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EU-China FDI in the 21st century: Who is ready for a "win-win" strategy?

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Abstract

The increasing role of emerging economies at the international level over the last two decades, leads to profound rebalancing of world production, trade and investment. This is particularly true when looking at China's influence on world and European affairs. Indeed, China has constituently remained the top destination for foreign investments, notably from the EU. Symmetrically, Chinese investment abroad has been multiplied by 2 over the past 5 years, providing EU leaders (political and businessman) with new challenges (competition coming close to your home market) and new opportunities (expansion and investment at a time of EU financial constraints).

This paper aims at providing a comprehensive overview of the evolution of FDI between EU27 and China and analyzes the most important changes in foreign investors' strategies as well as China's main objectives in investing in the EU. The overview and detailed analysis are based on a unique database (called COFM and compiled by the authors for the European Commission – DG Trade) enabling to relate macro developments with individual operations at micro / corporate level, and providing therefore a vast and complex set of information related to EU-China investment flows.

EU27 is the largest investor into China and among the largest recipient of Chinese investments. However, motivations behind European and Chinese firms' decisions to invest abroad are quite different and are evolving over time. While low labour costs were a key point of attraction to go in China a decade ago, European enterprises are now more attracted by the domestic market growth potential. Economic and political incentives also explain the recent boom of China's FDI abroad. Indeed, Chinese FDI has massively increased their investment into EU27 over the last decade, even during the global financial crisis. Chinese leaders have therefore officially prioritized Chinese outbound investment over the historical priority of inbound foreign direct investment and the country has benefited from the global financial crisis to expand its international position, particularly in EU27.

Key words: EU-China FDI, COFM data, country/sector breakdown, investors' strategy

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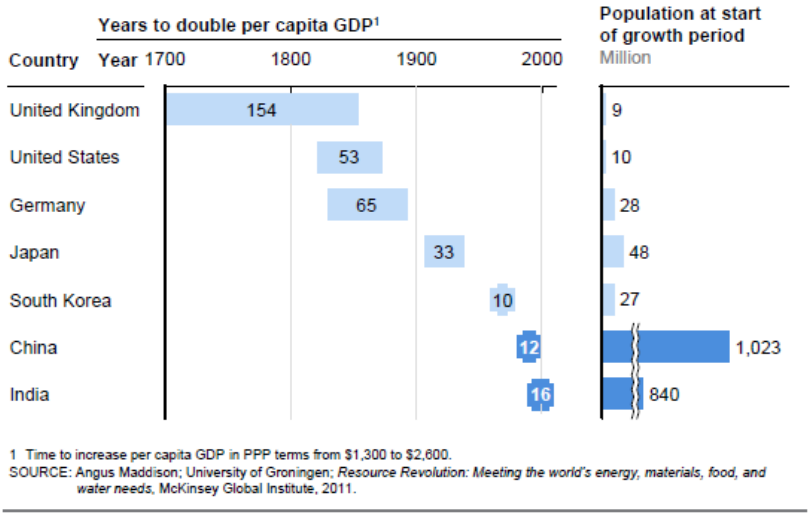
1. Introduction

The increasing role of emerging economies at the international level over the last two decades leads to profound rebalancing of world production, trade and investment. As pointed out by a McKinsey report on emerging cities published in June 2012[2], Asia was the center of gravity in the world economy until 1500, accounting for roughly 30% of global GDP. But in the 18th and 19th centuries, urbanization and industrialization vaulted Europe and the United States to prominence.

We are now observing a decisive shift in the balance back toward Asia and two key characteristics result from this rebalancing. First of all, incomes are rising faster and at a greater scale than in the past in developing economies. In fact, China has doubled its GDP per capita at the end of the 90s in only 12 years, to be compared to 154 years spent by the United Kingdom to urbanize. Secondly, this rebalancing targets incomparable population size, India and China gathering 100 times the population observed at start of growth period in the United Kingdom and the United States.

Figure 1: Comparison of historical economic transformation

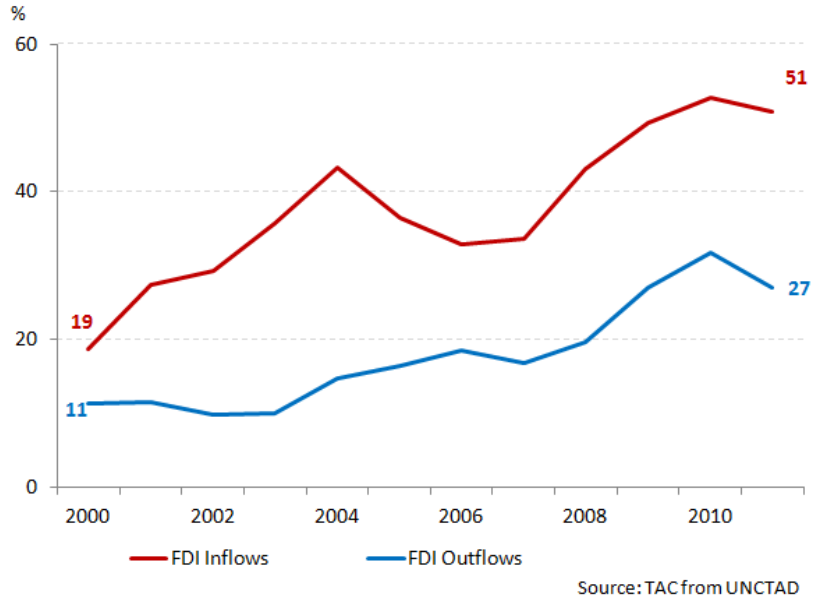


Source: McKinsey Global Institute

But the dynamic of investment flows is also shifting very rapidly. According to UNCTAD, developing and transition economies absorbed half of global FDI inflows in 2011 (51%) against 19% in 2000. In parallel, the share of total FDI outflows from developing and transition economies reached almost 30% in 2011 against 11% in 2000. The global rebalancing is particularly true when looking at China's influence on world and European affairs. Indeed, China has consistently remained the top destination for foreign investments, notably from the EU. Symmetrically, China has massively invested abroad over the last decade, accounted for 3.6% of total outward investment from developing countries in 1995, 10% in 2005 and a massive 20% in 2010 (according to UNCTAD data) in the midst of the global economic crisis. This made it the second largest developing country in terms of outward FDI, beaten only by Hong Kong, which acts as a "key transit" point for operations in and out of China. This shift provides EU leaders (political and businessmen) with new challenges (competition coming close to your home market) and new opportunities (expansion and investment at a time of EU financial constraints).

[2] « Urban world: Cities and the rise of the consuming class », Dobbs R *et al.*, McKinsey Global Institute, June 2012

Figure 2: FDI outflow and inflow from developing and transition economies



This paper aims at providing a comprehensive an overview of the evolution of FDI flows between EU27 and China, and their evolving strategies. Our analysis also provides insights that help understanding key medium-term challenges for companies located in the two regions. The analysis is based on a unique database (called COFM), compiled by the authors for the European Commission / DG Trade, and enabling to compute aggregate investment flows (FDI and ODI), using individual operations at the micro or corporate level. This approach therefore provides a vast and complex set of information related to the analysis of EU-China investment flows.

2. A proprietary tool for monitoring FDIs in China

In reviewing and analyzing investment flows, one of the main difficulties is determining how these capital flows are measured. This is certainly true at the global level, but it is even more difficult in the case of China. For example, how should one classify investments below the threshold of 10% of the equity of targeted companies? How do you deal with offshore centers that act as critical intermediaries for FDI in order to avoid taxes and transparency?

The official Chinese source of data for foreign direct investments into and out of China comes from the Ministry of Commerce (MOFCOM). MOFCOM provides free information detailing the breakdown of Chinese FDI outflows abroad by country and by industry. However, they do not provide any details for a country or industry analysis. The second official and recognized data source for FDI, at the international level, is UNCTAD. Unfortunately, they report only global historical figures and do not give information about bilateral FDIs or a details industry breakdown.

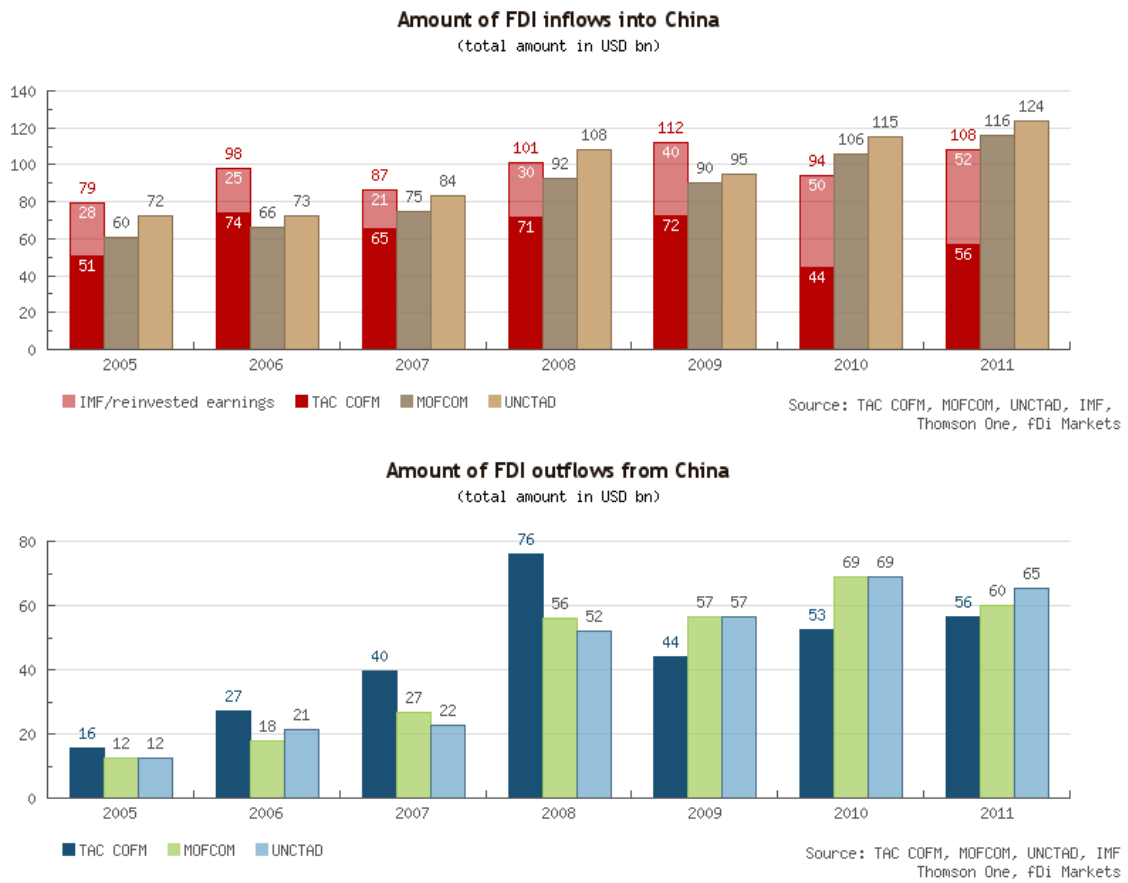
In order to improve the analysis of inward as well as outward FDI related to China, the ChinaObs/FDImonitor (COFM) database was established by the research group TAC (through the 'EU-China Economic Observatory' quarterly report, supported by the European Commission). COFM aggregates industry and country-level information on all operations and deals related to foreign investment into and out of China (M&A and Greenfield investments) since 2005. It allows detailed

analysis country by country of investment and industries, as well as the type of investment made (equity participation, full acquisition, Greenfield etc.)

COFM is constructed using two major private databases, which provide information at the project/deal level: the Thomson One database from the Thomson Reuters group, for mergers and acquisitions, and the fDi Markets database and the Financial Times group, for Greenfield investments. The availability of information at the operations level allows parent companies to be distinguished from 'ultimate parent' companies for both the acquirer and the target company involved in FDI. Therefore, these measures incorporate all operations in which the ultimate parent acquirer is China and the parent target is different from China. They specifically exclude Chinese M&A abroad by the intermediary of its subsidiaries in Hong Kong when the ultimate parent target is China.

The following charts present and compare annual FDI figures in China since 2005 from three different sources: the TAC bottom-up approach (COFM), official Chinese data from MOFCOM and UNCTAD figures as reported in the World Investment Report.

Figure 3: Amount of FDI inflows and outflows in China



It is worth noting that the differences between the three sources are not abnormal, since methodologies and concepts used in the data collection vary from one source to the other. A detailed analysis of these discrepancies, such as the one conducted by TAC in a previous report for the European Commission, or Mlachila and Takebe (2011), lead to the identification of the following differences and/or uncertainties:

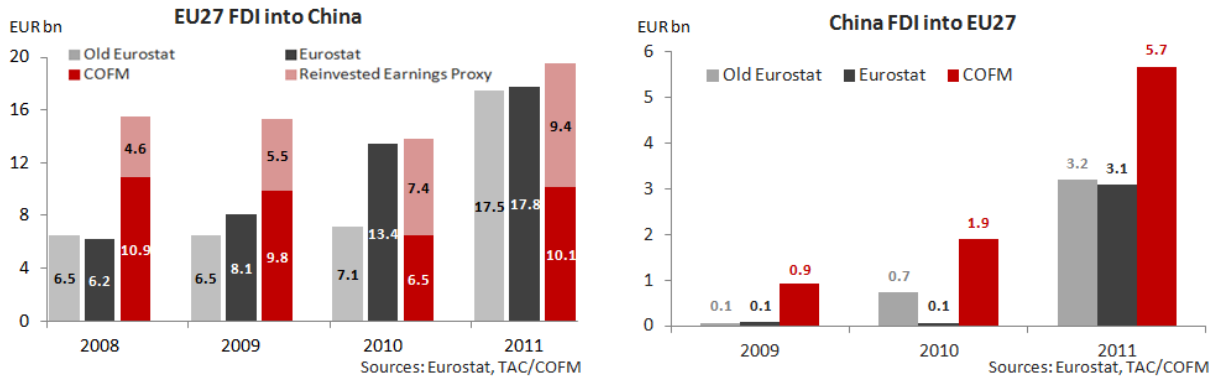
- The accounting of reinvested earnings and changes in capital structures of existing foreign companies in China. The COFM database concentrates on new operations and new investment made from outside into China. By construction, they do not incorporate what is happening within existing foreign companies operating in China. Conversely, MOFCOM reports that it is incorporating reinvested earnings (the share of profits made by foreign companies in their operations in China that are not transferred as dividends. There is also an uncertainty on the treatment by MOFCOM of changes in capital structure of foreign invested enterprises (FIEs): the standard IMF methodology when dealing with FDI figures is to deduct any purchase of equity capital in FIEs by domestic investors from foreign investors, but MOFCOM does not explain its own statistical treatment and it is not unreasonable to believe that such amounts are not computed / deducted in the Chinese statistics, even though it seems that the amounts are growing in recent years. For a better comparison, it is therefore safe to assume that we should statistically add reinvested earnings reported in balance of payment statistics under the heading of Direct investment in China. The graph above shows the reinvested earnings figures as indicated in the IMF Balance of Payment Statistics for China.
- A plausible over-reporting of FDI inflows in MOFCOM figures. Interestingly, the observation on the number of operations reveals huge discrepancies in the total numbers (with MOFCOM figures apparently looking at individual establishments and not company-level numbers), but a very parallel trend over time... feeding suspicions about MOFCOM figures as the simple arithmetic would then suggest a massive increase in the size of individual operations, while conversely we can be confident that the FDImonitor has a better recording capability for larger deals.
- A plausible under-reporting of FDI outflows in MOFCOM figures. In principle, investments abroad need to be pre-approved by MOFCOM, but in practice, small-scale investments do not necessarily go through this process. The recent administrative reforms allowing such authorization processes to be decentralized for smaller outward investment operations is likely to increase the degree of under-reporting.
- Chinese investment abroad by intermediaries of their subsidiaries or affiliates operating outside China (Hong Kong, Macao and offshore destinations such as Cayman Islands) appears not to be properly included in MOFCOM data.
- Complex financial structures designed for large infrastructure or commodity-related investments appear not to be included in MOFCOM's data, probably because they may be considered more as 'project finance' types of investment rather than direct investment. COFM includes such operations when the provider of funding for any special purpose vehicle is ultimately a Chinese entity. A similar remark is valid for outward FDI related to official bilateral aid flows from China (so-called 'Angola Mode', where it is virtually impossible to disentangle genuine FDI from bilateral aid and suppliers/construction contracts).
- Problems of missing or incomplete data in the COFM database. Even if the two providers of raw data (FT FDImarket and Thomson One) confirmed that such missing amounts were only for small operations, we tried to estimate the total amounts that was not included in the database and we find that the impact of these missing amounts on the total would be limited to less than 10% of the total.

The absence of detailed information and data discrepancies have become more of an issue as the overall amount of Chinese outward FDI has substantially increased. The degree of attractiveness of different countries for China's ODI is becoming a new policy dimension taken on board by officials everywhere, including in the EU, while symmetrically the absence of detailed information feeds into worries about China's grasp of sensitive or large assets in foreign countries.

The following graphs provide a brief comparison between the old and revised Eurostat figures with COFM data. Important differences remain between sources, explained by FDI reporting methodology and the definition used. Looking at EU27 FDI into China, the main difference is related to reinvested earnings. Indeed, Eurostat figures register reinvested earnings while COFM only includes new operations. We build a proxy indicator of reinvestments of earnings by EU27 firms into China. To construct it, we apply the share of total reinvested earnings-to-total FDI into China by EU27 nations. This proxy explains well the differences between sources in 2010 and 2011.

COFM figures register much larger Chinese investments into the EU27 than Eurostat reports. The huge difference in 2008 is explained by the Rio Tinto deal, which equaled EUR 9.7bn.

Figure 4: EU27-China FDI by sources



3. Trends and patterns on inward/outward FDIs flows

The rapid economic growth and the increasing openness of China have placed the country as the top destination for foreign investment, becoming the 2nd FDI recipient in the world in 2011 after the USA (according to UNCTAD data). In parallel, the Chinese government is encouraging firms to invest abroad, particularly with the unveiling of its "Go Global" policy initiated in 1999.

According to COFM data, China FDI outflows have been multiplied by at least 3 between 2005 and 2011, from USD 15.6bn to USD 55.9bn, and are now catching FDI inflows. Indeed, FDI outflows and inflows were quasi-equivalent over the last 3 years. However, the number of deals operated by foreign investors in China is strongly higher than the number of Chinese operations abroad; the gap is reducing with a ratio of inflows to outflows around 9 in 2005-2006 to 3 in 2011-2012Q3.

Figure 5: Number of operations into and out of China

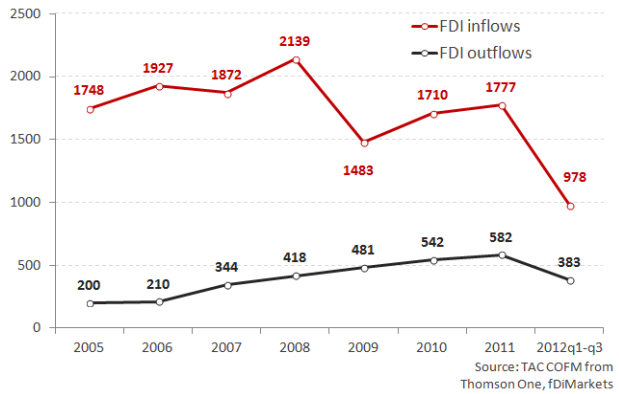
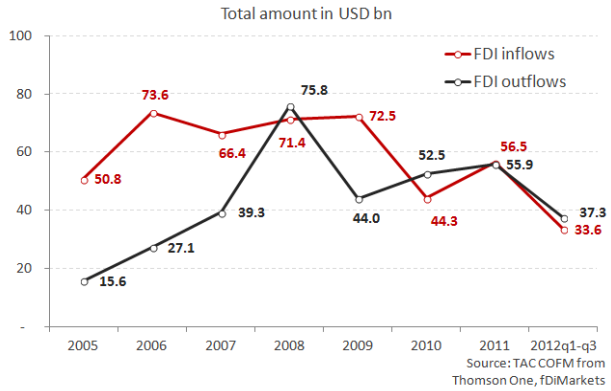
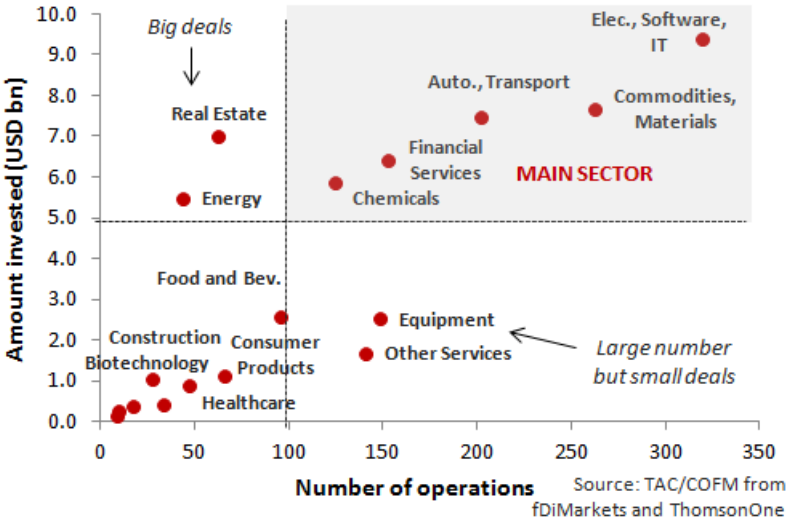


Figure 6: Amount invested into and out of China



Over the 2005-2012Q3 period, MNCs massively invested (more than 100 deals and more than USD5bn per year) in the electronic/ software/IT, the commodities/materials (which include metals, textiles, paper, plastics etc.), the automotive/transport sector, the financial services and chemicals (cf Figure 7). In parallel, the equipment sector and the other services attracted around 150 new operations per year while large amounts were invested in the real estate and the energy sector (alternative energy).

Figure 7: FDI inflows into China by sector per year (2005-2012q3)



Main investors in China are mostly from mature economies, particularly from EU27 (such as Carrefour, Siemens, Volkswagen, Standard Chartered Bank etc.), the USA (IBM, Wal-Mart, General Electric), and Asian countries (such as the Japanese company Mitsubishi Corp and the Taiwanese electronic company Hon Hai Precision Industry).

Table 1: Top 10 MNCs in China (by number of deals over 2005-2012Q3)

	Foreign companies	Country	Sector	Number of deals
1	IBM	USA	Elec., Software, IT	66
2	HSBC	UK	Financial Services	63
3	Carrefour	France	Food and Bev.	56
4	Wal-Mart	USA	Food and Bev.	54
5	Mitsubishi Corp.	Japan	Commodities and Materials	52
6	Hon Hai Precision Industry	Taiwan	Elec., Software, IT	40
7	Siemens	Germany	Elec., Software, IT	40
8	Volkswagen	Germany	Auto., Transport	40
9	General Electric (GE)	USA	Elec., Software, IT	38
10	Standard Chartered Bank	UK	Financial Services	36

Source: TAC/COFM

In parallel, Chinese MNCs have widely expanded their presence in the world over the past decade, from USD 15.6bn of new investments abroad in 2005 to USD 55.9bn in 2011. However, characteristics of China outward FDI are different from inward FDI in China. In fact, the number of deals operated by China abroad is less important than the ones operated in China by foreign companies. However, when Chinese investors decide to go abroad, they massively invest. Indeed, while the average deal size of FDI operated in China is around USD 35mn, Chinese deals operated abroad have been around USD 100mn since 2005. More precisely, EU27 and the United States have been the main investors into China since 2005, the main EU partners being Germany, UK and France.

The main interests for Chinese MNCs are threefold:

- One of the main interests to go abroad is to secure domestic needs in energy and natural resources (a national interest). Indeed, largest amounts were invested in the energy and the commodities/materials sectors. This explains why Chinese investors massively invest in developing countries, particularly in Brazil, Argentina, Russia, Indonesia but also in mature economies such as the USA, Canada and Australia.
- Then, Chinese MNCs aims at improving their market position abroad with the growing competitiveness domestically, to diversify their activity abroad. Looking at motives behind Chinese Greenfield investments, "proximity to markets/customers" and "domestic market growth potential" explain two third of reasons to invest abroad. It also reveals the strategy of Chinese investors to use some countries as a production platform to export to neighborhood countries. Consequently, COFM database shows that the automotive/transport, equipment but also services (financial and others) are among main sectors of interest.
- Finally and not less important, China massively invested in the knowledge-intensive economy, meaning that Chinese enterprises invest mostly in mature economies to access and transfer technologies. The main destination is here the EU27, the main destination of Chinese investments so far, and the USA, particularly in the electronic/software/IT.

Table 2: Main destinations and sectors of FDI outflows from China in 2005-2012q3

Rank	Main destinations	Main sectors	Number of deals	Amount (USD bn)	Deal Size (USD mn)
1	EU27	Elec./Software/IT, Equipment, Commodities/Materials, Auto/Transport, Energy, Services	815	48.3	59
2	Brazil	Energy, Commodities/Materials, Food and Beverages, Auto.Transport	76	28.2	371
3	USA	Energy, Financial Services, Elec/Software/IT, Equipment, Commodities/Materials	333	26.5	80
4	Australia	Commodities/Materials, Energy	224	25.0	112
5	Hong Kong	Financial Services, Auto/Transport, Electronic/Software/IT	350	24.5	70
6	Canada	Energy, Commodities/Materials	114	24.0	211
7	Indonesia	Energy, Commodities/Materials	57	10.6	186
8	Russia	Energy, Commodities/Materials	85	9.8	115
9	Singapore	Energy, Auto/Transport	97	9.4	97
10	Argentina	Energy, Food and Beverages	12	9.4	783

Source: TAC/COFM

Overall, private enterprises operate the largest number of operations abroad but the largest share of amount invested came from public enterprises. The objectives behind Chinese investments abroad highly depend on the type of investors.

Figure 8: Number of M&A abroad by type of Chinese investors

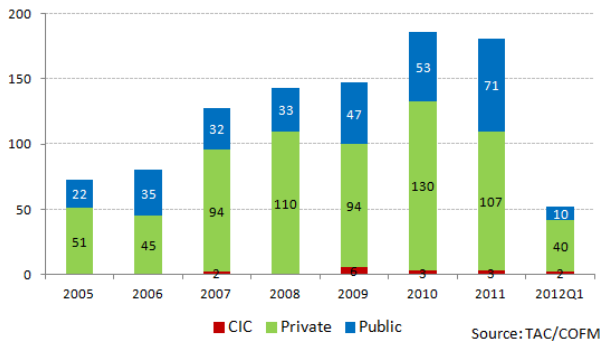
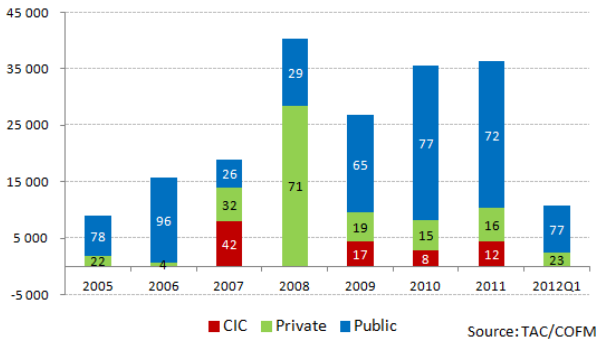
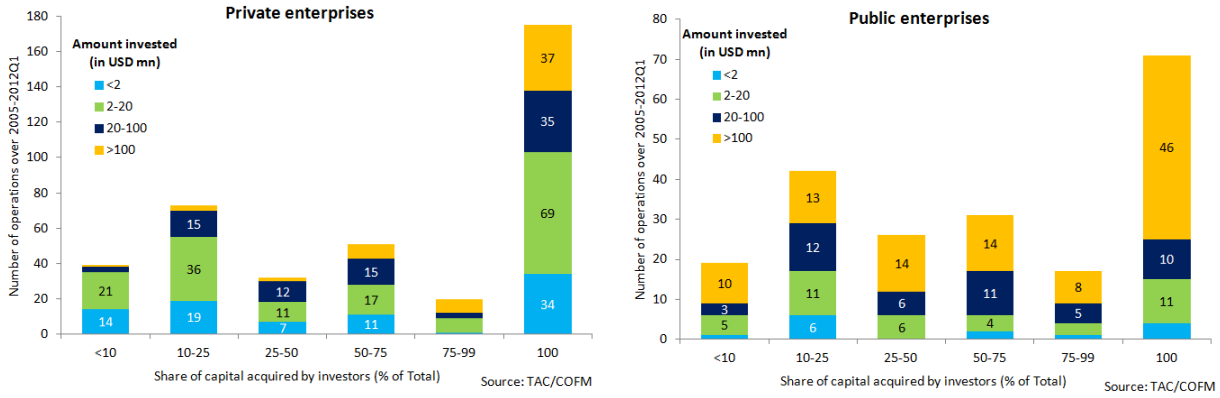


Figure 9: Chinese M&A by type of investors (USD mn)



According to the COFM database, private enterprises generally operated 100% acquisitions of small enterprises, by investing less than USD 20mn. At the opposite end, the targeting of public enterprises is not to take control of foreign enterprises as (while the most important number of deals is also full acquisition) they mostly focus on big enterprises. Indeed, the historically high saving rate of state-owned enterprises has provided an ample supply of loanable funds for international growth opportunities. As a result, they often invest more than USD 100mn in each operation.

Figure 10: Chinese ODI patterns - Share of capital vs. Amount invested

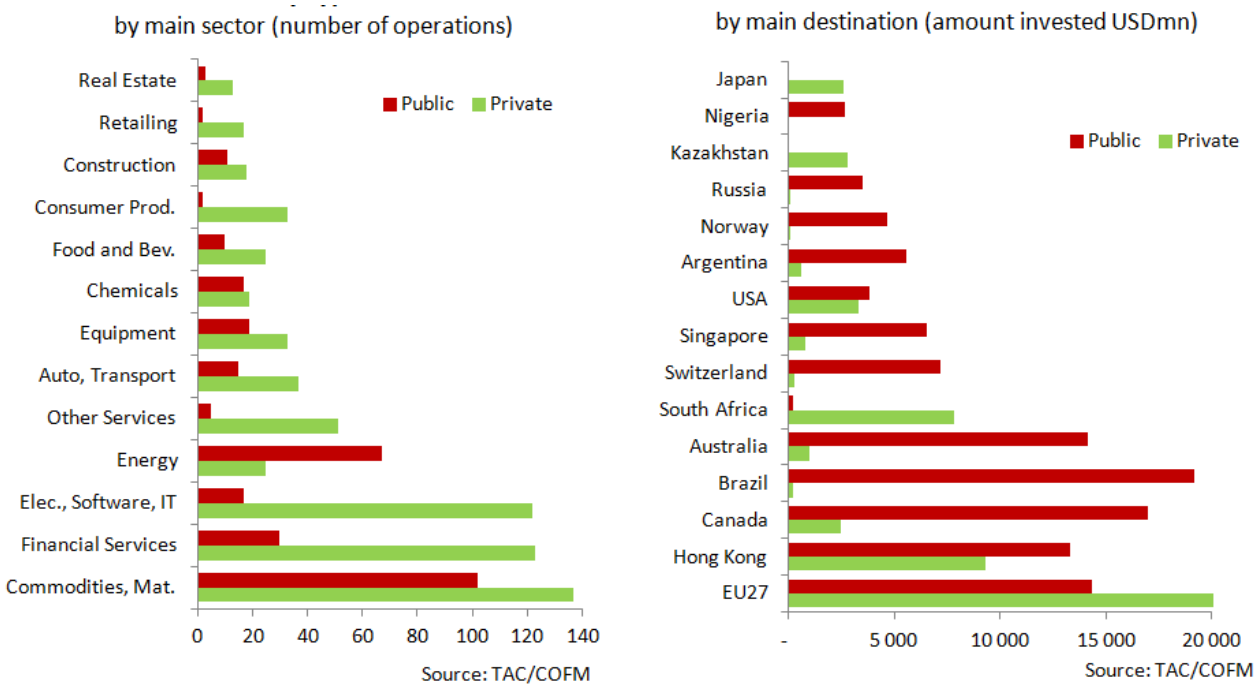


Then, both public and private Chinese enterprises have specific motives in terms of sector of interest and region.

FDI from public enterprises are chiefly commodity focused: Chinese firms are compelled to invest in raw materials and energy overseas. They massively invest in countries with high natural resources such as Brazil, Canada, Australia, Argentina, Russia and Norway. They also massively invest in EU27 within the infrastructure or utility sectors, i.e. in more "sensitive" sectors such as in GDF Suez in France or the UK utility group Thames Water.

Private enterprises mostly invest abroad for business interests and to acquire technology and strategic assets: Chinese firms are looking for maximizing profit by acquiring new opportunities abroad as competition increase in the domestic market. Then, in order to compete internationally with multinational enterprises, private enterprises have to catch-up by acquiring advanced technology, new brands and managerial know-how. COFM figures show that they also operated a large number of operations in the commodities & materials but also in the financial services and the electronic/software/IT sectors and to a lesser extent in the services, the automotive & transport and the equipment sectors.

Figure 11: Chinese ODI by type of investors

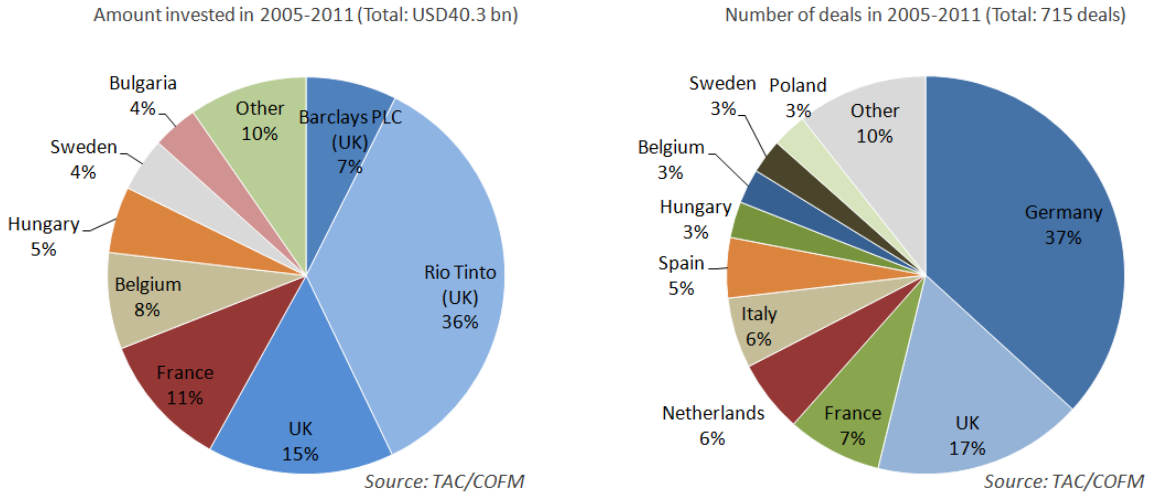


4. Key facts on FDI flows between EU27 and China

According to the COFM database, EU27 as a whole is the first destination for Chinese investors, with 13% of the total amount invested abroad by China over the period 2005-2011. It is followed by Hong Kong (7%), Canada (7%), Brazil (7%), Australia (7%) and the USA (6%).

More specifically, UK, France, Belgium, Hungary and Sweden attracted the largest amounts of Chinese FDI (with respectively 58%, 11%, 8%, 5% and 4%). However, a very small number of very large deals have an overwhelming influence on the aggregate figures per host country: two Chinese investments in the UK accounts for 75% of the total Chinese investment in the country (Rio Tinto and Barclays Bank). The significant shares of Belgium and France being also related to large operations in each country (Fortis, GDFSuez-Exploration Business). Nonetheless, the UK remains the largest recipient of Chinese investment (by amounts) even after taking out these two large deals, and is second to Germany by number of operations.

Figure 12: Breakdown of Chinese FDI in EU27



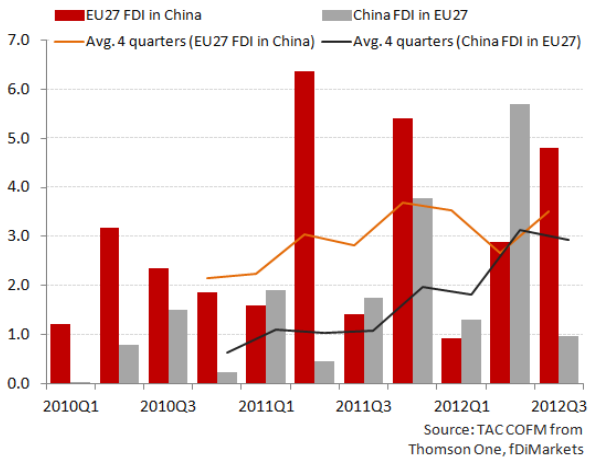
Among the "significant" recipient of Chinese investment are some of the eastern and central European countries, notably Hungary and Bulgaria. However, China is still a negligible source of FDI for EU27 countries, representing only 0.1% of total inward FDI flows (according to Eurostat data over the 2005-2010 period), while almost 50% came from North America.

While EU27 is the largest recipient of Chinese investments, it is also the largest investor into China, the main investment partners remaining Germany, the UK and France. Overall, Germany diversifies their investments in the automotive & transport sector, the chemical sector, the electronic/software/IT and the equipment sector. The United Kingdom selected a different strategy acquiring opportunities in the commodity & materials, the food & beverages and financial services. Finally, France mostly operated significant operations in the automotive & transport, the commodities & materials and consumer products.

Table 3: Main sector of interest for European countries in China

	Germany	UK	France
Auto/Transport	X		X
Chemicals	X		X
Electronic/IT	X		
Equipment	X	X	
Commodity/Mat.		X	X
Food & beverages		X	X
Consumer products		X	X
Financial services		X	
Other services	X	X	

Figure 13: EU27-China FDI evolution (amount in USDbn)



Looking at the recent evolution, China FDI in EU27 has widely increased since 2010. As a result, China FDIs in EU27 are now catching EU27 FDI in China in 2012Q1-Q3 with respectively USD 8.0bn against USD 8.6bn. But more specifically, China FDI in EU27 doubled EU27 FDI in China in 2012Q2 thanks to large deals in the utility sector (the main FDI recipients being Portugal, the UK and Germany). The next section will describe the evolving FDI strategies in EU27 and China which explain in part the growing interest of China FDI abroad.

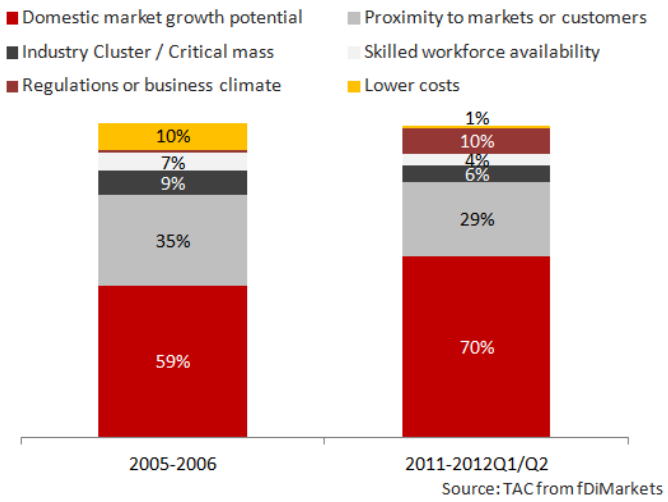
5. The emergence of new strategies

If EU27 remains the largest investor into China and among the largest recipient of Chinese investments, motivations behind European and Chinese firms' decisions to invest abroad are quite different and are evolving over time.

As part of the economic reform movement initiated in the late 1970s, the Chinese government has continued the process of institutional transformation, seeking to attract foreign capital and technology as a critical element of its strategy to catch up with the West. The impressive increase in Chinese FDI inflows throughout the 2000s has contributed to the acceleration of China's GDP growth and made it the top destination for global FDI in developing economies. This first wave of FDI to China is generally associated to the period of internationalization of production processes. During this period of low labour costs in China, foreign companies, particularly investors from EU27 and the USA, were attracted to outsource low-skilled activity in China.

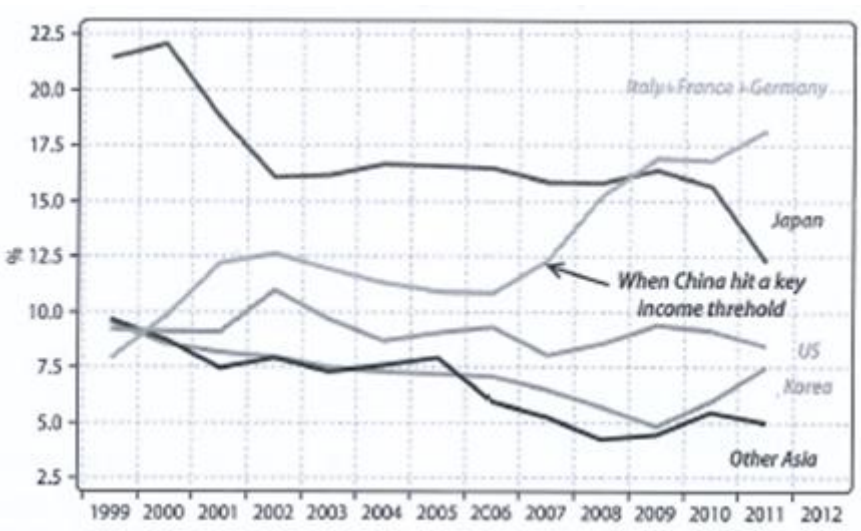
Then, China entered in a transition phase aiming at "structurally rebalancing" its economy with household-driven demand to play a larger part in overall economic activity. This rebalancing phase is under way and fundamentally requires a larger share of value addition attributes to wages. As observed on the Figure X, while low labour costs were a key point of attraction for foreign investors to into China a decade ago, this motivation is disappearing. However, it remains that multinational companies continue to invest in Central and Western provinces thanks to government tax incentives and lower costs.

Figure 14: Motives behind Greenfield investments in China



Interestingly, foreign enterprises increasingly invest into China to tap the domestic market growth potential, from 59M in 2005-2006 to 70% in 2011-2012Q2. European enterprises massively invest in China, particularly in the healthcare, the automotive sector (the biggest world market) and in the consumer products. It results that China is already one of the biggest market for a number of big European retailers, such as L'Oreal, JCDecaux, Richemont etc. Indeed, China started to import a lot more of consumer goods from Europe in 2007, i.e. since the significant increase in wages.

Figure 15: China started to import a lot more consumer goods from EU in 2007
(% of total consumer goods imports, excluding cars)



Source: GaveKal

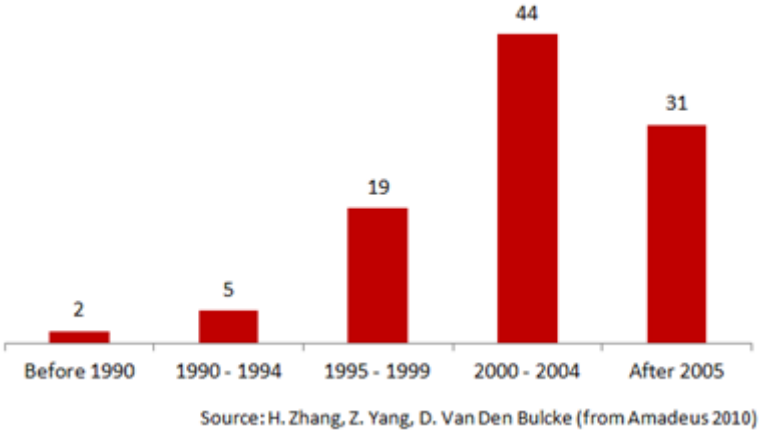
Outward FDI from China also emerged over the past decade with the Go Global policy, initiated by the Chinese authorities in 1999. It encourages the globalization of domestic enterprises and therefore overseas investments by Chinese enterprises (Wu and Chen, 2001). Consequently, Chinese FDI has massively increased their investment into EU27 over the last decade, even during the global financial crisis.

Moreover, innovation increasingly becomes a priority in China in order to sustain economic growth, increase technological know-how to move up its supply chain production from low value-added

activities. Indeed, to maintain productivity and stay competitive in a globalized market, Chinese firms must move up the value chain through strategic industrial upgrading and innovation. Therefore, Chinese leaders have now officially prioritized Chinese outbound investment over the historical priority of inbound foreign direct investment.

It results that the emergence of Chinese enterprises in Europe is quite recent. As pointed out by a report by Zhang, Yang and Van Den Bulcked (2011), the average age of Chinese owned enterprises is only about eight years. Only one quarter of Chinese companies in Europe have been in existence for more than ten years.

Figure 16: Periods of establishment of Chinese enterprises in Europe
(% of number of firms in 2010)



Explanations behind Chinese motivations to go in Europe are multiple. Basically, private enterprises aim at operating full acquisitions of small and medium enterprises (SMEs) for business interests and to acquire new technology and know-how. Conversely, state-owned enterprises are more attracted by sensitive sectors in EU27 such as in the infrastructure and the utility sectors.

The table 4 summarizes several main characteristics of the Chinese companies in Europe explained in the report by Zhang, Yang and Van Den Bulcke (2011). Consistently with results obtained from COFM database, they observed that the majority of the Chinese investments in Europe are carried out by small and medium entrepreneurial enterprises, especially in the Eastern European countries. Many Chinese entrepreneurial companies moved into Eastern Europe around 2000, while the larger Chinese multinational enterprises only got strongly attracted by the West European market since the mid 2000s.

The Chinese entrepreneurs who entered Eastern Europe last decade were looking for new business opportunities, especially in the import and distribution of Chinese consumer goods. Then, private industrial companies and state-owned enterprises mostly invest into Western Europe to acquire new technology by taking over existing European firms or raise capital through IPOs in European stock exchanges. As pointed out in their report, Zhang, Yang and Van Den Bulcke mention that these firms are quite distinct from the above mentioned entrepreneurs in Eastern Europe as their international expansion results from their performance in the domestic market. Their international expansion and their ensuing search for technologies and or brands in Europe are clearly intended to re-enforce their competitive position in China. Chinese SOEs are and continue to be the major source of Chinese investment in Europe. Because these SOEs can rely on their strong financial position and privileged relationship with the government in China, their overseas investment projects are often quite substantial in size and take place in sectors such as mining, public utilities and infrastructure.

Table 4: Key features of Chinese enterprises in Western and Eastern Europe: a comparison

	Western Europe	Eastern Europe
Type of company	Mostly state owned or private industrial companies	Individual and family owned entrepreneurial enterprises
Location	Highly concentrated in regional economic hubs	Agglomerated in capital cities
Sector distribution	Manufacturing and distribution of high-tech industrial goods and active in knowledge intensive sercices	Labor-intensive and low tech manufacturing, such as wholesale and retail in consumer goods, especially textile products
Size distribution	Large and Medium sized companies	Small and micro companies
Entry form	Greenfield and acquisition of existing companies	Greenfield
Evolution	- Long established state owned shipping and trading companies - Recent investment by large industrial groups - Take-over of established European family businesses by state and private Chinese companies	- Mostly established around 2000 by immigrant entrepreneurs - Increasing number of industrial groups starting to manufacture consumer goods.
Partnership	Mostly with local companies	Mostly with domestic and overseas individual Chinese

Source: Zhang, Yang and Van Den Bulcke, 2011

In spite of the global economic uncertainties, China has benefited from the financial crisis to expand its international position. The Eurozone crisis has even created new opportunities for China in the EU. This ties in with Chinese ambitions for its next phase of growth based on innovation and high and green technology. A striking example is the automobile sector, where Rover Group is now owned by the Shanghai Automotive Industry Corporation while Volvo is owned by the Chinese Geely Automobile Holdings. Then, state-owned enterprises and CIC have benefited from the crisis to invest in sensitive sectors in Europe. As an example, Three Gorges Corporation, a Chinese state-owned company, bought a stake in Portugal's energy company, EDP, when the government's stake went on sale to comply with austerity cuts in accordance with EU demands.

6. Key medium-term challenges

European motivations to invest in China are evolving with the economic development of China with a decreasing interest to outsource low-skilled activity in China ("horizontal" FDI) and a growing attraction to tap the increasing domestic market ("vertical" FDI, especially in consumer products, automotive sector, healthcare etc.). The potential negative substitution effect on the EU labour market would decrease progressively while the income effect would increase resulting in positive effects on the labour market.

This section aims at raising key medium-term challenges and potential issues related to FDI in China and EU27 and the following table summarizes the potential effects of the evolution of EU27 FDI in China and Chinese FDI in EU27.

Table 5: Key medium-term challenges for EU

	Objective, strategy	Potential risks
EU27 FDI in China	Decreasing interest to outsource low-skilled activity in China Growing motivation to tap the growing domestic market, particularly in the healthcare, automotive sector, consumer products.	FDI catalogue orientations, restrictions vs openness Increasing competitiveness of Chinese companies Local partnership, IPR issues
Chinese FDI in EU27:		
- SMEs	A large number of investments: main destination in terms of number of operation, but small amounts invested Search for new business opportunities in low tech manufacturing and labor-intensive	Moderate risk for EU (small amounts invested and low tech manufacturing)
- New "champions"	Improving their market position abroad, growing their competitiveness domestically, diversifying their activity, acquire new technologies	Actual or future competitors IPR issues
- State-owned companies	National interests Invest in knowledge-intensive economy to access and transfer technologies Invest in infrastructure, utility sectors	Increasing competitiveness, with the objective to move up in the supply chain. Target sensitive sectors (such as the utility sectors) IPR issues

Several potential risks can emerge for EU companies when investing in China, such as the question of intellectual property rights (IPRs) particularly for Small and Medium Enterprises. Even if China is one of the favored destinations for foreign investors, the country remains a very restrictive country in terms of FDI.

The European Chamber's 2012 Business Confidence Survey on European businesses in China shows that the discretionary enforcement of regulations by Chinese authorities is the most significant obstacle. Indeed, 40% of respondents report that Chinese government policies towards foreign enterprises are less faire than they were two years ago and 50% of companies report missed opportunities due to market access barriers. In fact, the XIIth five-year plan and the revised Investment Catalogue converge in putting innovations / higher technology and the development of new energy-related and environmentally-friendly industries as the highest FDI priorities. Medical services are also a key industry that stands to benefit from the revised draft. However, significant barriers are maintained (or even reinforced) in the automotive sector, financial services, communication technology and more globally authorities discourage investment within industries that consume large amount of energy or are already in excess capacity in China. A number of restrictive were also launched in the real estate sector in the context of the cyclical control of the real estate bubble.

But potential medium-term challenges in EU27 from Chinese investments are highly dependent on the type of investors. The majority of Chinese investments come from Small and Medium Enterprises (SMEs) particularly in the Eastern Europe. Their objective is mostly to find new business opportunities, while potential competitors for European enterprises are more the new "champions"

which emerge very rapidly. Indeed, the Fortune Global 500 survey registered 47 enterprises from emerging economies in 2005 and 116 in 2011 with 61 enterprises coming from China (Sinopec Group, China National Petroleum, State Grid, ICBC, China Mobile etc).

State-owned companies mostly invest in Europe for national interests, either in knowledge-intensive economy to access new technologies, either in sensitive sectors such as utility (especially during the global financial crisis). In addition, increasing competitiveness in Europe can emerge from those investors as they have inexpensive strong supply of funds.

7. Conclusion

The increasing role of emerging economies at the international level, particularly China, leads to profound rebalancing of world production, trade and investment. China has consistently remained the top destination for foreign investments, notably from the EU. Symmetrically, Chinese investment abroad has been multiplied by 2 over the past 5 years.

The objective of this paper is to provide a comprehensive overview of the evolution of FDI and evolving strategies between EU27 and China, allowing understanding key medium-term challenges for European companies. The analysis is based on a unique database developed by TAC for the European Commission / DG Trade, enabling to relate macro developments with individual operations at micro or corporate level: the COFM database.

The center of gravity of economic activity and investment flows has moved from developed countries to Asia, with income levels rising at a greater scale than in the past in developing countries and in countries with incomparable population size (which explains the strong attractiveness of foreign investors). However, European companies face a number of potential risks when investing in China, such as high FDI restrictiveness, potential IPR issues and growing competitiveness in China.

Conversely, if China is still a negligible source of FDI for EU27 countries, amounts invested increased very rapidly over the past few years. Indeed, with innovation becoming a priority in China, particularly to sustain economic growth, Chinese firms must move up the value chain through strategic industrial upgrading. Chinese leaders have therefore officially prioritized Chinese outbound investment over the historical priority of inbound foreign direct investment. China has benefited from the global financial crisis to expand its international position, particularly in EU27 by investing in the automotive sectors but also in more sensitive sectors (such as the electricity sector in Portugal etc.). The rapid emergence of the new Chinese "champions" might lead to an increase in competitiveness in Europe in the future.

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