012.

**Empirical background**

Quantifying Chinese FDI flows to Europe and in particular to Germany are challenging for researchers in this field. Incomplete databases (e.g. OECD, EUROSTAT) and wide discrepancies, resulting from data collection problems and varying statistical methodologies, make it difficult to assess the entire scope of Chinese OFDI. Schüler-Zhou and Schüller (2009) highlight the need of a careful interpretation of official Chinese FDI data due to Chinese deficiencies of statistical systems. Therefore, Chinese official statistics may be used to explain broader patterns, but must be complemented by additional data from other sources. Beugelsdijk, Hennart, Slangen and Smeets (2010) point out a problem with FDI stocks by indicating a potentially large mismatch between FDI stocks and actual multinational enterprise (MNE) affiliate activities in host countries. It is argued that FDI stocks might not show the real value-adding MNE affiliate activity and that locally raised external funds and labor productivity may also have an impact on the value-adding activity (Beugelsdijk et al. 2010). According to Beugelsdijk and colleagues (2010) this might result in under- and overestimation, when measuring the value-adding activities of MNEs based on FDI stocks. Consequently, aggregated FDI data may not accurately reflect Chinese MNE value-adding activities.

Starting from the 1990s, China’s worldwide OFDI flows were almost insignificant with around USD 800 million, but have risen at a tremendous pace since then (UNCTAD WIR 2009). After joining the World Trade Organization (WTO) in 2001, Chinese OFDI flows rose from USD 2.8 billion in 2003 to over USD 48 billion in 2009 (UNCTAD WIR 2009, 2010). The EU has also seen a significant increase in Chinese OFDI flows, increasing from just USD 190 million in 2005 to nearly USD 6 billion in 2010 (MOFCOM 2010).
On a country level, China is Germany’s most important trade partner outside the European Union, and the third most important worldwide with exports to China worth EUR 64.8 (USD 84.9) billion in 2011 (German Embassy to China 2012). Conversely, Germany is China’s largest trading partner in the EU, accounting for around one-third of China’s total trade with EU countries and its fourth largest trade partner in the world (excluding Hong Kong). Imports from China to Germany were worth EUR 79.4 (USD 104) billion in 2011, underpinning the importance of bilateral trade between the two countries. The reciprocal FDI stock, however, reveals a large gap. The German FDI stock in China accumulates to EUR 26.6 (USD 34.9) billion and Chinese FDI stock in Germany to only around EUR 0.83 (USD 1.1) billion in 2010 (German Embassy to China 2012). Yet, a clear upward trend can be seen with respect to Chinese OFDI in Germany, which since 2010 has attracted the largest amount of inward FDI flows in Europe, with USD 412 million in 2010. OECD (2012b) data indicates that the Chinese FDI stock in Germany more than doubled during the period of 2006 to 2009, in spite of the financial and Euro crisis.

China’s growing outward FDI flows can be looked at from another aspect, by dividing FDI activities into Greenfield investments and M&As, with a focus here on the latter one. Cross-border M&As have progressively become China’s predominant investment vehicle throughout the world, especially among state owned enterprises (SOEs) investing abroad (OECD 2008). The premier targeted industry in Germany has been the high-end market machine building industry, also promoted through the Chinese Government ‘Go Out Policy’ (Federal Foreign Office 2012). Based on the Thomson One Banker (2012) database, illustrated in Figure 1 below, there has been a significant upward trend in the number of M&As in Europe and a rise in the number of deals in Germany. Though, the 2007/2008 crisis seemed to have had an impact in Germany, hampering the M&A activity of Chinese firms. However, the size of the acquisition deals of Kion Group GmbH and Putzmeister Holding GmbH in 2012, with a deal value of alone USD 876 million and USD 474 million respectively, supports the increasing interest of Chinese companies in German firms (Financial Times 2012). With rising OFDI flows to Germany, the motives for Chinese OFDI with alone 15 out of the 53 EU wide acquisitions occurring in Germany in 2012, need to be looked into even more closely.
The subject of foreign direct investment is a well-studied field in the epistemic IB community. A multitude of studies have been conducted on the internationalization of firms predominately from industrialized countries in the past. These traditional explanations, thus, incorporate mainly a Western perspective. Other works extended the traditional FDI theory, trying to elaborate on the drivers of FDI from emerging countries, in particular China.

**Traditional FDI theory**

Dunning (1977, cited in Wei, Alon and Ni 2011) developed a concept of ownership, localization, and internalization (OLI) advantages, known as the Eclectic Paradigm Theory. It describes the advantages that lead companies to undertake FDI. Ownership specific advantages are unique capabilities and know-how that companies possess prior to the expansion, but can then be applied in a foreign country. Resource endowments and factor costs found abroad can be regarded as location-specific advantages when utilized. Internalization advantages are given if a firm’s own production in a foreign nation is more advantageous than for instance licensing, due to a need of a high degree of control or in order to hold on to competitive advantages that may result from managerial or technical know-how. The theory predicts companies that can positively apply these three factors to pursue FDI. Dunning (1998, cited in Wei et al. 2011) identifies four further FDI drivers: resource-, market-, efficiency-, and strategic asset-seeking motives. Another traditional FDI theory, set forth by Johanson and Vahlne (1977), claims that the internationalization
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process by firms occurs in gradual and incremental steps, by which firms gain ‘experiential knowledge’. The knowledge developed by these firms is country-specific and is used to reduce a concept referred to as ‘psychic distance’.


Theoretical extension and new concepts for Chinese OFDI

The adequacy of Dunning’s OLI paradigm to explain developing country OFDI is disputed. Lecraw (1993, cited in Buckley, Cross, Tan, Xin and Voss 2008) raised two important questions. Firstly, which underlying competitive advantages can firms from developing countries use in order to compete internationally? Secondly, what influences these firms in the decision processes of choosing an investment location?

Buckley, Clegg and Cross (2007) claim that capital market imperfections, special ownership advantages of Chinese companies and institutional factors might be seen as a special theoretical dimension of Chinese OFDI. Buckley and colleagues (2007) suggest that the institutional environment has had a strong impact on Chinese OFDI, promoting natural resource-seeking FDI and find further that strategic-asset seeking was no major driver for Chinese OFDI prior to 2001.

Based on secondary literature Buckley, Cross, Tan, Xin and Voss (2008) develop a standard model of developing country OFDI. Testing then aggregate level data from official Chinese statistics between 1991 and 2005, they find that only two of their theoretical explanations hold true for Chinese OFDI. Special ownership advantages of Chinese firms (‘home country embeddedness’), more specific Chinese firms’ financial advantages and the importance of home government are identified. Subsequently, Dunning’s four basic FDI motives and government involvement were tested for historic and emergent trends of Chinese OFDI. It was found that government involvement had decreased over time due to a more liberal policy by the Chinese government with regard to FDI. Further, it was discovered that initial market seeking-strategies supporting the export function of Chinese firms, developed to “defensive, import-substituting and quota-hopping FDI” and to “offensive, to develop new markets FDI”. Additionally, the erstwhile strategic asset-seeking FDI to “obtain information and foreign market knowledge”, emerged as strategic asset-seeking FDI to “obtain foreign technology and brands and to access foreign distribution channels and capital markets” (Buckley et al. 2008).

Child and Rodrigues (2005) assert that “while mainstream theory tends to assume that firms internationalize to exploit competitive advantages, Chinese firms are generally making such investments
in order to address competitive disadvantages”. This goes with the latecomer theory and catch up strategy, allowing firms to close the competitive gap in the world market (Child and Rodrigues 2005). Thus, in contrast to a firm’s exploitation of prior proprietary, firm-specific advantages through internationalization, Child and Rodrigues (2005) see Chinese OFDI as a mean to improve competiveness and overcome competitive disadvantages, resulting from sole operations in the domestic market. Findings that show motives for Chinese cross-border M&As to lie primarily in market development and to be asset-seeking, and subsequently to create value for Chinese firms, support this argument (Wei et al. 2011).

Schüler-Zhou, Schüller and Brod (2011) investigate the push and pull factors for Chinese OFDI in Europe. They highlight the significance of the Chinese pursued government policy which has a major impact on the industries that are to be targeted by Chinese firms. Through a questionnaire-based survey sent to 92 investment promoting agencies (IPAs), Schüler-Zhou and colleagues (2011) show that most Western EU, in contrast to Eastern EU, countries provide no special incentives for Chinese firms to invest. Liu and Tian (2008) find based on an analysis of 20 questionnaire responses from Chinese companies in the UK that these firms apply leapfrog strategies, using M&As in industrialized nations, as part of their catch up strategy. They stress, however, the demand of long-term commitment and large capital resource by these firms. Drawing on interviews with three manufacturer firms in the US, Germany and Sweden, Wu, Ding and Shi (2011, cited in Alon, Fetscherin and Gugler 2011) conclude that even as asset-and market-seeking motives were predominantly shared by all three companies, firms pursued different strategies. They further point out that Chinese manufacturer firms’ FDI is motivated by the aim of enhancing their brand reputation in the domestic market.

**Conclusion and implications**

Traditional FDI theories fail to explain the entire scope of FDI drivers and investment patterns of Chinese companies. More than in the traditional theory of FDI the institutional component of Chinese OFDI seems to play an important role in making investment decisions and seemingly less so the own firm-specific advantages. The latecomer theory and catch-up strategies through M&As and strategic asset-seeking investments, challenge the incremental development of country-specific knowledge as proposed by Johanson and Vahlne. Moreover, the research by Buckley and colleagues (2008) indicates that motives for Chinese OFDI might change over the course of time and may not stay consistent. This might as result provide a crucial point of departure in the explanation of increasing OFDI flows to Germany. It is hereby worth emphasizing, that even within the same motive of strategic asset-seeking FDI, the underlying
pursued goals might considerably change over time. The different impact and weight of institutional constraints, the domestic industrial environment and the thus far as less significantly seen resource-based view of the firm, may lead to different FDI motives over time.

**Proposed research design**

The research project shall examine if the key motives for Chinese OFDI in Germany have changed over time and explain the rise of OFDI in recent years. The initial scope of the research objective thus comprises all foreign direct investments conducted by Chinese firms in the past and present in Germany. Due to the size and infeasibility of such a research framework and especially under considerations of the constraints laid down by a Bachelor thesis the research objects need to be limited.

Firstly, the study shall be limited to the automotive, industrial, machinery and equipment sector in Germany. This industry is strongly export oriented and among the primary targeted industries of Chinese OFDI and thus can provide sufficient evidence. Secondly, the research is limited to the FDI entry mode of Chinese M&A. M&As are the predominate entry vehicles for Chinese OFDI in the world, and in particular in view of industries of high developed countries. Further, this type of FDI is well observable, allowing to acquire information more easily from databases (e.g. Thomson ONE Banker, Dealogic), official government organizations (e.g. chamber of commerce) and media reports.

Finally, the study shall focus on only two periods in time in order to analyze past and present motives for OFDI in Germany. The years 2002-2004 are chosen to identify past motives. The years are selected in such a way to fall after the start of the investment promoting ‘Go Out Policy’ of the Chinese government (1999) and the accession to the WTO in 2001. This ensures equal determining factors for the two periods chosen. The year 2012 presents the time period analyzed for the present motives. The first time period is deliberately chosen to embrace a longer time range in order to account for the low number of M&As and thus ensure enough research objects to be included in the study. At least 5 research objects in the time period of 2002-2004 and 13 research objects in 2012 can be identified. A cross check of these results with other databases will be required and will likely reveal more cases, as potential acquisition with unknown status are excluded.

Studies in the past applied aggregate national level data, especially FDI flows and stocks (e.g. Buckley, Clegg, and Cross 2007), survey-based data (e.g. Schüler-Zhou, Schüller and Brod 2011) or case studies (e.g. Wu, Ding and Shi 2011) to explain the phenomenon. The former method tries to explain broader OFDI patterns at a macro level and is therefore not suitable for analyzing motives at the firm (micro) level. The
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survey-based data method requires a relatively large number of firms to be surveyed, especially in view of low expected response rates. Moreover, with regard to the strategically important and sensitive research questions of this proposal, answers given in a survey are more likely to provide only superficial motives for Chinese OFDI.

Due to the relatively new phenomenon of Chinese OFDI in Germany and the limited number of Chinese M&As, this study, thus, shall adopt an exploratory case study method. It allows for a qualitative analysis of a small number of cases and a judgment sampling selection method which conforms to the criteria laid down concerning the industry sector, FDI entry mode and the time frame to be analyzed.

For the purpose of this study four semi-structured interviews will be conducted. Two representatives of companies acquired in each of the two time periods 2002-2004 and 2012 will be asked to participate in face-to-face interviews. A larger number of requests will be sent out in order to increase the likelihood to find qualified interview participants. High representatives, in particular local managers that can provide information about the motives behind the acquisition of the German companies, will be targeted for interviews. All companies will be given the possibility to be treated confidentially and referred to under code names in the final research paper, due to the sensitive nature of the questions asked.

The advantage of a semi-constructed face-to-face interview is the possibility to structure questions around potential motives identified through the literature review. These questions will consider the following motives for Chinese OFDI in Germany: a) firm- b) industry- and c) institution-level factors. An example of a question asked, could be as follows: *Was the position of your firm in the Chinese domestic market considered as a motive to pursue FDI? If yes, please elaborate on the reasons.* The structured approach allows for comparable results between the four different case companies. Moreover, a semi-constructed interview, nevertheless, leaves rooms for new elements and insights that have not been considered before. It is this openness and flexibility which can be regard as beneficial for exploratory research.

Further, the personal character of interviews increases the chances to gain more valuable insights and avoid superficial responses by follow-up questions and clarifications. However, interview responses give highly subjective views and must not necessarily be true. Caution should be applied to the stated motives of OFDI as the interviewee might provide a ‘front version’ and not reveal all the true underlying reasons for FDI. Answers, therefore, can be regarded as having only a limited validity.

A number of drawbacks result from the proposed research method of data collection. First of all, it must be acknowledged that this research method does not provide the power to make strong generalizations
due to the small number of cases that will be investigated. Further, the access to the rather small number of potential interview partners might prove to be considerably difficult, especially in view of this seemingly sensitive topic proposed. In addition, access to the ‘right’ persons may be hampered, for instance by Chinese language barriers. Further, profound interviews require an intensive preparation and may not provide the results needed. The (unstructured) collected data from interviews might be difficult to analyze and to compare to other results received. Some disadvantages can be overcome by including other sources, such as news articles of Chinese M&As, access to official government agencies and organization that deal with German-Sino relations, to support the research objective and perhaps to provide access to a network of firms. Other drawbacks of the research design must be pointed out. The delimitation to Chinese M&As in a German high developed industry sector leads likely to a bias towards strategic-asset seeking FDI and can thus not necessarily be regarded as representative of Chinese OFDI. Moreover, there are various factors that cannot be controlled for (e.g. macroeconomic environment), which subsequently reduce further the explanatory power of data collected. Further, companies selected that entered the German market in 2002-2004 and are still in existence, are more likely to pursue long-term strategic goals. A cross-case analysis approach may be used as a method of data analysis, in particular in view of the structured parts of the interview. This will enable a meaningful comparison and reveal differences and similarities. These may be subsequently used to develop hypothesis (induction) with respect to the nature of Chinese rising OFDI flows. The exploratory research might be used to test the feasibility for more extensive research studies in this area in the future.

The proposed time schedule for the research project looks as follows: The first month will be used to specifically define the research question(s) and objective(s) together with the assistance of the supervisor. This is followed by investigating the exact population size and further literature review. Subsequently, in the following month, selected companies will be contacted in several ways to ask for the participation in interviews and interview questions will be simultaneously prepared. Before scheduled interviews are conducted from the beginning of the third month onwards, secondary literature sources will be supported by information collected from agencies and ‘experts’ within this field, to prepare for the interviews and enhance interview questions. The end of the third and beginning of the forth month will be used for in-depth analysis of the responses received. The research project shall be entirely written up one to two weeks before the hand-in date.
References


