

Comparing Chinese, Japanese and South Korean FDI in Central and Eastern Europe: macroeconomic versus institutional factors¹

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preliminary version – to be finalized with the results of research questionnaires

1. Introduction

Chinese outward FDI is one of the most spectacular cases of today's international economics in terms of rapid growth, geographical diversity and cases of takeovers of established western brands. Chinese firms mainly invest in Asia, Latin America and Africa where they search for markets and natural resources. Developed economies of Western Europe and the United States however also became their important targets offering markets for Chinese products and assets that Chinese firms lack such as advanced technologies, managerial knowledge and distribution networks. Moreover, Chinese firms increasingly invest in Central and Eastern European countries (CEECs). Although these investments constitute a small share of China's total FDI in Europe (10%) and are quite a new phenomenon, but since 2006 we could observe rising inflows of Chinese investments in the region, which are expected to increase (McCaleb and Szunomár, 2013).

However, Chinese companies are not the first investors in CEECs from East Asia as Japanese and South Korean FDI started to flow into the region in the early nineties. For example, among East Asian investors, South Korea has a dominant role in the Czech Republic and Slovakia, while Japan in Poland and the Czech Republic. The start of Chinese FDI is marked

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by CEECs' newly acquired EU membership (2004 and 2007), where favoured locations are Hungary and Poland.

The aim of the paper is to analyze and compare motivations and location determinants of Chinese, Japanese and South Korean FDI in the largest recipient countries within the CEECs – namely Hungary, Poland, the Czech Republic and Slovakia – with special focus on the role and impact of host country macroeconomic and institutional factors. After the introductory section, the paper presents the theory and literature on FDI location determinants with special focus on FDI determinants in CEECs, followed by the brief discussion of the changing patterns and motivations of East Asian OFDI. The paper's main section contains the authors' findings on similarities and differences in characteristics and motivations of Chinese, Japanese and South Korean FDI in CEECs. In addition, it provides a detailed description of the impact of both macroeconomic and institutional factors based on several case studies of and interviews with East Asian firms established in the CEECs.

2. Theory and literature review

Majority of research on motivations for FDI apply the eclectic or OLI paradigm by *Dunning* (1992, 1998) that states that firms will venture abroad when they possess firm-specific advantages, i.e. ownership and internalization advantages, and when they can utilize location advantages to benefit from the attractions these locations are embedded with. Different types of investment incentives attract different types of FDI which *Dunning* (1992) divided into four categories: market-seeking (Tariffjumping or export-substituting FDI is a variant of market-seeking FDI, Kinoshita-Campos, 2003), resource-seeking, efficiency-seeking and asset-seeking. Localization advantages “comprise geographical and climate conditions, resource endowments, factor prices, transportation costs, as well as the degree of openness of a country and the presence of a business environment appropriate to ensure to a foreign firm a profitable activity” (Resmini, 2005, p 3). Much of the extant research and theoretical discussion is based on FDI outflows from developed countries for which market-seeking and efficiency-seeking FDI is most prominent (Janicki-Wunnava, 2004; Buckley et al., 2007; Leitao-Faustino, 2010).

The rapid growth of OFDI from emerging and developing countries resulted in numerous studies trying to account for special features of emerging MNCs behavior that is not captured within mainstream theories. For example, *Mathews* extended OLI paradigm with linking,

leverage, learning framework (LLL) that explains rapid international expansion of companies from Asia Pacific (Mathews, 2006). Where linking means partnerships or joint ventures that latecomers form with foreign companies in order to minimize risks involved with internationalization as well as to acquire “resources that are otherwise not available” (Mathews, 2006, p 19). Latecomers when forming links with incumbents also analyze how the resources can be leveraged. They look for resources that can be easily imitated, transferred or substituted. Finally, repeated processes of linking and leveraging allow latecomers to learn and conduct international operations more effectively (Mathews, 2006, p 20).

Nevertheless, traditional economic factors seem to be insufficient in explaining FDI decisions of MNCs. In the last decade international economics and business researchers acknowledged the importance of institutional factors in influencing the behavior of MNCs (e.g., Tihanyi et al., 2012). According to *North*, institutions are the “rules of the game” which are “the humanly devised constraints that shape human interactions” (North, 1990, p 3). Institutions serve to reduce uncertainties related with transactions and minimize transaction costs (North, 1990). *Meyer and Nguyen* (2005, p 67) argue that informal constraints are “much less transparent and, therefore, a source of uncertainty”. As a result, *Dunning and Lundan* extended OLI model with the institution-based location advantages which explains that institutions developed at home and host economies shape the geographical scope and organizational effectiveness of MNCs (Dunning and Lundan, 2008).

Besides, the change of CEECs from centrally planned to market economy resulted in significant research on FDI flows to these transition countries. However, most of the studies focus on the period before 2004, the year of accession of 10 CEECs into the EU (Carstensen and Toubal, 2004; Janicki and Wunnawa, 2004; Kawai, 2006). During the transition CEECs went through radical economic changes. These changes had been largely induced by foreign capital. Foreign multinationals realised significant investment projects in this region and established their own production network. Investors, mainly from EU-15 countries, were attracted by relatively low unit labor costs, market size, openness to trade, and proximity (Bevan-Estrin, 2004; Clausing-Dorobantu, 2005; Janicki and Wunnawa, 2004; WIR 2007). Extant literature suggests diverse institutional factors that influence inward FDI. In the case of CEECs, the prospects of their economic integration with the EU increased FDI inflows while in the CEEC countries that lagged behind with implementation of transition policies, which postponed their EU accession, FDI inflows were discouraged (Bevan-Estrin, 2004).

When analyzing the impact of institutional characteristic of CEECs such as form of privatization, capital market development, state of laws and country risk, the studies show varying results. According to *Bevan and Estrin* (2004, pp. 777) institutional aspects were not a significant factor impacting investment decisions of foreign firms. *Carstensen and Toubal* (2004) argue that they could explain uneven distribution of FDI across CEECs. *Fabry and Zeghni* (2010, p 80) point out that in transition countries institutional weaknesses such as poor infrastructure, lack of developed subcontractor network, unfavorable business environment may explain FDI agglomeration more than “positive externalities”. *Campos and Kinoshita* (2008) based on a study of 19 Latin American and 25 East European countries in the period 1989-2004 found that structural reforms, especially financial reform and privatization, had strong impact on FDI inflows.

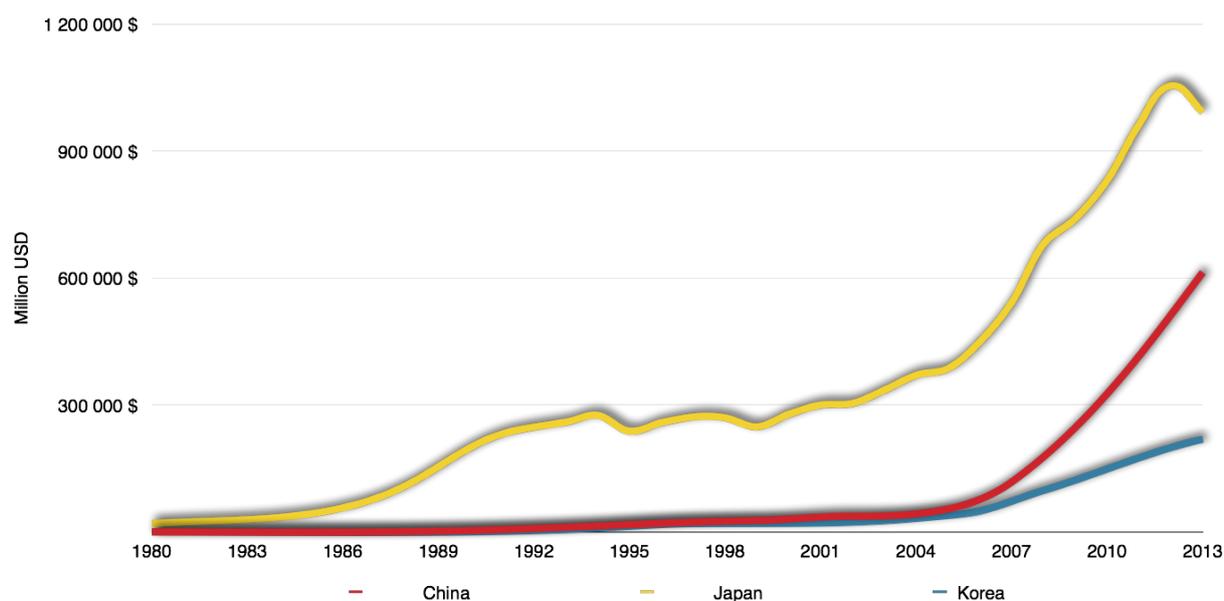
Heiduk (unpublished manuscript) divides institutional factors at the EU level that impact the behavior of MNCs and their production networks into two types: Deepening and widening regional integration, Interests groups and protectionism. *Heiduk* (unpublished manuscript) notes that MNCs investing in CEECs benefit from comparative advantages of a given CEE country and at the same time from “the institutional framework of EU’s customs union, single market and monetary union. This unique framework provides internal trade, investment and market access facilitation resulting in reduction of trade costs.” *Heiduk* (unpublished manuscript) also points out that the EU’s numerous preferential trade agreements produced incentives for establishing cross-border production networks, especially in automotive and ICT sectors. The second type of EU-level factor is related with EU MNCs that lobby at the EU level for protection of their industries and production networks from external competition.

The example of extra-EU foreign investors in CEECs is presented in a study by *Kawai* (2006) who analyzed motivations and locational determinants of Japanese MNCs. The author found that by 2004 Japanese investment in CEECs was low when compared with European counterparts and 90% of it was located in the Czech Republic, Hungary and Poland (*Kawai*, 2006, p 6). Japanese MNCs’ investment in CEECs was motivated by relatively low labor and land costs, well educated labor force necessary in manufacturing sectors and access to rich EU markets (*Kawai*, 2006; *Woon*, 2003). Majority of Japanese FDI in CEECs was directed at manufacturing sector (more than 90%), especially transport equipment and electronics. Japanese investors in CEE from manufacturing sector region preferred countries with lower corporate tax and high rate of GDP growth (*Kawai*, 2006; *Woon*, 2003).

3. Changing patterns and motivations of Chinese, Japanese and Korean OFDI

China's rise is often compared to the post-war "Asian Miracle" of its neighbours. If we analyse the internationalization procedure of Japanese, Korean and Chinese companies we can find several common features as well as some differences. Nevertheless, one of the main common characteristics of these three nations is the creation and support of the so-called national champions, i.e. domestically-based companies that have become leading competitors in the global market. In fact, during their developmental period, both the Japanese and Korean governments gave strong state financial support to their companies to protect and promote them as well as to strengthen them for international competition. China has followed them later in subsidizing domestic industries and supporting their overseas activities for example in the form of government funding for OFDI. (Irwin-Gallagher, 2014)

**Figure 3.1. Chinese, Japanese and Korean OFDI stock at current prices
1980-2013**



Data source: UNCTADStat

Japanese companies started to expand overseas by the early 1960s, with a modest growth at the beginning. The Foreign Exchange and Foreign Trade Control Law and the Foreign Capital Law were the two main laws which regulated (and somewhat restricted) Japanese firms' international activities during the 50s, 60s and 70s. However, the revision of the Foreign Exchange and Foreign Trade Control Law in 1979 accelerated the overseas activities of Japanese companies as this revision created the opportunity for free outward investment (Yang et al, 2009). As a result, Japanese OFDI stock began to increase in the late 1970s,

reaching 154 billion USD in 1989, 300 billion in 2001 and 992,9 billion USD in 2013, according to UNCTAD statistics (see Figure 3.1.).

Japan led the way in government-subsidized OFDI already in the 1950s, well before the liberalization through offering subsidized loans to companies investing abroad. *Irwin and Gallagher* (2014) highlight that Export-Import Bank of Japan (JEXIM) created a branch focusing on OFDI already in 1953, which gave almost 70 billion USD by 1999 to finance its companies foreign investments. Likewise, the Japan Bank of International Cooperation (and its predecessor, the Japanese Development Bank) started its operation mainly with export loans in the 1950s but has evolved later to an outward investment creditor as OFDI loans accounted for 74 percent of total loans in 2012 (Irwin-Gallagher, 2014).

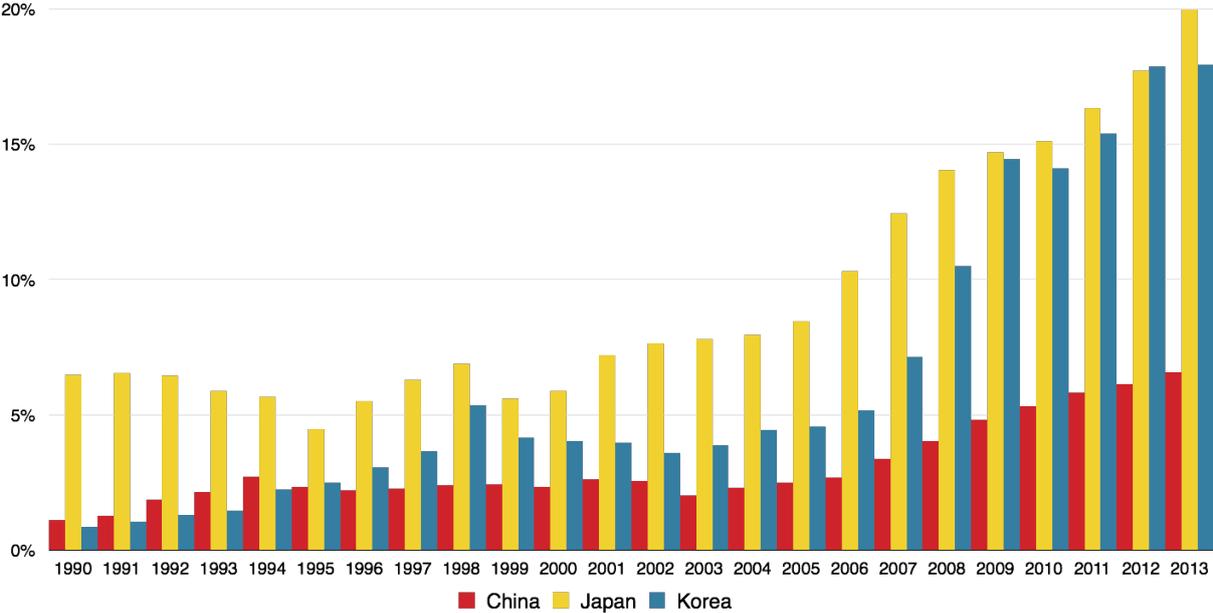
Till the end of the 1970s, Japanese OFDI was characterized by natural resource-seeking motives in order to supplement the countries resource-poor economy (Park, 2003). Between 1979 and 1985 Japanese companies overseas investments were motivated by market-seeking, as, according to Yoshida (1987), market expansion was cited as the number one reason for Japanese firms' investment in the United States. Besides market-seeking investments, in the last twenty years, efficiency-seeking became an other important motive for Japanese companies for cost reduction reasons (Yang et al., 2009).

South Korean companies internationalization was relatively late compared to Japan. Korean OFDI policy started to evolve only in 1968 when the Act of Foreign Exchange Management was passed (Chan-Cui, 2014). However, OFDI remained restricted till the 1980s, since Korean development was hindered by problems of balance of payments. As a result, except for special cases – such as the access to natural resources or open export markets – OFDI was generally prohibited by the Korean government. According to *Kwak* (2007), for that reason, up to 1980, only 352 cases representing OFDI worth of 145 million dollars were registered. As legal and economic circumstances changed in the 1980s, OFDI began to increase significantly. According to UNCTADStat total stock of OFDI rose from 0.97 billion USD in 1987 to 19.9 billion in 2001 and 219 billion USD in 2013 (see Figure 3.1.).

The Korean government has also subsidized OFDI through supporting its national champion companies, though to a smaller extent compared to Japan. By the 1990s, OFDI lending grew substantially, but it still couldn't not provide sufficient momentum for Korean OFDI. (Irwin-Gallagher, 2014). Korean OFDI used to be relatively small given the size of the economy, when compared to its GDP but this situation has changed somewhat recently (see Figure 3.2.), mainly after the financial crisis.

Traditionally OFDI was aimed mainly at accessing natural resources or creating new export markets in Asia, North America and Europe, however, efficiency-seeking OFDI is growing fast, especially in Asian markets. According to a survey from 2004 cited by Kwak (2007, pp. 29-30), investment decisions were primarily made by (labour) cost reduction motives, followed by market seeking concerns (34.5%), the overseas relocation of partner companies (9.9%), and opening up towards third markets (4.9%).

**Figure 3.2. Chinese, Japanese and Korean OFDI stock as a percentage of GDP
1990-2013**



Data source: UNCTADStat

In hand with the so-called “Open Door” policy reforms, the Chinese government also encouraged the country’s investment abroad in order to integrate China to the global economy. The only entities allowed to invest abroad were state-owned enterprises (SOEs). The total investment of these first years was not significant and concentrated to the neighbouring countries, mainly to Hong Kong. The regulations were liberalized after 1985 and a wider range of enterprises – including private firms – was permitted to invest abroad. After *Deng Xiaoping’s* famous journey to the South in 1992, overseas investment increased dramatically, Chinese companies established overseas divisions almost all over the world, concentrated mainly in natural resources. Nevertheless, according to UNCTADstat, Chinese OFDI averaged only 453 million US dollars per year between 1982 and 1989 and 2.3 billion between 1990 and 1999 (see Figure 3.1.).

In 2000, before joining the World Trade Organization (WTO), the Chinese government initiated the go global (zou chu qu) policy, which was aimed to encourage domestic companies to become globally competitive. They introduced new policies to induce firms to engage in overseas activities in specific industries, notably in trade-related activities. In 2001 this encouragement was integrated and formalized within the 10th five-year plan, which also echoed the importance of the go global policy (Buckley et al., 2008). This policy shift was part of the continuing reform and liberalization of the Chinese economy and also reflected Chinese government's desire to create internationally competitive and well-known companies and brands. Both the 11th and 12nd five-year plan stressed again the importance of promoting and expanding OFDI, which became one of the main elements of China's new development strategy.

Chinese OFDI has steadily increased in the last decade (see Figure 3.1.), particularly after 2008, due to the above mentioned policy shift and the global economic and financial crisis. The crisis brought more overseas opportunities to Chinese companies to raise their share in the world economy as the number of ailing or financially distressed firms has increased. While OFDI from the developed world decreased in several countries because of the recent global financial crisis, Chinese outward investments increased even greater: between 2007 and 2011, OFDI from developed countries dropped by 32 per cent, while China's grew by 189 per cent (He-Wang, 2014, p. 4; UNCTAD 2012). As a consequence, according to the World Investment Report 2013, in the ranks of top investors, China moved up from the sixth to the third largest investor in 2012, after the United States and Japan – and the largest among developing countries – as outflows from China continued to grow, reaching a record level of 84 billion US dollars in 2012. Thanks largely to this rapid increase of China's outward FDI in recent years; China also became the most promising source of FDI when analyzed FDI prospects by home region (UNCTAD 2013, p. 21).

Irwin and Gallagher (2014) found that - unlike Japan or Korea - China's market entry has more to do with developing project expertise and supporting exports than it does with tariff-hopping or outsourcing industries fading on the mainland. They identified two major reasons for China's high (31%) ratio of OFDI lending to total OFDI: „First, China has a greater incentive to give OFDI loans than Japan or Korea ever did because its borrowers are state-owned so it can more easily dictate how they use the money. Second, China has a greater capacity to give OFDI loans because it has significantly higher savings and foreign exchange

reserves than Japan and Korea, both today and especially during equivalent developmental stages” (Irwin-Gallagher, 2014, pp. 22-23)

4. Characteristics and motivations of Chinese, Japanese and South Korean OFDI in CEECs

Although CEECs differ in many respects, they have some common features as possible locations for far-east investors. Their economies have been in the process of catching up over the last decades, defined mainly by European powers and FDI has a key role in their restructuring. There was investment from East Asian countries in the CEECs as early as the nineties (Japanese Suzuki factory in Hungary). Most of these countries became increasingly interested in boosting trade relations with and attracting investments from East Asian economies. The economic and financial crisis of 2008 intensified these ambitions.

The largest recipient countries of East Asian investments within the CEECs are Hungary, Poland, the Czech Republic and Slovakia. Altogether in the four countries around 90 per cent of foreign investments are from Europe, only an average of 7.4% of FDI comes from other countries, mainly from the USA, South Korea, Japan and China. Typically, equity capital and reinvested earnings dominate in East Asian invested capital, while other forms are not that significant. The only exception is Poland, where the “other investment” category (meaning mainly intercompany loans) outnumbers equity capital and reinvested earnings in the case of Chinese and Japanese investments.

Figure 4.1. FDI stock in selected CEECs from the main East Asian countries, 2012
(million EUR)

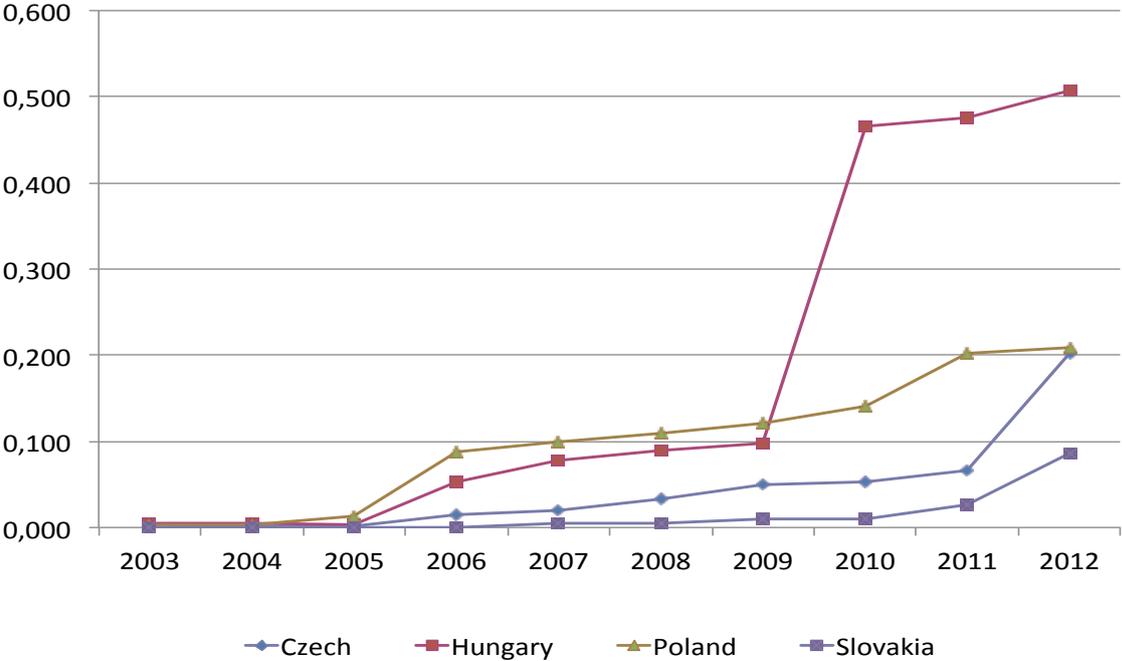
	China	Japan	South Korea
Czech Republic	-7.1	1058.1	1228
Hungary	65.4	772.6	1047.7
Slovakia	47.1	92.9	1899.1
Poland	218.5	1093.1	625.8

Data source: national bank data and OECD data for Slovakia

As figure 4.1. shows, according to selected CEECs’ national banks data South Korea has a dominant role in all countries except Poland; Japan is the largest East Asian investor in Poland, and the second largest in the Czech Republic, Hungary and Slovakia; while China is less significant.

In fact, the role of Chinese capital in CEE countries is still relatively very small, but recently this capital inflow has accelerated significantly and has also played an important role in the region's recovery from the crisis. Figure 4.2. shows Chinese FDI in the selected CEE countries based on a Chinese data source. As can be seen from the figure, there is a large discrepancy with the above-cited national data, especially in the Czech and Hungarian case. According to Chinese statistics, Chinese FDI in the Czech Republic started to increase from 2006 and reached 202 million USD in 2012. The official statistics explain this huge increase with the recalculation of stock for 2012, however, the components of this supposed growth are unknown. There is an inverse discrepancy in the case of Hungary as, according to Chinese data, the amount of Chinese investments reached 507 million USD by 2012.

Figure 4.2. China’s OFDI stock in Visegrad Countries, 2003-2012, (USD million)



Source: CEIC China Premium Database, 2012; MOFCOM 2013.

Nevertheless, this amount is far greater when taking into account cumulative Hungarian data, since a significant portion of Chinese investment is received via intermediary countries or companies, therefore it appears elsewhere in Chinese statistics. According to Hungarian reports, Chinese investment in Hungary by 2013 was around 3 billion USD⁴.

⁴ More than 1.5 billion USD from that is the investment of the Chinese chemical company Wanhua, which acquired a 96 per cent stake in the Hungarian chemical company BorsodChem through its Dutch subsidiary in 2010 and 2011 and later also invested in the development of BorsodChem. It is the largest Chinese investment in the CEE region so far.

Chinese investors typically target secondary and tertiary sectors of the selected countries. Initially, Chinese investment has flowed mostly into manufacturing (assembly), but over time services attracted more and more investment as well, for example in Hungary and Poland there are branches of Bank of China and Industrial and Commercial Bank of China as well as offices of some of the largest law offices in China, Yingke Law Firm (in Hungary in 2010, in Poland in 2012), Dacheng Law Offices (in Poland in 2011, in Hungary in 2012). Main Chinese investors targeting these countries are interested primarily in telecommunication, electronics, chemical industry and transportation. In addition to the largest investor, Wanhua, major investors are Huawei, ZTE Corporation, Lenovo, Sevenstar Electronics Co., BYD Electronics and Comlink.

Major Japanese investors are Suzuki Motor Corp., Sumitomo Group, Toyota, Denso, Matsushita Electronic Components, Panasonic, Sanyo and Mitsui. Majority of Japanese FDI is concentrated in the electronics and automotive industries. Only recently Japanese investors expanded their interests towards other industries such as food (Lotte's acquisition of Wedel and Pijalnie Czekolady), financial services (Meiji Yasuda's interest in Europa Group and Warta Group), fleet management (Hitachi Capital's acquisition of Corpo Flota) and cosmetics (Rohto's interest in Dax Cosmetics).

Korean investments are also focused in the electronic and automotive industries as well as chemical industry. LG Electronics, Daewoo, Kia, Hyundai and Nexen are one of the the major investors. According to researcher *Vilém Semerák* of the Prague-based CERGE-EI Institute the South Korean firms are following the footsteps of German ones in Central and Eastern Europe. "I actually think that South Korea is trying to replicate the German influence in central and Eastern Europe. When you look at what Kia and Hyundai have been doing in the past two years, they are clearly trying to imitate what Volkswagen and other car producers have been doing". They have moved their development centres to Germany and try to produce Europe-designed cars for European customers. And just like the Germans, they are also making use of cheap labour and relatively good production conditions in central and Eastern Europe." (Richter 2014).

Japanese and Korean MNCs when entering CEE markets most often choose greenfield entry mode. Korean MNCs initially engaged only in productive investment, but recently also carry out research and development activities (Szcudlik-Tatar, Mejssner, 2014). Regarding

Chinese entry mode, there are examples for greenfield or quasi-greenfield⁵ investments (Huawei, ZTE, Lenovo), as well as M&As (Wanhua) and joint ventures (Orient Solar, BBKA) (Szunomár et al., 2014).

4.1. Motivations of OFDI – macroeconomic aspects

Major advantages of CEECs to foreign investors are: “(1) the country’s tradition of manufacturing; (2) many qualified and skilled workers; (3) qualified production managers; (5) advantageous geographical location for the EU market; (6) relatively well established infrastructure (roads, railways, electric power, etc.); (7) lower labor costs than EU-15 countries; and (8) FDI incentive programs (several years’ tax holidays, duty free import of equipment, job creation grants, site development support, etc.).” (Ikemoto, 2007, p. 92).

When searching for possible factors which make the region a favourable investment destination for China, quality and the cost of labour is to be considered first. The selected CEECs’ workforce is skilled compared to other Central and Eastern European countries (CEECs). Labour costs are lower in the CEE region than the EU average, however, there are differences within the region as well; unit labour costs are cheaper in Bulgaria and Romania than in Hungary, Slovakia, Czech Republic and Poland. These differences don’t seem to really influence Chinese investors as there is more investment in Hungary, Poland and Czech Republic than in Romania and Bulgaria, however, an explanation for that can be the theory of agglomeration effect as generally OFDI in these countries is the highest in the region.

Concerning market size, Poland is the biggest in terms of the size of population, while the others are medium-sized or small. The Czech Republic and Slovakia are relatively affluent markets as well based on GDP per capita in purchasing power standards. In addition to the size of the market, the country’s convenient location in the center of Europe, generally positive overall business conditions also play an important role when searching for possible investment locations. For example, according to a survey by JETRO of Japanese manufacturing investors in Europe, cited in KPMG (2014, p. 24-25) (table X), Poland is assessed better in terms of management problems than the Czech Republic and Hungary. When choosing location in CEE for its new factory, Hyundai chose Czech Republic arguing: proximity of their other plants, strength of the Czech economy, the fact that the country is

⁵ Parent companies of Huawei, ZTE or Lenovo haven’t built up new operational facilities (as they chose the form of contract manufacturing) but created new long-term jobs by hiring new employees.

largest exporter of cars, components and electronics in the region. *Chiappini* (2014) found that Japanese overseas investments are mainly driven by host market size, yen real exchange rate, macroeconomic stability, resource endowments and some policy variables, such as confidence societal rules, control of corruption, government effectiveness, political stability and private sector policies.

Based on the well-known theory of *Dunning* (1992), we can distinguish four kinds of motivations to invest abroad. A foreign direct investment has a market seeking motivation if it aims to supply the local market or markets in adjacent territories. It may represent a deeper involvement of the firm, following the success of exports, or the expansion of the firm to a new market. Efficiency seeking FDI has two main forms: increase cost efficiency by transferring a part of production to low labour costs locations and investment aimed at rationalising the operations of existing MNEs. Natural resource seeking FDI flows mainly in utilisation of location specific minerals, raw materials and agricultural products. Firms increasingly use FDI to obtain tangible or intangible strategic assets that may be important to their long-term strategy but are not available at home. This is a strategic asset seeking motive. Using the mentioned framework of *Dunning*, we can find examples of all the four motivation types.

Concerning Japanese multinationals, a large majority of Japanese FDI in CEECs was directed at the manufacturing sector, especially transport equipment and electronics (like Yazaki, Toyota, Suzuki, Sumitomo, Panasonic, Sony). Toyota built a joint venture factory (TPCA) with Peugeot in the Czech Republic in 2001 (producing since 2005) and opened a transmission factory in Poland during the same year and an engine factory in 2005, that supplies TPCA. TPCA produced 200,000 cars in 2014, but has cut back planned production and employees for 2015.⁶ Several Japanese investors in the CEECs manufacturing sector preferred countries with lower corporate tax and a high rate of GDP growth. Thus, overall, Japanese FDI in CEECs is characterized by efficiency-seeking and market-seeking motives (Kawai 2006).

Access to EU markets was an important market-seeking factor (Woon 2003). The very first big Japanese investment in the transition countries was of Suzuki: in 1991 Hungarian Suzuki Corporation was established and serial production of cars started in 1992. By July 2014 over 2.5 million cars had rolled off the assembly line. The main motivation here was to get behind

⁶ <http://www.praguepost.com/technology/43340-tpca-to-lay-off-workers>

“EU walls”, as Hungary had signed an association agreement in 1991 and had prospects for membership. Suzuki continually invested in developing its factory and increased share of local supplies (in order to reach the local content level required for tariff-free exports to the European Union).

South Korea has had similar motives. Among the first, being a risk-taker and market seeker, Daewoo established a basis in Poland in the automotive industry and in electronics. The large Korean producer exploited the opportunities of the Polish privatisation process when taking over FSO automobile factory in 1996. Its suppliers followed and also invested in Poland. Later, other South Korean car producers (Kia and Hyundai) made use of cheap labour and relatively good production conditions and moved their development centres to the V4 to produce cars for European customers. The Hyundai Mobis plant is the third major South Korean investment project in the Czech Republic⁷. The Hyundai car plant started its production in 2009 and is still following an increasing trend in output. A Nexen tyre factory is built in Zatec, the agreement was signed in June 2014.⁸ In 2004 KIA Motors started to operate in Slovakia employing 3500 workers and producing five car models and also engines (ICEG 2012). These heavily export-oriented investments had the aim of acquiring markets utilising a qualified labour force.

Although generally, Chinese OFDI are characterized by natural resource-seeking and market-seeking (Buckley et al., 2007), in developed economies Chinese investment are more concerned with the wide range of objectives, including market-, efficiency- and strategic assets-seeking motives⁹ (Rosen-Hanemann, 2013, p. 69 and WIR p. 46). In the case of developed countries, Chinese SOEs usually have the majority of deal value but non-state firms make the greater share of deals (Rosen-Hanemann, 2013, p. 71). In addition to greenfield investments and joint ventures, China's merger and acquisition (M&A) activity in

⁷ In July 2014 the investment agreement was signed about the construction of the company for production of headlamps in Mošnov. The construction of the company is planned for September 2015 offering around 6-900 jobs. <http://www.mobis-auto.cz/en/aktuality/140804.php>

⁸ The firm will have a capacity estimated at 6 million units annually with more than 1,000 employees. <http://www.rubbernews.com/article/20140627/NEWS/140629958/south-koreas-nexen-tire-signs-czech-plant-deal#>

⁹ As *Clegg and Voss* note, the industry-by-country distribution of Chinese OFDI is difficult to determine from Chinese statistics. However, based on their findings, it can be stated that Chinese investments in mining industry are taking place mainly in institutionally weak and unstable countries with large amounts of natural resources and that these investments are normally carried out by SOEs. Investments in manufacturing usually take place in large markets with low factor costs, while Chinese companies seek technologies, brands, distribution channels and other strategic assets in institutionally developed and stable economies (Clegg-Voss, 2012, p. 19).

developed countries has recently gained a momentum and continue an upward trend since more and more Chinese firms are interested in buying overseas brands to strengthen their own. Considering the motivation of Chinese investments in CEECs, their economic integration into the EU has been the most important attractive factor especially in the manufacturing sector. Accessing the old EU-15 markets was the most important, while local markets were of secondary importance (market-seeking). EU membership of the V4 countries allowed Chinese investors to avoid trade barriers and the countries served as an assembly base due to the relatively low labour costs (efficiency-seeking, see McCaleb-Szunomár 2014). However, parallel with the increasing number of mergers and acquisitions in the region, strategic asset-seeking motives have become more and more important for Chinese MNCs in recent years. Chinese investments are also motivated by the seeking of brands, new technologies or market niches that they can fill in European markets.

Describing Chinese investments in the CEE region, Jacoby (2014) observes that their characteristics differ somewhat from those in the EU. Among the three forms of FDI (greenfield investment, mergers & acquisitions and strategic alliances) we can find more greenfield projects and fewer strategic alliances from the Chinese side than in the EU.

4.2. Motivations of OFDI – institutional aspects

The change of institutional setting of CEECs due to their economic integration into the EU (in 2004 and 2007) has been the most important driver that spurred OFDI in the region, especially in the manufacturing sector. Majority of Chinese firms that invested in CEECs after their EU accession were motivated mainly by accessing the old EU-15 markets and CEE markets were of secondary importance. CEECs' EU membership allowed investors to avoid trade barriers and the countries served as an assembly base due to the relatively low labor costs. The motive of overcoming trade barriers shows similarity with Japanese investments in CEECs in the second half of the 1990s. Japanese MNCs established assembly plants in CEECs, but sold their products mainly in the affluent Western European markets (Woon, 2003).

Another aspect of the EU membership that is inducing investments in CEECs is institutional stability (e.g., protection of property rights). According to *Morck et al.* (2007), one of the drivers of Chinese OFDI is unstable institutional, economic and political environment of their home country. It is in line with the findings of *Clegg and Voss* (2012, p 101) who argue that

Chinese OFDI in the EU shows “an institutional arbitrage strategy” as “Chinese firms invest in localities that offer clearer, more transparent and stable institutional environments. Such environments, like the EU, might lack the rapid economic growth recorded in China, but they offer greater planning and property rights security, as well as dedicated professional services that can support business development (Witt and Lewin, 2007; Wu, 2011).”

In their investment decisions in CEECs, East Asian firms might also be attracted by Free Trade Agreements between the EU and third countries such as Canada, the USA (being negotiated), and the EU neighboring country policies etc. as they claim that their CEECs subsidiaries are to sell products in the host, EU, Northern American or even global markets. Moreover, East Asian firms’ CEE subsidiaries allow them to participate in public procurement. Example is Nuctech company that established its subsidiary in Poland in 2004 and initially targeted mainly Western European market. Recently Chinese firms also interested in investing in CEECs became more inquisitive about food safety standards and certificates. They would be interested in exporting agricultural products with EU safety certificates to China where food safety has been a problem.

Characterising Asian investments and their motivation in the Visegrad region we have to mention the role of state subsidies and incentives. Especially before EU membership, but also afterwards, governments and local authorities applied sometimes tailor-made incentives to attract large investors¹⁰. In the case of Hungary the so-called “customs free zones” were highly attractive for greenfield foreign investors during the nineties. These export oriented automotive, electronics and other firms provided a huge share of foreign trade of the country. Poland and Slovakia too, provided corporate tax allowances and other incentives for foreign investors, for example, in Poland there are special economic zones with support services. The Czech government has also given subsidies, for example about €200 million in tax allowances, partial funding for employee training and other investment incentives to draw Hyundai to a high unemployment region (Walewska, 2014). Similarly, TPCA¹¹ was granted generous incentives from both the Czech state and from the town of Kolín, which paid for the complete development of the industrial zone, costs of traffic route extensions, sound barriers, new housing units and other adequate infrastructure. As a result, the town of Kolín is indebted

¹⁰ It must be highlighted that CEE countries usually compete for foreign investment by offering different types of incentives.

¹¹ The company is situated in the industrial zone Kolín-Ovčáry with around 3500 employees. Eighty percent of all parts for cars are sourced in the Czech Republic. More than 100 supplying firms (about 60 of them Japanese and a similar number of them from Western Europe) followed TPCA to the Czech Republic to work also for other car factories.

until 2019 (Guidote, 2008). The recently concluded agreements with Hyundai and Nexen have also included state incentives.¹²

Chinese MNCs seems to pay more attention to the level of political relation than Japanese and Korean firms. The smaller amounts of Chinese investments in the Czech Republic or Slovakia can be explained by the colder political relations of the past years (see Fürst-Pleschová, 2010). By contrast, Hungary – which is the major recipient of Chinese OFDI in the CEE region according to Hungarian cumulative data – has had historically good political relations and earlier than other CEECs, since 2003, intensified bilateral relations in order to attract Chinese FDI. Hungary is the only country in the region that introduced special incentive for foreign investors from outside the EU, which is a possibility to receive a residence visa when fulfilling the requirement of a certain level of investment in Hungary¹³. Moreover, Hungary has the largest Chinese diaspora in the region which is an acknowledged attracting factor of Chinese FDI in the extant literature that is a relational asset constituting firm's ownership advantage (e.g., Buckley et al., 2007). Example is Hisense's explanation of the decision to invest in Hungary that besides traditional economic factors was motivated by “good diplomatic, economic, trade and educational relations with China; big Chinese population; Chinese trade and commercial networks, associations already formed” (CIEGA, 2007).

In case of Poland only recently Chinese firms became also attracted by privatization of state enterprises which provide access to technology (patents), brands, distribution networks, and manufacturing capacity for European markets. Examples are: in early 2012 Liugong Machinery's acquisition of Huta Stalowa Wola's construction equipment division and its distribution subsidiary, Dressta. Until 2005, Dressta was a joint venture between Komatsu America and Huta Stalowa Wola and has sales offices around the world. Secondly, in 2013 China's Tri Ring Group Corporation acquired Polish Fabryka Łożysk Tocznych (the biggest Chinese investment in Poland so far), producer of bearings for automotive sector.

¹² Under terms of the Nexen contract, the Czech state will provide incentives at a maximum of \$190 million, of this, \$100 million tax relief on corporate income, \$50 million financial support to strategic investment, \$15 million for job creation, \$15 million from the Ústí region as a discount on the land and \$4.5 million in financial support for training.

¹³ Third country nationals are allowed to acquire Hungary's permanent residency status through investing in Special Hungarian Government Bonds that have a minimum 5-year maturity. The minimum initial investment by each subscriber is 250,000 EUR.

4.3. Evaluation of questionnaires (based on interviews with major East Asian investors from each selected CEECs)

Work in progress – see Annex for sample questionnaire

5. Conclusion

The investigation of the motivations of East Asian OFDI in CEECs shows that Chinese, Japanese and Korean MNCs mostly search for markets. CEECs' EU membership allows them to treat the region as a 'back door' to the affluent EU markets (tariff-jumping FDI). Investors are attracted by the relatively low labor costs, skilled workforce, and market potential. It is characteristic that their investment pattern in terms of country location resembles that of the world total FDI in the region. Our paper also showed that the CEE region (including the selected group of countries) is not homogeneous and that there are differences in the economic relations between CEE countries and East Asia, too.

Having examined the CEECs-East Asian economic ties, we can conclude that while Japan and South Korea previously had larger roles, recently China is pushing forward. Analyzing the difference in motivations before and after the global financial crisis it can be assessed that although it did not have an impact on East Asian investments in CEECs directly but it did have indirectly because as a reaction to the global financial crisis CEECs started to search for new opportunities for their recovery from the recession. For example, Hungary's "Opening to the East" policy was initiated after (and partly as a result of) the crisis, but the crisis also made Poland look eastward. China took these opportunities and has increased sectoral representation of Chinese firms in CEECs in recent years. Another reason for this higher Chinese representation could be a diversification strategy, because recently Chinese global investment strategy places great emphasis on diversification in all respects.

According to our research results, the characteristics, motivations and location determinants of Chinese investments in CEECs differ somewhat from Japanese and South Korean FDI: while in the case of the latter two countries macroeconomic factors (such as labour costs, market size, corporate taxes, etc.) had and still have a decisive role in selecting FDI locations, Chinese firms in addition to macroeconomic factors seem to attach more importance to institutional factors. Country-level institutional factors that impact Chinese MNCs' location choice within CEECs seem to be the size of Chinese ethnic population, investment incentives such as special economic zones in Poland, resident permits in exchange for given amount of

investment (in Hungary), privatization opportunities, etc., but also good political relations between host country and China (example Hungary's good relations and very high level of Chinese FDI when compared with other CEECs; while it is said that Liu Gong's acquisition of HSW might have been delayed because of COVEC's problems with building part of Polish highway).

Will be completed with the conclusion of the evaluation of questionnaires...

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Annex

Initial Questionnaire

RESEARCH PROJECT:
**Comparing Chinese, Japanese and South Korean FDI in Central and Eastern Europe:
macroeconomic versus institutional factors**

Confidentiality Clause: *The information provided in this survey will be used for the purpose of the study only. These surveys will remain confidential and will not be distributed. Anonymity will remain at all times.*

1.1. When did your enterprise invest in Hungary/Poland/Czech Republic/Slovakia?
(Please, underline as appropriate)

- | | |
|--------------|--------------|
| a. 1978-1990 | d. 2004-2007 |
| b. 1991-1999 | e. 2008-2013 |
| c. 2000-2003 | |

1.2. What is your company's investment type? (please, tick the box)

a. Greenfield	
b. Joint-venture with my company's majority share	
c. M&As with my company's majority share	
d. Wholly-owned company	
e. Joint-venture with my company's minority share	
f. M&As with my company's minority share	

1.3. What was your main motivation to invest in Central and Eastern Europe? (multiple answers possible, please, tick the box)

Domestic/Chinese market saturation	Access to technologies	Cost reduction	Government policy "go global"
Fierce competition on domestic/Chinese market	International well-known brands	Cheaper capital	Avoid trade barriers against Chinese exports

Production overcapacity	Distribution channels	Easier access to capital	Becoming global class corporation
Extending domestic competitive advantage to international markets	Products produced in Poland have label “Made in the EU”	Access to natural resources	Weak legal protection and IPR protection in domestic market
Diversification strategy	High quality universities		Following behavior of companies from my industry
Access to European Union market			Host country’s political stability, stability of law, security
			Benefitting from host country’s preferential investment policy

Other, please specify:

1.4. Why did you choose Hungary/Poland/Czech Republic/Slovakia for your investment?

(Multiple answers possible)

a. Because of large market	
b. First mover advantage	
c. Low barriers of entry	
d. Chinese Diaspora	
e. Skilled labor force	
f. Investment incentives (e.g., favorable taxes, special economic zones)	
g. Positive experience of other Chinese investors	
h. The country is location of my company’s clients	
i. Presence of international companies from the same industry	
j. Good infrastructure connecting Hungary/Poland/Czech Republic/Slovakia with other European markets	

If yes, how important is/are the client/s?

Not important	Slightly important	Average importance	Important	Very important

1.8. Does your subsidiary in Hungary/Poland/Czech Republic/Slovakia benefit from European Union funds?

If yes, what type? Please specify:

1.9. Have you heard about Free Trade Agreement negotiations between the United States and the European Union?

a. Yes	
b. No	

1.10. Would Free Trade Agreement between the United States and the European Union result in your company's increased investment in CEECs?

a. Yes	
b. No	

1.11. In what CEE countries did your company invest till now? Please write the year of investment next to the country. (Multiple answers possible)

Albania	Bosnia and Herzegovina	Bulgaria
Croatia	Czech Republic	Estonia
Hungary	Macedonia	Montenegro
Latvia	Lithuania	Poland
Romania	Serbia	Slovakia
Slovenia		

1.12. In what CEE countries do you plan to invest in the next 3 years? (Multiple answers possible)

Albania	Bosnia and Herzegovina	Bulgaria
Croatia	Czech Republic	Estonia
Hungary	Macedonia	Montenegro
Latvia	Lithuania	Poland
Romania	Serbia	Slovakia
Slovenia		

1.13. What are the main fields of activity of your planned investments in CEE countries in the next 3 years? (Multiple answers possible)

- | | |
|---------------|-------------|
| a. Production | c. R&D |
| b. Sales | d. Services |

Other, please specify:

1.14. What are main obstacles your company's subsidiary in Hungary/Poland/Czech Republic/Slovakia is facing? (Multiple answers possible)

a. High level/burdensome, complicated bureaucracy	
b. Difficulty obtaining visa	
c. Customers are unfamiliar with our brand	
d. Customers worry about product quality and safety	
e. Different business culture between China and Poland	
f. Lack of knowledge about legal and market risks in Poland	
g. Difficulty in finding business partners	
h. Other, please specify	

1.15. What is your company type:

a. State-owned enterprise	
b. Limited liability company	
c. Joint stock limited liability company	
d. Cooperative stock company	
e. Private company	
f. Other, please specify:	

1.16. To which industry does your main business belong? (Multiple answers possible)

1.17. How many people does your company in Hungary/Poland/Czech Republic/Slovakia employ?

Thank you very much for your cooperation!

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