

# **Chinese Outward Foreign Direct Investment in Finland: The main motives and obstacles**

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Abstract:	
<p>The objective of this study is to identify the main motives and obstacles behind the current Chinese outward foreign direct investment in Finland. Chinese outward foreign direct investment has become prominent global phenomena and China holds the position as the second largest investor in the world. In the recent years Chinese investors have displayed increased interest in Finland as an investment destination. Therefore, understanding the underlying motives behind the investment decisions has become ever more important. Chinas' political and economic environment has a direct impact on the FDI. However, due to the novelty of the phenomena, there are is no coherent theory that explains the push and pulls trigger of Chinese investment. Therefore the theoretical framework of this study is based on the leading foreign direct investment theories, which are being viewed from a macro and micro level perspectives. The main theory of this study is Dunning's taxonomy of FDI motives, which is used in evaluation of the Chinese FDI motives in Finland. The empirical study is conducted by using mixed methodology, which includes both quantitative and qualitative methods. The primary data was collected by in-depth interviews and government publications. The secondary data was collected from books, academic journals, newspapers and statistics. The findings of this study reveal Chinese investment in Finland is prompted by market and strategic asset seeking motives. Chinese companies enter the Finnish market to be closer to customers and suppliers, in search of talent and entering a larger geographical area. Acquiring innovations, new technologies and assets have attracted Chinese investor's capital. The main obstacle to attract investment is unfamiliarity of Finland among the Chinese investors. The prospective investors regard small market size, high operation cost and taxation as main hindrances. The outlook of Finland as an investment destination for Chinese ODI was considered optimistic if promotion and sales skills of Finnish enterprises improve.</p>	
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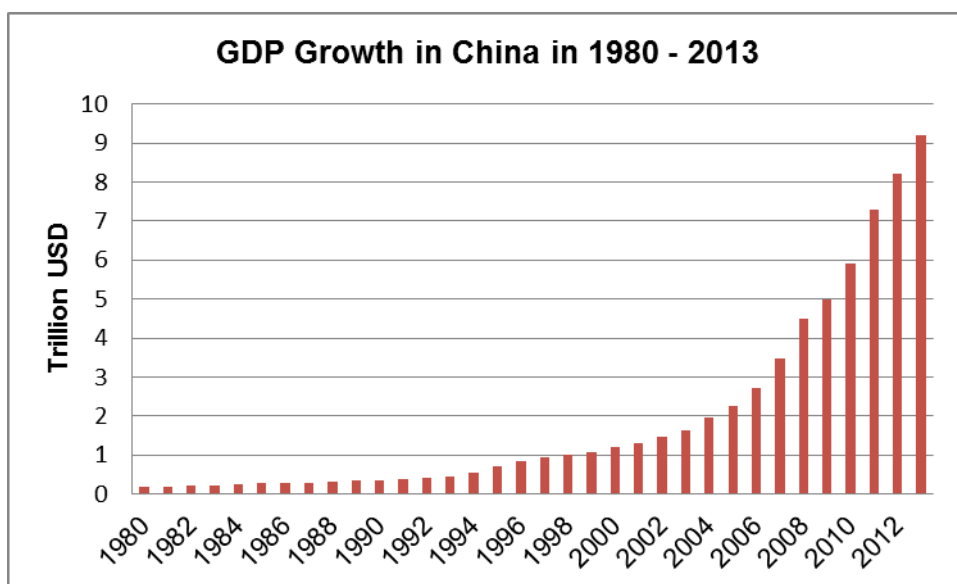
# **1 INTRODUCTION**

The first chapter of this study introduces the authors' motivation for studying Chinese outward direct investment in Finland and the significance of the phenomenon. Next, the aim of the study is being outlined, structure of the study is being explained and previous research history of the topic is introduced. Finally, the research questions are being formulated.

## **1.1 Motivation for the choice of research topic**

China's economy has undergone a great change since the adoption of major economic reform in 1978. Building on its astonishing economic growth over the past three decades, China is holding the position of the second largest economy in the world. China's economy has rapidly grown from an isolated developing country to one of the most influential power players globally, also in the form of foreign direct investment (FDI) and outward direct investment (ODI). The opening up policy and economic growth, urbanization and the accumulating wealth of the population have transformed Chinese society. Thanks to economic reform over the past three decades over 500 million people have been raised out of poverty. The rapid development of the Chinese economy is founded on rational leadership that focuses on identification of problems and systematical problem solving. However, despite the significant economic growth, China has considerable internal challenges, including increasing social and regional disparities.

Table 1. GDP Growth in China between 1980 and 2013 (World Bank, 2014).



As displayed in the graph above the growth of GDP has been enormous in the past three decades. In 1980 the gross domestic product (GDP) of China was only 202 billion USD (193 USD per capita) and in 2013 GDP was 9.3 trillion USD (6807 USD per capita). Since 1980s, Chinese economy's annual growth has been annually between 3,8 percent and 15,2 percent (China's National Bureau of Statistics). In the recent years global economic slowdown has been reflected in China's annual economic growth, which has been falling.

In 2013 the annual growth was 7,7 percent which were stronger growth than in Japan, Europe or the United States. The Chinese Government has been taking action to boost economic growth by implementing an extensive economic stimulus package and an expansive monetary policy. In 2014 the annual growth has been 7,5 percent and it is estimated to decelerate to 6 percent by the end of 2016 (Bank of Finland, 2014). Some financial analysts, however, point out that if the inflation rates remain moderate at 2 to 3 percent and employment remains at current state, the Chinese economy will fend despite slower economic growth. They further argue that the economic growth expectations may regulate the politics in a manner, which is discordant with fundamental economical elements (BOFIT, 2014).



*Table 1. China in the global economy in 2013 (National Bureau of Statistics of China, Ministry of Commerce People's Republic of China, Unctad, World Bank).*

	<b>China</b>	<b>Comparable share</b>
Population	1.35 billion	20% of world population
Gross domestic product GDP	\$9.240 trillion	12.4% of world GDP
GDP per capita (PPP adjusted)	\$11.904	37% of EU-28 average
GDP growth	7.7 %	2.9% global average growth
Inflation	2.4%	3.9% global average
Exports	\$1.85 trillion	11.7% of world trade
Imports	\$1.7 trillion	10.3% of world trade
Foreign exchange reserves	\$3.88 trillion	Largest in the world
Inward FDI flows	\$125billion	2nd largest in the world
Inward FDI stock	\$956 billion	4.7% of the world FDI stock
Outward FDI flows	\$107.8 billion	3rd largest in the world
Outward FDI stock	\$660.4 billion	11th largest in the world

As exhibited in the table China holds currently the position as the world's largest exporter and it is the second largest importer. Moreover, China is the holder of the biggest foreign currency reserves in the world (National Bureau of Statistics of China, 2013). China's economy, rapid annual growth has been mainly due to inward FDI (Whalley and Xin, 2006, p. 123-135). The Chinese economy is currently in transition and is seeking to shift to a model that is more balanced between exports and domestic demand. With annual GDP growth rates of average 9-10 percent in the past three decades, it is being estimated that China will become the second largest economy in the world after USA in 2018 (PwC, 2013). According to the International Comparison Program (ICP) China's economy will double in size in about a decade if it continues to grow at the current 7 percent. When China's GDP is measured by purchasing power parity (PPP), it is the third largest economic center after the EU and the United States. The economic growth is mainly due to FDI inflows to China, which have enabled the rapid acceleration of the economy.

The economic growth has an impact of the Chinese FDI trend and China is currently in transition. Chinese investors are investing heavily on foreign economies and in 2013 China was the 3<sup>rd</sup> largest foreign direct investor economy in the world. The astonishing growth of the economy, changing economic dynamics and new position in the global economic environment makes China an intriguing research topic. The topic is a great

personal interest of the author due to her close tie with the country. Establishing closer economic relationship between the countries is one of authors' great interests.

Promoting Finnish companies and Finland as an investment destination for Chinese is one of the authors' professional interests. Therefore the authors' personal attempt of the study is to deepen the understanding of the fundamentals lying behind Sino-Finnish FDI motives and through to develop ideas and strategies for mutual collaboration.

## **1.2 Aim of the study**

The main purpose of the study is to examine the current state of investments between China and Finland in order to determine what the underlying main motives for the outbound FDI flows are. Both China and Finland's future depend ever more on the countries' ability to discover growth through international expansion. Alongside with the economic growth, China is losing its low-cost advantage, and the country is in transition to become a high-value economy. Therefore, China is increasingly concentrating on developing the capabilities and obtaining technology that the economic transition requires. This is capitalized only through collaboration with foreign entities. Simultaneously Finnish economic growth is dependent on Finnish companies' international expansion. Finland has high expertise in several sectors such as IT, cleantech and medical technology to name a few. However, Finnish companies are unacquainted with to expand in emerging markets due to their inadequate knowledge and limited experience of these markets (Tekes, 2013). Emerging markets are lucrative since they offer great growth potential. The long trade history and sound relationship between the countries provide a promising basis for increased Sino-Finnish collaboration. There would be multiple benefits of the exchange since both Chinese and Finnish companies have several tangible and intangible assets. Where Chinese companies are experienced in doing business in emerging markets and have access to low-cost resources, Finnish companies are innovative and possess leading technologies. The phenomenon of Sino-Finnish investments is still new and the current research on the topic is scarce. Lastly, the additional aim of this study is to contribute updated data of Sino-Finnish investment research and provide some new angles to the previous studies.

### **1.3 Structure of the study**

The first chapter introduces the motivation for the choice of research the reader to the topic. The author will also outline what makes the topic significant for research. Next the objective of the study and research questions is formulated. Finally the limitations concerning the study are introduced. The second chapter provides a theoretical framework for the study. It will elucidate the main definitions of the study. The literature review introduces the most profound and cited micro and macro level FDI theories with a focus on Dunning's taxonomy of FDI motives. The third chapter will present and describe the methodology chosen for the study. It will provide a description of the material and methods that the author utilized for conducting this study. The fourth chapter begins with an introduction to the history and the current trend of Chinese ODI to familiarize the reader to the phenomenon. Next, the findings of quantitative and qualitative research are introduced. The final chapter begins with a discussion and analysis of the findings of this study from the objective of the main theory chosen for this study. The chapter will end with a suggestion for further research.

### **1.4 Previous research and research gap**

The flow of FDI from developed economies into emerging economies has been researched extensively. There are several studies concerning of Western MNE's foreign direct investments. However, the research on emerging economies' foreign direct investment patterns and outflow, such as China's, is still a novel academic topic. The available information of influencing factors and motives behind Chinese investments in Finland and other small, developed economies are scarce. There is also limited information on the overview and experiences of the Chinese investors have over Finland as a host country.

Consequently, with the significant growth of the Chinese outward direct investment, there is increasing academic contribution on the phenomena of Chinese investment patterns and trends. The authors have examined the new and rapidly growing trend of the global economy through giving overview of the general development and features of Chinese FDI. Yang (2003, 2006) introduces the Chinese FDI categorized as FDI emerging from a developing country and illustrates networks behind Chinese FDI. Yan,

Hong and Ren (2010) exhibit the determinants of ODI investment by Chinese enterprises during Chinese economy's institutional and economic transition. The Chinese FDI strategy has been researched, for example by Martins (2013). Timing and mode entry and partner selection decisions have been studied, for example by Lau and Bruton (2008). The cross-border acquisition strategy of Chinese companies have been examined, for example by Li and Xie (2013). The governmental role in Chinese FDI has been explained, for example by Morck et al (2008). He states that Chinese firms need to consider institutional, political and social aspects in their strategies. Nolan (2012) explains that there is still a significant gap between the operational system of large state-owned Chinese companies and the leading international enterprises due to the governmental influence.

The academic research and literature on Chinese investments in Finland is scarce. There are only few academic reviews and articles published by universities covering Chinese investments in Finland. The motives of Chinese foreign direct investments in the Baltic Sea region have been examined by Kaartemo (2007) and Barauskaite (2009). The studies include all the countries in the region without having specific country focus. The motives and location factors of Chinese ODI investments in small and developed economies focusing on Finland and Sweden has been studied by Lintunen (2011). Tax treatment of Chinese foreign direct investments in Finland has been researched by Räsänen (2012). Due to the limited research of Chinese ODI in Finland there is not information available for Chinese investors regarding the Finnish business environment and an overview of the experiences. Further research on Chinese FDI in Finland would benefit both Chinese stakeholders and Finnish service providers. Research on this topic would also contribute to the global research on the phenomena of Chinese ODI through giving better location specific information.

## **1.5 Research questions**

Since the economic reform in 1978 China has been a magnet for global FDI streams. The phenomenon of Chinese outward flow of FDI is still novel, yet it is becoming a prominent trend. The number of Chinese investments increased significantly after mid-2000s. The total investments accounted for 101 USD billion in 2013 making China the third largest foreign investor in the world (Bank of Finland, 2014). China identifies

investing abroad as a top priority of the Chinese Government in the period of the 12th Five-Year-Plan (2011-2015) stating that “China must adapt to a more balanced growth model, in which we place equal stress on imports, exports, attracting foreign capital and promoting outbound investments, instead of the current dependence on exports and foreign capital”. China has become an ever more prominent investor in the European Union, however Finland at current is among the minor investment destinations (Heritage Foundation, 2014). In order to attract more Chinese capital to Finland to gain a better understanding of the underlying motives behind Chinese investments as well as China’s general positioning in the global economy are crucial. The aim of the study is to detect distinct motives behind the investment decisions Chinese companies and investors undertake. Therefore the research questions for the study are following:

- What are the main motives for the Chinese investments in Finland?
- What are the main obstacles for Chinese investments in Finland?

## **2 THEORETICAL FRAMEWORK**

This chapter constitutes the theoretical base for this research and aims to bring into attention the most relevant theories and paradigms that exist in foreign direct investment. The main motives for FDI are discussed in details as it is the main subject of the research questions of this study. Even though FDI has “been studied extensively for several decades, no consensus to accept any theory of FDI determinants has been found. The available explanations based on the current mixed empirical evidence of FDI are country effect, differences in perspectives, markets, methodologies, sample-selection and analytical tools (Lily et al., 2014).

The leading research on the motivations for FDI have been developed by Dunning, Hymer and Veron. Dunning’s Taxonomy of FDI motives is chosen as the main theory of this thesis. His theories have made a profound impact on the development of modern FDI theories. It is one of the key theories in contemporary international business research, explicitly for studying foreign investment, entry modes and internalization, location decision and multinational enterprises’ activities (Huggins; Demirba; Ratcheva, 2007). Dunning is also regarded as one of the most significant references in international strategy (Peng and Zhou, 2006). This is supported by the Journal of International Business Studies (2009), which nominated Dunning the fourth most

important author on international business alongside with authors such as Peter Buckley and John and Klaus Meyer.

## **2.1 Key definitions**

In the following chapter the main concepts of this study are defined. Many of the concepts have several interpretations, so their meaning in this research is clarified and delineated. Also, brief background information on each concept is provided for the reader.

### **Foreign Direct Investment (FDI)**

Foreign direct investment (FDI) has a significant role in international business. The term refers to international investments where a resident in one economy attains a lasting interest and control in an enterprise resident in another economy through a long-term relationship (IMF, 1993). FDI is commonly investments such as wholly owned subsidiaries, joint ventures and mergers and acquisitions. FDI consist of three components equity capital, reinvested earnings and other capital, which mainly comprises of intra-company loans (UNCTAD, 2002). The foreign investor needs to hold at least 10 per cent either ordinary shares or voting power of an enterprise, so that the investment can be considered FDI (OECD, 1996). This is one of the main factors which differentiates FDI for instance from Foreign Portfolio Investment.

Dunning (2001) expands the definition of FDI by referring it to the intellectual capital and transfer of technology, hereby, including knowledge, technology, capital and financial assets, which are located in foreign economy. Foreign investments may be categorized either as horizontal or vertical FDI. Horizontal FDI is associated with investments, which are related to product facilities, which will benefit the host country market. Vertical FDI refers to investments in foreign economy, which are undertaken in order to gain advantage of resources and efficiency through intermediate input production (Tadesse and Ryan, 2004). The third type of FDI is Conglomerate FDI, which consists of both horizontal and vertical FDI (Moosa, 2002, p. 24). The FDI option which investor will be undertaken is defined by its strategy and location.

When reviewing reported data on FDI it is to be taken into account that it cannot be fully compared across all countries, since there are variations how the data collected of each FDI component is being collected. There are differences in particular about reinvested earnings, since pooling of the data depends on company surveys, which in several countries is not mandatory to report. Generally, companies engage in FDI in order to obtain strategic competences through forming strategic linkages with companies that attain complimentary capabilities (Nohria and Gracia-Pont, 1991). According to the most cited taxonomy of FDI motives by Dunning (1993) classifies four distinguishable motives for investment, which are resource seeking, market seeking, efficiency seeking and strategic-asset seeking investment. These motives will be reviewed in the theoretical framework chapter. The common characteristics of FDI in developing countries are that the activities are undertaken by multinational enterprises. Their activities are usually categorized into natural resource based activities, domestic market-oriented manufacturing and services, and export oriented, labor intensive manufacturing (Perkins et al. 2013, p.365) FDI enables a company to acquire strategic resources in a foreign market (Chen and Chen, 1998).

A new methodology for collecting and reporting FDI statistics will be implemented in the late 2014. The revised 4<sup>th</sup> edition of a Benchmark Definition for FDI, MMD4, will contribute more detailed and sophisticated measure of where international investments derive from, where it is headed to, and essentially, where it is creating jobs and value-added. The methodology differentiates between ‘real FDI’ to various financial flows that are at current regarded as FDI, yet do not bring extra value to ‘the real economy’. The upgraded measure for FDI contributes a more encompassing understanding of the economic and social effects of FDI and MNE activities to governments and other stakeholders alike (OECD, 2014).

### **Outward Direct Investment (ODI)**

Outward direct investment is also known as an outbound direct investment (ODI). The term stands for an investment flow out of a resident economy into foreign economy. According to the OECD definition transactions and positions are considered to be ODI when the ultimate controlling parent is from a foreign economy. The flow is contrary to the flow of FDI in which the investment flows into a resident economy. The investment

can be made in a form of Greenfield investment, merger and acquisition or expansion of an existing foreign business operation (Investopedia). MNEs engage in ODI in order to gain competence and have better business opportunities. The investments take commonly place when the domestic market is saturated and foreign market offers better prospects. ODI commonly occurs when the country's economy is growing to the extent that risk capital can be injected to foreign investments. For instance, foreign MNEs invested heavily in the Chinese economy in the 1990s. Consequently, China's economy had extensive growth and currently Chinese MNEs are engaging in ODI in rapidly increasing numbers.

### **Multinational Enterprise (MNE)**

Multinational Enterprise (MNE) is defined as an enterprise that manages value-adding activities, which are located in more than one country (Dunning and Lundan, 2008). In addition to owning value-adding activities, MNE may acquire resources and create goods and services in a range of countries. MNEs are divided into three categories by their strategies: global corporations, multi-domestic corporations and transnational corporations. MNE can be identified for having two distinct characteristics. First, it accesses, controls and coordinates several value-added activities in foreign markets. Second, it internalizes at least some of the cross-border markets for the intermediate products arising from these activities. The largest share of MNE activity is carried out by private enterprises from market economies. This indicates that MNEs are motivated mainly by what they find to benefit their direct shareholders, before the benefit of the wider community to which they belong to (Dunning and Lundan, 2008).

## **2. 2 Main Theories of FDI and Internalization**

The impact of FDI on the economic growth has been researched extensively. The study of capital related internalization and FDI derives back to 18<sup>th</sup> and 19<sup>th</sup> centuries Classical views. The engagement in research of the topic became prominent due to an increasing involvement in international trade. Despite extensive studies in internalization and early attempts to explain FDI, the research history of FDI is rather brief. The 1950s onwards was the outset of reconstruction of new global economy. MNEs were increasingly involved in international production and FDI became a



prominent research topic. However, the new era of FDI research began in the 1970s when the MNEs' investment motives were first time recognized to be multilateral and variable, instead of simply to be a response to the differences in the rates of return on capital between countries. Most of leading theories has been introduced during the latest four decades, with a majority of them published in the 21<sup>st</sup> century reflecting the internalization and increasing rate of global FDI activities.

The different determinants related to FDI have been defined in the modern theories. Therefore, it is to be noted that prior to the modern theories of FDI, the determinants and impacts of FDI, were evaluated theoretically without verifying it with empirical evidence. In the 1950s econometric models equations and indices were first utilized in discovering empirical results. Despite the prominence of the topic, the researchers have not able to create a single FDI theory or taxonomy that could explain the phenomenon. *Dunning's taxonomy of FDI motives* was chosen as the main theory for this thesis due to the worldwide recognition and general approval of the theory. The following chapter introduces other leading FDI theories and empirical studies that had a significant impact on the formulation of Dunning's taxonomy of FDI motives. The theoretical framework attempts to provide a general view on what factors trigger MNEs to engage in FDI.

### **2.2.1 Early theories of FDI motives**

One of the earliest classical attempts to explain internalization was Adam Smith's theory of international trade in *An Inquiry Into the Nature and Causes of the Wealth of Nations* (1776). Smith argues that a country should specialize in, and export, commodities in which it had an absolute advantage. When a country can produce a commodity in a lower price per unit than its trading partner, it has an absolute advantage in that commodity. Correspondingly, a country should import commodities in which its trading partner has an absolute advantage. Another classical theory that has a significant impact on the formulation of later FDI theories is a David Ricardo's theory of *Comparative Advantage in Principles of Political Economy* (1817). Ricardo opposed Smith's view of absolute advantage and claimed a country does not need to possess an absolute advantage in the production of any commodity for engagement in international trade. The two countries could profit from trade if each had a relative advantage in production. Relative advantage exists when the ratio of the labor embodied in the two commodities altered between both countries. Thus, each country would have a

minimum of one commodity, which production would consume less labor than that of the other country.

The modern contributions to microeconomic FDI theory date back to early 20th century. Among the first attempts to explain FDI as a phenomenon was Heckschers' (1919) and Ohlins' (1933) *the Heckscher-Ohlin model* on the international capital movement. The theorem is based on Ricardian framework of comparative advantages by predicting commercial patterns and production founded upon the factor endowments of a trading region. The Heckscher-Ohlin model evaluates international trade focusing on trade equilibriums between countries that have differences in abundance factors. The model states that the commodities a country will export are most probable to be the ones, which production leverages on the use of those productive factors that are relatively abundant in local market. Prior to the established trade agreement, the theorem argues that the price of the capital-intensive commodity in the capital-abundant country will decrease the price of the commodity in the trade partner country. Correspondingly, the price of the labor-intensive commodity in the labor-abundant country will decrease the price of the commodity in the trade partner country. After the trade between the countries is established, companies began exporting their commodities to the market that have higher price. Consequently, a capital abundant-country will engage in exporting capital-intensive commodities, while the labor-abundant country will export the labor-intensive commodities. The Heckscher-Ohlin model assumes that both countries are identical, with the exception of the difference in resource endowments. In addition, the theorem suggests that the aggregate preferences between the countries are identical. .

*The Rybczynski theorem* (1955) extended Heckscher-Ohlin models' analytical framework to be more comprehensive through a change in the factor endowments. In the theorem Rybczynski argued how differences in an endowment influence the outputs of commodities when a country has a full employment. Rybczynski suggested that when a region is open to trade with other regions, regional relative factor supply changes can be adjusted to regional outputs without a demand to adjust regional factor prices. An increase in the relative endowment of a factor will increase the production of commodities that engage that factor relatively intensively. Consequently, the production of commodities that do not engage that factor will decrease. The phenomenon shifts in production will increase the regional demand for the factor whose endowment has

increased. The essential mechanism for Rybczynskis' theorem is trade, given that regional production outputs are adjusted by changes in regional exports and imports. The theory has received recognition for its good analytics of the effects of capital investment, immigration, and emigration within the context of a Heckscher-Ohlin model.

Shortly after the Rybczynski theorems' introduction, Robert A. Mundell (1957) applied it to his theory *International Trade and Factor Mobility* on tariff-induced capital movement between two countries. His theory suggests that an increased trade barrier will stimulate factor movements. Further, factor barriers will stimulate trade. When capital-abundant and labor-abundant countries engage in trade, then theory expects both countries to export the commodities, which it is most abundant. With factor price equalization, capital flows will occur only when capital mobility is removed. Supposedly, if a labor-intensive country imposes a tariff on the capital-intensive commodity, its relative price increases. The imposition of tariff shifts the labor-intensive sector into the capital-intensive sector. The change in production when the prices are constant, results in an excess supply of labor and an excess demand for capital. Thus, the marginal commodity increases in a labor-abundant country in comparison to a capital-abundant country. Mudell's model state that changes in the structure of trade stimulates capital to search opportunities internationally. Despite novel insights, Hecksher and Ohlins', Rybczynskis' and Mundells' theories of underlying motives behind trade are limited due to their incapability of providing a comprehensive framework for analyzing trade and capital flows under more variable conditions. The main disadvantage of these theories is the limited scope of capital mobility. The theories are built upon the static two-country, two-factor, two-country framework creating a fixed setting for capital movement (Jin, 2010).

A milestone in the research history of FDI was reached when Stephen Herbert Hymer (1960) challenged traditional theories in his doctoral thesis titled with "*The International Operations of National Firms: A study of Direct Foreign Investment*". The focus of the research was about explaining how multinational enterprises are able to compete successfully against local firms. Through an empirical study of U.S. MNEs Hymer discovered that traditional theories were insufficient in fully explaining the motives of MNEs engagement in FDI. Hymer's argumentation is widely based on the existence of market imperfections (Nicholas Lohr, 2013, p. 37) He took market

imperfections as his theoretical assumption and analyzed MNEs FDI through “industrial organization approach”. Based upon this research, he developed the monopolistic advantage theory. The theory distinguishes two major and one minor reason for FDI. The first major reason is the profitability gained from diminishing competition between firms in different countries. The second major reason is that certain MNEs can profit from exploiting their existing advantages by founding foreign operations. The third minor reason is diversification, which was considered minor due to control is not necessarily involved in the investment. Further, Hymer argued that MNEs choose to invest abroad rather than to sell or license technology in order to cut or even eliminate competition. Hymer’s argumentation is widely based on the existence of market imperfections (Nicholas Lohr, 2013, p.37). According to Hymer it is requisite for firms to possess either proprietary or monopolistic advantage, which is specific to their ownership and able to outweigh the disadvantage that they have in cross-border competition, in order to own and control foreign value-adding facilities. Hymer further claims that firm-specific advantages enable MNEs operating profitability in foreign economies.

Corresponding to Hymer’s market imperfections and monopolistic advantage theory, Vernon (1966; 1979) developed a *Production Life Cycle Model* out of the critique of a neoclassical comparative advantage theory. The theory analyzes the relationship between product life cycle and possible foreign direct investment flows through an example of U.S. MNEs pattern in Western Europe after the Second World War. According to Vernon the monopolistic advantage could not distinguish the firms’ motives in their choice between export and FDI.

Vernon claimed that firms undertake FDI at certain stages of the manufacturing lifecycle. He distinguished that there are four stages in the production cycle. The first stage is an introduction of the product. During this stage the products are still unknown to the public and their demand is low. The introduction takes place in local, such as national, level. The products are then first introduced and exported to countries with similarities such as needs, preferences and incomes. Vernon assumes that if similar evolutionary patterns for all countries are presumed, then products are introduced in the most advanced countries such as the U.S. The second stage is growth. During this stage the success of the product is determined. The product is produced where the production cost is lowest and introduced to larger market segment. Growth stage is distinguished by

aggressive marketing. The demand for the product at growth stage will determine if the product will move into maturity stage or begin to decline. The third stage is maturity. During this stage, the production cost falls as a result of standardized production. This enables mass production and firms benefit of economies of scale. At this stage the production and the technology may be outsourced to developing countries to save on production costs. The final stage is decline of the product. During this stage, the demand of the product is gradually reduced, which will be reflected in both production and sales. The outdated products will exit the markets due to new alternatives that are entering the market. The demand for the product will decrease first in developed countries reaching last to the developing countries. The model uses solely U.S. firms as empirical evidence. Vernon's theory reflected the common 20th century observation that a large portion of the innovative products originated from U.S. Later, Vernon (1985) acknowledged that despite the theory could explain innovativeness of the U.S. MNEs the phenomena had relatively declined with the rise of a global surge of innovation.

The first attempt to establish an academic framework to describe the activity of MNEs was introduced by McManus (1972) and the framework was further developed by Buckley and Casson (1976) who introduced *The Theory of Internalization*. The theory was grounded on empirical evidence on the global pattern and development of FDI theories. Buckley and Casson argued that due to imperfections in the intermediate commodity market stimulate MNEs to seek growth through internalization. According to the theory organizations prefer to hold on to monopolistic advantages within the organization because of market imperfection and transaction costs. Intermediate commodities include various types of knowledge and expertise, such as patents, trademarks and reputation. As a result of the imperfection of intermediate commodity markets, organizations cannot efficiently evaluate the price of an intermediate commodity during the transaction in the external market. This will result in market uncertainty and a high transaction cost. Therefore, in the international operation, MNEs prefer the mechanism of administrative degree over transaction in the external market in order to reduce transaction cost and achieve maximum profit of intermediate commodities.

## 2.3 Dunning's taxonomy of FDI motives

Dunning is most renowned for his taxonomy theory (1993) which quadrates with his eclectic (OLI) paradigm that was first introduced in 1977. Both theories are created as an integration of several internationalization theories, including such as Hecksher (1919) and Ohlin's (1933) factor endowment theory, Hymer's (1960) monopolistic advantage theory, Vernon's (1966; 1979) Production Life Cycle Model alongside with Buckley and Casson's Theory of Internalization (1972). Dunning's eclectic (OLI) paradigm and taxonomy of FDI motives are holistic frameworks for identifying and evaluating the significance of the factors that influence FDI and MNEs engagement in international production (Stoian and Filippaios, 2008). The paradigm is a general, yet profound, theory. It attempts to explain the patterns of international business activity by focusing on the sources of competitive advantage that allow a firm to enter and compete in foreign markets.

In eclectic (OLI) paradigm Dunning explains FDI motives through an attempt to examine why, where and when/how decisions. Dunning (1997, p.275) suggests a firm will undertake an internalization process through FDI if the following three conditions are met.

1. It has net *ownership* (O-) advantages from other countries.
2. It brings some *location* (L-) advantages to use the company's ownership advantage abroad rather than at home.
3. It serves the company's benefit to *internalize* (I-advantages) those advantages instead of using the market to transferring them to foreign firms.

Table 2. OLI paradigm motives to engage in FDI (Dunning 1981).

		Advantages		
		Ownership	Location	Internationalization
Route of Serving Market	Contracts	Yes	No	No
	Exports	Yes	Yes	Yes
	Foreign direct investment	Yes	Yes	Yes

The model exhibits the requirements that are needed in order to engage in international trade as well as what kind of route will be chosen for serving the market. Dunning states that firms that possess only an ownership advantage will benefit economically the most by contracting its international production. Further, a firm with both ownership and internalization advantages should establish a new affiliate in a foreign country only if there are advantages from being localized. Otherwise, a firm should engage only in exporting to that foreign market. The firms that have all the OLI advantages should serve a foreign market through FDI. The limitation of the paradigm is that it is not able to explain or predict all kinds of behavior of individual firms or trends of international production (Dunning, 2001, p.176).

Dunning's taxonomy (1993) provides a more systematic approach to FDI motives through classifying them into four main categories: resource-seeking, market-seeking, efficiency-seeking and strategic asset-seeking motives. The first three categories are corresponding with the eclectic paradigm's O-advantages since their motives are to exploit FDI. As opposed to these categories the motive of strategic asset-seeking FDI is to acquire new assets for MNE. However, in order to engage in asset seeking FDI a firm needs to have certain domestic country specific advantages, which in the Chinese firms case are commonly exchange rates and market size.

The majority of the investments are seeking more than one type of advantage (Dunning and Lundan, 2008). In the first stage of engagement in FDI firms' motives are most commonly market- or resource-seeking. However, as the degree of international operations increase, the motives expand to efficiency and strategic asset-seeking investments. FDI can be characterized aggressively proactive or defensive. Chinese

firms approach to internalization is proactive and is typical for latecomer economies, where both economy and MNEs develop in fast pace. China has adopted proactive policies that enhance the attractiveness of FDI. The strong value-added institutional reforms, industrial policies, economical openness, including a certain degree of liberalization, are in the central role of Chinese FDI. The support Chinese firms receive are reflected in, for instance, in entering protected Western markets through mergers and acquisitions, which is exemplified by Geely acquiring Volvo in 2010 (Richet, Delteil and Dieuaide, n.d., 2014).

### **2.3.1 Resource-seeking FDI**

The first motive for the company to engage in FDI is resource-seeking. The main motive to this type of FDI for MNE is to acquire resources, which are specific and scarce. The commodities are commonly natural resources or raw materials (Dunning, 1993, p.56). The resources are usually of a higher quality and more cost-effective than at the domestic market, if the resource exists at the market (Dunning and Lundan, 2008, p.68). In all the resource seeking strategies, the key factors impacting on MNEs' investment decision are commonly the ones that have an effect on whether the company should produce a commodity domestically or purchase it abroad. The main motive for MNEs to obtain resource-seeking investments is to increase profitability and competitiveness in the markets it serves than it would be without engagement in FDI (Dunning and Lundan, 2008, p.68). Historically the majority of Chinese acquisitions has been undertaken to gain access primarily to resources that are scarce in China. The rapid development of manufacturing and building of infrastructure in China are the main underlying reasons for the phenomenon.

The resource-seeking motives are further subdivided into three categories (Dunning and Lundan, 2008, p. 68-70). The first motive is to acquire physical resources, which are rare in the domestic market. The MNEs that are prompt to gain physical resources are commonly primary producers or manufacturers. The aim of the MNEs is to save in the production costs and secures supply of resources. The physical resources the companies seek are commonly mineral fuels, industrial minerals, metals and agricultural products. Most often the main feature of physical resource-seeking FDI is often capital expenditure, which is relatively bound to the location. Chinese companies have been increasingly engaged in this type of FDI particularly in Africa for the past few decades



(Dunning and Lundan, 2008, p.68). China is the second largest importer of oil, yet its strategic oil reserves are minor. Therefore, China has started exploring opportunities through proactive engagement in an ODI in countries such as Angola, Equatorial Guinea and Sudan. Additionally, the majority of China's largest acquisitions have taken place in the resource sector. A state-owned China National Petroleum Company acquired a 100 percent holding of PetroKazakhstan in 2005. A member of a state-owned company, Sinopec, purchased a 96.9 percent stake in Russian oil company, Undmurtneft, in 2006 (Titan, 2010). A state-owned company, Jiangxi Copper Corporation, made the largest single foreign investment in Afghanistan in 2013, with a USD 4.4 billion investment in an undeveloped copper deposit (Downs, 2013).

The second motive is to minimize costs through seeking well-motivated yet inexpensive semi- or unskilled labor. The MNEs who are prompt to engage in cost minimizing are commonly manufacturers and service providers that have high labor costs. Thus, engagement in this category of FDI is usually flowing from developed economies to developing economies (Dunning and Lundan, 2008, p.69). Traditionally the great share of inbound FDI to China was concentrated on manufacturing. However, as the wages have risen alongside with economic growth, Chinese MNEs have begun to outsource labor intensive -manufacturing to countries with lower production costs in an increasing number. Besides investing in natural resources and infrastructure, the manufacturing sector in sub-Saharan Africa has attracted extensive number of Chinese investments.

The third motive is to seek technological capability, management or marketing and organizational skills, which are most commonly available in developed economies. The quest for skilled labor is increasing in the world, which generates potential for high value-seeking FDI to Finland. Chinese companies have shown interested in investing in Finland due to highly educated and skilled labor. Song Labs, a Chinese high-tech company manufacturing radiotherapy equipment, invested in Kuopio due to the highly educated and skilled labor among other factors. The company started to research and develop as well as manufacture the equipment in 2013 (Invest in Finland, 2013).

### **2.3.2 Market-seeking FDI**

The second FDI motive is market-seeking, which is the most common type of FDI. It is also the most common strategy for internalization of companies from emerging countries (UNCTAD WIR, 2013). The MNEs that are prompted by market-seeking FDI

invest in most of the cases in a specific country or a nearby country in order to supply commodities. Many of these markets have previously been serviced by exports from the investing MNE. The exporting has been ended due to an imposed tariff or other cost-raising barrier by a host country or the market size makes local production for economical. Market-seeking investment encases multifold benefits that the investing company can leverage. The underlying motives vary from sustaining or protecting existing markets to exploiting or promoting new markets (Dunning and Lundan, 2008, p.70). The location factors of market-seeking FDI are commonly market size, prospects for market growth and indigenous resources and capabilities. Additionally retaining competitiveness can pull investment. Furthermore, the engagement in market-seeking FDI improves the company's market power on local, regional and international level. Engaging in this type of strategic market-seeking investment derives often for defensive and aggressive reasons (Dunning and Lundan, 2008, p. 70)

There are four dominating motives why MNEs are prompted to engage in market-seeking FDI. The first motive is MNEs engage in market-seeking FDI to improve or retain their competitiveness. MNEs' which main suppliers and customers have established facilities in new markets often need to engage in market-seeking FDI to preserve their power position (Dunning and Lundan 2008, p.70). The investment provides strategic local advantages for companies. Being in the proximity of suppliers, customers and competitors, the companies are more agile and can react to the changes in the market in a faster pace. The second motive to be more market-oriented is prompted by a want to serve the local consumers' tastes and needs better. Localization of commodities varies from cultural aspects to indigenous resources and capabilities. In general MNEs have a better power position when they are familiarized with the local language, business etiquette, legal aspects and market procedures. The impact of adjusting to local taste is highlighted in commodities, such as drugs and cosmetics, a variety of food and drink goods and intermediary services such as financial and professional services (Dunning and Lundan, 2008, p. 70). The third motive is prompted by reduction of transactions costs. When MNE is present at the target market from an adjacent facility the supply costs are diminished. The third motive is highly country and activity specific. The commodities that have high transportation costs and can be manufactured economically in small quantities have a high probability to have a manufacturing facility close to the serviced market. MNEs from countries that have a

long distance to their important markets are more likely prompt to engage in this type of market-seeking FDI. The fourth motive is prompted by market competitive reasons. The MNEs often consider a physical presence in the main markets where its competitors are crucial. Also, the majority of the large-scale MNEs in oligopolistic sectors, such as oil, pharmaceuticals and advertising, have operations besides the triad areas in R&D. The engagement in other than the triad areas is taken due to defensive or aggressive reasons (Dunning and Lundan, 2008, p. 71). The difference between market-seeking and other types of FDI motives lies in the trend that market-seeking MNEs commonly keep their foreign affiliates as independent production units instead of connecting them to an integrated network within the MNEs' international activities.

Market-seeking motives constitute the majority of Chinese FDI internationally. The Chinese MNEs' engagement to market-seeking FDI has significantly increased in the past decade. Traditionally the underlying motive has been trade-supporting reasons. The internalization helps business to access distribution networks, to expand the volume of host country's exports in rapidly growing markets and to facilitate the exports of domestic producers (Buckley et al., 2010). The majority of Chinese market-seeking investments in Europe are concentrated on establishment of trade offices and the acquisition of distribution networks. Furthermore, the Chinese capital is injected in Europe and other advanced markets to respond to the increased sophistication of domestic markets demand (Pietrobelli et al, 2011).

### **2.3.3 Efficiency-seeking FDI**

The third motive to engage in FDI is efficiency-seeking, which aims to rationalize and position the existing resource-seeking or market-seeking FDI in a manner which benefits the investing MNE from the common governance of international activities. The main motives to engage in this type of FDI are to benefit from a common governance policy, risk diversification and economies of scale and scope (Dunning and Lundan, 2008, p.72). Additionally, gains deriving from production endowments, institutional arrangements and economic policies can pull investment. The benefits are mainly generated from product or process specialization, the learning process of international production, and the opportunities for minimizing the cost and price differences via exchanges. The common factor for companies undertaking efficiency-

seeking FDI is size. Typically, the companies are comparatively large MNEs which processes are standardized and geographically wide (Dunning and Lundan, 2008, p. 72).

According to Dunning and Lundan there are two main motives to engage in efficiency-seeking FDI. The first reason is to leverage from the differences in the availability and cost of traditional factor endowments in different economies. The second reason is to gain a benefit of the economies of scale and scope as well as of variance in consumer tastes and supply capability. Additionally MNEs benefit from different cultures, institutional arrangements and demand patterns (Dunning and Lundan, 2008, p.72).

Considering that the production and labor costs in China are low, the motive for Chinese investors to make efficiency-seeking investments in Finland is unlikely. However, developing countries have a tendency to place investments to developed countries for market-seeking purposes; small and large developing countries have a tendency to invest in developed countries for efficiency-seeking reasons, whereas large developing countries do so for both market and efficiency-seeking reasons (Kim and Rhee, 2009, p.140).

It should be noted that when reviewing the motives to engage in FDI it should be taken into consideration that many large MNEs have pluralistic objectives and the motives are a combination of all the above mentioned types of FDI. The motive may also change parallel to the development of foreign production and when company becomes established and experienced foreign investor (Dunning, 1993, p. 56).

#### **2.3.4 Strategic asset-seeking FDI**

The fourth FDI motive type is strategic asset -seeking. Strategic assets refer to resources and capabilities that are difficult to trade and imitate (Amit and Schoemaker, 1993, p. 36). A common way to make strategic asset-seeking investments is through acquiring assets of foreign company in order to replenish or increase the company's current assets. Strategic assets are often sought through merging or acquiring assets of foreign companies to gain competitive advantage in a new market and to promote long-term strategic objectives (Dunning and Lundan, 2008, p.72). The MNEs that are prompted by this type of FDI are commonly established MNEs that aim for an integrated international or regional strategy, and new foreign direct investors that look for acquiring a competitive strength in a foreign market. The main motive for strategic-

asset seeking FDI is to leverage of minimizing a particular cost or marketing advantages over the competing MNEs international portfolio of physical assets and skilled labor competences. Thus, strategic-asset seeking FDI enable companies to increase their ownership-specific advantages or decline other companies' competitiveness (Dunning and Lundan, 2008, p.73). The European manufacturing industry with its modernized technology has prompted Chinese investment during the recent economic crisis in Europe. The investment allows Chinese manufacturing industry to move up its' value chain and advance their position in the domestic market. Chinese has displayed specific interest in industrial machinery and automotive industries. Companies such as Volvo, Putzmeiser and Ferretti have attracted Chinese capital, which benefits their product positioning in rapidly growing Asian markets (Hanemann, 2013).

Strategic asset-seeking and efficiency-seeking investment share in common that they both target to profit from the benefits of the common ownership of diversified activities and capabilities or alternatively of closely related activities and capabilities in diverse economic environments. The parties engaging this type of FDI comprises of both established MNEs that seek integrated international or regional strategy, and direct investors that are making investments for the first time in order to access or acquire competitive advantage in a new market (Clegg and Voss, 2012, p.14; Dunning and Lundan, 2008, p. 72-74). Owing to the characteristics of the investments, the majority of the strategic asset-seeking investments are taking place in developed countries (Dunning, 1998). However, recently the trend is changing and increasing number of MNEs from developing countries are taking part in the strategic asset-seeking investments due to their apparent lack of ownership advantages (Dunning and Lundan, 2008, p. 74). This trend can certainly be read from the increasing number of Asian companies who are acquiring strategic assets. They commonly build a competitive advantage through acquisition of established companies in developed companies (Makino et al, 2002; Deng, 2009).

Chinese MNEs have joined the strategic asset-seeking FDI as a latecomer and in order to catch up with the international competitors, they are making significant investments rapidly (Deng, 2007). Only two decades ago China's total foreign holdings that were acquired through merger and acquisition were almost nonexistent. However, the trend has been soaring and in 2013 Chinese firms made 367 overseas deals accounting for US \$ 68 billion, making it the second largest investor after United States (Cheng, 2014).

One of the most recent examples of Chinese strategic asset-seeking investments is DongFeng Motor. In 2014 the company made a deal with Peugeot Citroen for USD 1,1 billion.

### **3 METHODOLOGY**

This chapter introduces the choice of methodology for this study. The research design is an essential part of the study since it establishes a framework for collecting and analysing data. Research questions provide a core for choosing an adequate research design. The chapter begins with specification of research design and data collection followed by an evaluation of research data. Next, the validation of this research is discussed. Finally, the limitations of this study are being named.

#### **3.1 Research design and data collection**

The research method of this thesis employs is a mixed research. This methodology includes both quantitative and qualitative methods. Since Chinese ODI in Finland is a novel phenomenon, there is limited scope of available primary data on the topic. Therefore the use of either quantitative or qualitative would be an inadequate choice of method. Either of the methods would result in creating obstacles and limiting the scope of research (Morse and Niehaus, 2009). Thus, mixed research can be considered as the incorporation of several methodological strategies or techniques in a single research study in order to address phenomena of interest that cannot be addressed solely by one method (Bergman, 2008, p. 9).

Several studies supporting the choice of mixed research, for instance Ras (2009) illustrated how adding a quantitative component to her qualitative case study improved the results. The choice of mixed method increased the trustworthiness of her interpretations of what she discovered from her interviewees. The quality of research has profoundly increased through the development of multi methodology and simpler forms of triangulation in research. The use of mixed methods can at many occasions contribute to improve results with diverse data and more valid results (Morse and Niehaus, 2009). Consequently, the use of a combination of methods can provide a tool for validate researched issues. All the same, it is to be noted that adding an extra method

could have a reverse causation. Quantitative and qualitative methods are commonly adhered to separate sampling principles; thereby validity issues are often inherent when an additional method is taken in a study that is initially outlined of qualitative or quantitative principles (Morse and Niehaus, 2009).

The methodology for a research needs to be determined by a theoretical drive, which denotes the conceptual direction of the project on the whole. A theoretical drive is either inductive or deductive and can be determined from the research question. Additionally, the synchronization of core and supplemental components needs to be performed either simultaneously or sequentially. The process of synchronizing is initiated in the theoretical drive and the requirements of the study (Morse and Niehaus, 2009). The theoretical drive chosen for this study is deductive. In deductive reasoning the research topic is approached from general to specific. A deductive approach considers first the existing theories and allows the author to develop an idea about the phenomena. Followed by the study of theories, the topic is being narrowed down to discuss and create a hypothesis. Followed by a hypothesis, observations of the phenomenon can be collected to address the hypothesis. This finally directs the research to the point where the hypotheses with specific data can be tested and create a confirmation of the original theories (Trochim, 2006).

The Overall view of Chinese ODI in Finland is formulated by using a desk study methods, such as statistical publications, news, articles and media reports of the companies involved in the bilateral investments. Further, open-ended theme interviews were conducted. The criteria for the chosen interviewees were profound experience in Sino-Finnish investment and trade. The interviews recorded and main points of the interviews were transcribed.

### **3.2 Research data**

Primary data in this research have been obtained by interviews with investors and business professionals engaged in Sino-Finnish investments and trade. The advantage of primary data is that the researcher collects data that is specific to the studied topic. Furthermore, the author has clear terms of the quality of the data. The disadvantages in the use of primary data are the difficulty and time-consuming process of the data collection. Additionally the researcher needs to take ethical considerations into account

when using primary data. Some of the information obtained through interviews may be confidential and protected, thus consent and permissions may be required for the usage. The crucial aspect of primary data is to ensure it has high standards. All the data needs to be collected accurately and in the correct format. The data need to be authentic and fake data is against prudent validity standards. Additionally the data need to be relevant and the unnecessary data need to be delimited. These factors have been adopted in this study and all the primary data is accurately collected, authentic and relevant.

Secondary data in this research has been obtained from reliable and official sources to ensure high standards of the data. The advantages of using secondary data are multiple. The main advantage of secondary data is time-efficiency (Ghauri, 2005). The accessibility of the data is simplified as databases can be obtained through academic online portals and search engines. On the other hand, one of the main obstacles in use of secondary data is the selection of valid data. Therefore the relevance and significance of the data has been carefully considered before including it in this study. Closely related to the advantage of accessibility of the data, saving money is another key advantage of secondary data. The cost effectiveness of secondary data is notable compared with primary data that may include additional costs (Ghauri, 2005). Secondary data that are continuous and regular, such as government statistics, provide feasibility for both longitudinal and international comparative studies, such as the chosen topic for this thesis. Even if there are significant differences between the countries, the government studies are regulated and the international criteria are implemented in the majority of countries. Another benefit of secondary data is that it may develop novel insights from previous research (Fabregues, 2013). Similarly, reanalyzing data can generate new discoveries. The disadvantages of secondary data are invalidity of the data. The inappropriateness may derive for instance from the inability to answer the research question or data is outdated. Another disadvantage is deficiency of control over data quality (Saunders, 2009). For instance, governmental institutions in general provide high standard data, yet this is not always the case. The possible validation problems regarding the data quality will be discussed in the following chapter.

### **3.3 Validation of study**

The concepts of reliability and validity have a high significance in mixed research since they determine the objectivity of the research. Reliability and validity can be considered



as two separate measurement instruments that exhibit the level of credibility and trustworthiness of a research. According to Bryman and Bell (2007) reliability and validity are divided into internal and external concepts. Internal validity refers to the degree of confidence in the cause and effect relationship in the study. External validity refers to the process of generalization and if the results can be extended to make predictions on a larger scale pool (Cambell and Stanley, 1966).

The mixed research method includes an opportunity for richer data and more in-depth findings. Simultaneously a risk of invalid results, due to additional research method increases. After a careful consideration of validation risks, the following principles were adopted in order to obtain reliability and integrity in this research. Since mixed research adopts both quantitative and qualitative methods, validation is being reviewed from both perspectives in the context of this study. In order to minimize the risk for invalid results in the quantitative part of the study, the accuracy of secondary data was confirmed in the following manner. Journals were accessed through academic portals i.e Arcada's Nelli Portal, academic literature was obtained from reliable online sources and library, news were gathered from reliable sources, such as Bloomberg and Forbes, and the statistics were collected solely from official sources. The accuracy of Chinese statistics has been under constant discussion in the previous years. Consequently, Chinese statistics bureau has taken actions to improve data methodology and collection to provide more valid and transparent data for policy makers. In 2012 China adopted a unified system to directly collect output, retail sales and investment data from companies to provide higher reliability and reduce manipulation of data by local authorities (Bloomberg, 2013).

In qualitative research, a primary objective for researchers is to authentically illustrate the studied phenomenon. The validity of qualitative research is compounded on the five following types: descriptive validity, interpretive validity, theoretical validity, evaluative validity and generalizability (Maxwell, 1992; Walsh, 2003). In this research these criteria are being taken into consideration. Descriptive validity refers to the accuracy of data. All the data used in this study are from official, reliable sources and all the interviews are transcribed accurately. Interpretative validity refers to the degree that the researcher accurately explains the meanings given by the participants of the studied topic. All the interviews that have been done to this research are transcribed in a verbatim account, so that the original viewpoint and the meaning of the interviewees is

accurate. Theoretical validity stands for the degree that a researchers' theoretical description is aligned with the data. Choosing theory triangulation or in other words use of several theories improves the validation. In this study theoretical validity have been approached by choosing to review multiple leading FDI theories, instead of reviewing only Dunning's taxonomy of FDI motives. Generalization refers to the degree to which the study can be generalized. The results in this study reflect the previous findings done in studies concerning Chinese investments in Finland. Furthermore the results are at large extent in accordance with mainstream theories. It is however to be noted that the majority of the theories and paradigms are designed for developed countries instead of emerging economies such as China.

### **3.4 Limitations**

The phenomenon of investments from China to Finland has history for less than two decades. ODI from China to Finland is a novel topic for academic research. Consequently obtaining secondary data creates a limitation in the study due to a scarce number of studies, publications and statistics on the topic. The number of Chinese companies and investors in Finland is limited, which sets an additional obstacle for gathering primary data. The pool of qualified respondents in Finland is relatively small and limited. Therefore, finding suitable interviewees was a laborious process. However, all the interviewees who participated in the study gave valuable information regarding the research topic.

This study concentrates finding the underlying motives behind Chinese investments through reviewing them based on Dunning's Taxonomy of FDI motives. The theory is written from a Western perspective and thereby cannot give a fully accurate description of Chinese motives to engage in FDI. The motives to invest in foreign economies diverge between macro and micro levels. Chinese government's investment motives may differ from those of Chinese private companies. The intricacy and scope of underlying motivation create a limitation for the study to measure and classify all of them, hence the results are based on Dunning's theory.

Another limitation of the study is its applicability to other small and developed countries since the chosen geographical scope is limited. The characteristics and

dynamics of each market are unique, which create a challenge to apply the findings to other markets. The political relationship between the countries has a definitive impact on the outcome of the economical input.

## **4 FINDINGS**

This chapter consists of reviewing the results that were generated by using both qualitative and quantitative research approaches. The research received 3 in-depth interviews from professionals working within Sino-Finnish investment and trade. The results reveal the underlying motives behind investments between China and Finland. Before the assessment of results, a general overview of Chinese inward and outward FDI is introduced in order to understand the current trends.

### **4.1 Overview of the Chinese investments**

#### **4.1.1 Foreign Direct Investment in China**

As the first chapter introduces the economic growth of China's originates four decades ago when economic reforms and trade liberalization was initiated. Since the opening up policy was adapted, China has transformed from a poor, developing country into one of the fastest-growing economies. Resulting from the economy's immense growth China has become a leading global economic and trade power. One of the main drivers to economic growth has been FDI. The early stage of FDI in China began in the early 1990s. Despite the open door policy in the late 1970s, the stream of FDI was modest for the first decades. The new welcoming era of FDI in China was initiated by Deng Xiaoping after his tour in southern coastal area in 1992. The tour stirred new confidence and entrepreneurship. Despite the FDI underwent a slope during the Asian financial crisis, the growth set in again in 2000 as China accessed into WTO.

After 10 years of 'Go Global Policy' was adapted, China took the position as the second largest recipient of FDI in the world. After three decades of economic reform, the annual inflow of FDI surpassed astonishing USD 100 billion. China has been estimated to have received USD 128 billion of FDI by the end of year 2014 (See Figure 1). The growth the previous year was only 1.7 percent in comparison to the 5.3 percent growth

in 2013. When the growth of FDI is measured by percentage, the FDI has annually been declining since 2013. The new downward trend is an indicator of the structural change in Chinese economy.

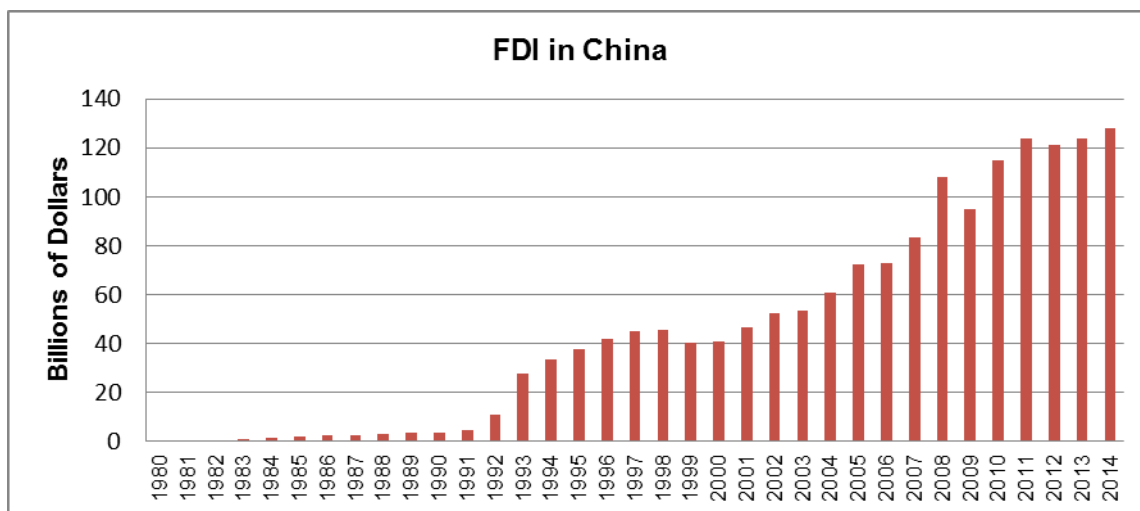


Figure 1. Foreign Direct Investment in China 1980-2014 (UNCTAD, 2015).

In terms of sectorial distribution of FDI, traditionally the largest share of the inbound capital was directed into labor-intensive, technology-intensive and capital-intensive manufacturing, which contributed for the massive economic growth and made China become recognized worldwide as the factory of world (Tseng and Zebregs, 2002). The sectorial distribution of FDI has changed over the past years and the main engine of Chinese economy has become the service sector. In 2014 the service sector accounted for 55 percent of all FDI. The labor-intensive manufacturing industry is experiencing slowing growth, whereas investment into high tech is increasing (UNCTAD).

#### 4.1.2 Outward Foreign Direct Investment from China

Whereas the FDI in China is slowing down its pace, the ODI from China is rising annually. The turning point for Chinese ODI dates back to Chinese government policy on its 10th five-year plan in 2001 that encourages outward direct investment to be adapted by number of governmental actors (Buckely et al. 2008).

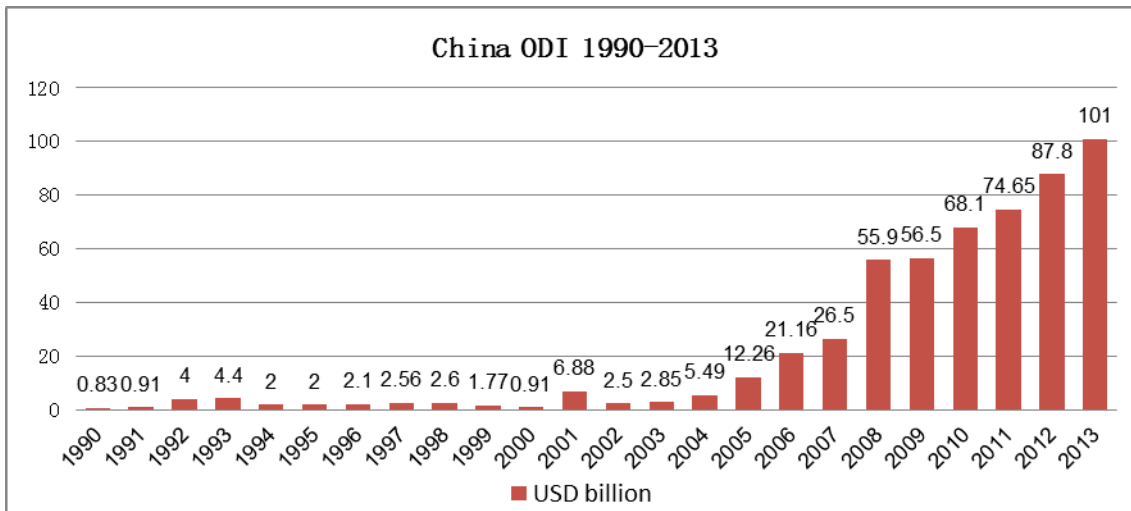
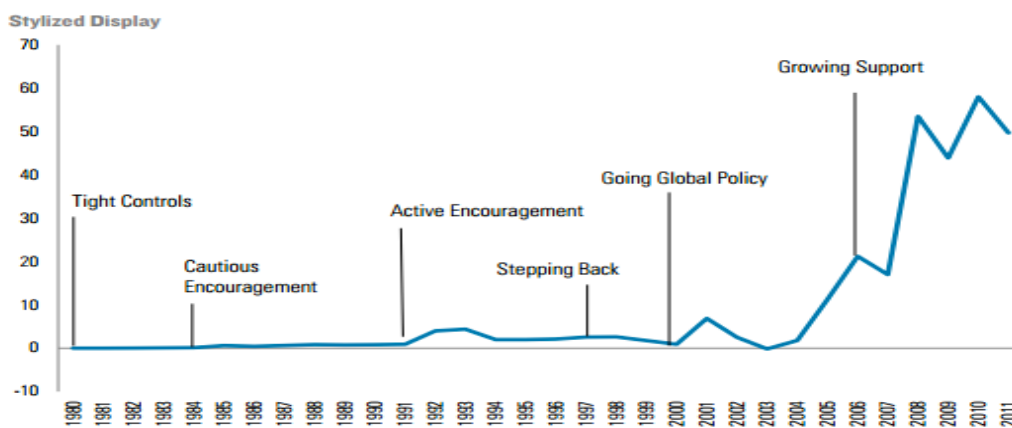


Figure 2. Outward FDI from China 1990-2013 (UNCTAD, 2014).

Chinese ODI has increased from USD 915 million in 2000 to USD 12.3 billion in 2005, and further to USD 101 billion in 2013 making China the third largest investor in the world (See Figure 2). Alone in the past 5 years ODI has almost doubled with 1.8-fold growth. According to the 12th Five-Year Plan (2011-2015) Chinese ODI is going to reach USD 150 billion by 2015. Consequently the influence of Chinese ODI to overseas finance has become indisputable with the growing investment rates.



Source: Authors. For a detailed overview of China's outward FDI framework and its liberalization, see Rosen and Hanemann (2009).

Figure 3. The Liberalization of Chinese Outward Direct Investment (Rhodium Group, 2012).

The significant growth of ODI was initiated by setting the 'Going Global Policy' and accession to the World Trade Organization. The reform had a positive effect on the

number of exports, which significantly broadened the export base. The acceleration and diversification of external gave further boost to expand market-seeking and trade-facilitating ODI internationally (See Figure 3). The rapid development of urban infrastructure and expansion of heavy industry among other factors are driving China's large demand for natural resources. In order to meet the requirements, the government had to renew its resources autarky and acquire resources from international markets. Alongside securities, Chinese companies wanted to expand to foreign markets in order to gain competitive edge (Rhodium Group, 2012).

Internalization of Chinese companies play central role in China's attempt to establish its position in global economy. The phenomenon has attracted attention from both worlds' leading politicians and media, since number of large Chinese enterprises are controlled by the government and are not market based (Bank of Finland). This new surge of Chinese investments forms both challenges and opportunities for EU countries. Chinese ODI however is seen attractive and it is predicted to improve overall European economic situation from the global economic downturn (Meunier et al., 2008).

Over the past decade China and Europe has established closer bilateral collaboration. Consequently China has become one of the most significant economic partners to Europe. Besides the growing number of exports, European companies have increased their presence in the Chinese consumer markets. Traditionally the investments flowed from Europe to China, but the number investments from China are rapidly rising. Until recent years Chinese investments have been minor in Europe compared with international FDI (See Figure 4). However the current development of Chinese ODI in EU shows that the trend is changing. Chinese investments are mainly directed to services and consumer markets (Deutsche Bank). At current Chinese ODI Finland is among the minor investment destinations in Europe, yet Chinese firms have shown stronger interest in investing in Finland in the past years (Bank of Finland, 2013). Despite the increasing number of Chinese ODI it is still minor in EU, accounting for less than 1 percent of the total stock of FDI (KPMG, 2013).

Geographical Distribution of China's OFDI Stock, 2004 and 2013

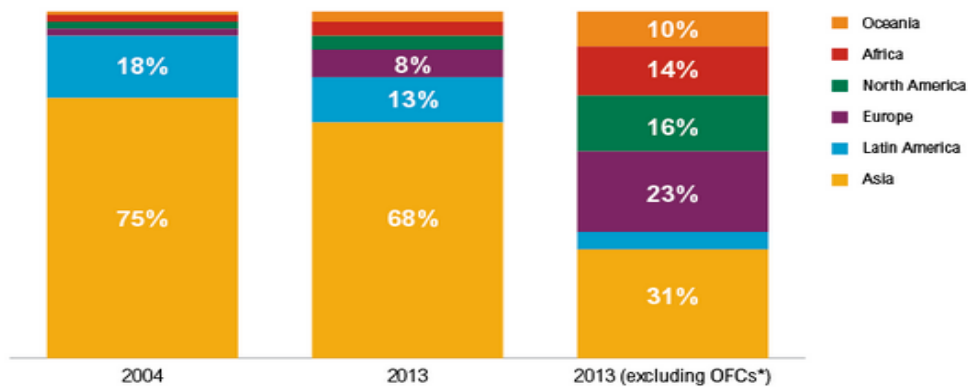


Figure 4. Geographical Distribution of China's ODI Stock in 2004 and 2013 (World Resources Institute, 2014).

The total stock of Chinese ODI in EU was only EUR 6.1 billion in 2010, which was less than what was held by India or Nigeria. Majority of Chinese investment in EU are fragmented and do not follow a general pattern. Thereby, Chinese investments do not equate to grand governmental strategy, but the investments are rather motivated by commercial drivers. However, the increase of investments is signaling a change in Chinese investment. The Chinese investors' interest was awakened by the debt crisis. Instead of retreating from European market China-based companies surged into EU. Some of the largest investments were directed to countries that were most severely hit by euro zone periphery. The investments were mainly motivated by cheapened assets and structural secular shift in Chinese ODI.

The growth model is shifting rapidly in China. Chinese companies' growth is constantly accelerating and it is inevitably linked to investing in developed countries. Chinese companies are now targeting their focus from securing natural resources to acquiring brands and technology in developed countries. Some companies are motivated to engage in the acquisition of well-known brands and technology in order to gain a competitive edge in the domestic market. For others, operating abroad provides a stable solution for performing value-added activities in advanced regulatory locations such as European Union (Hanemann, 2012).

The investments have been steadily increasing in the past years. The total investments in before European financial turmoil in 2010 were only USD 3.5 billion and almost tripled within one year resulting as USD 10 billion overall investments in 2011. The trend is upward and the investments accelerated to USD 18 billion by the end of year 2014. The sharp increase in the number of investments is due to recent economic reforms. In 2014 China has undergone several reforms, which enable Chinese investors to engage in ODI without governmental intervention. The companies are now able to invest abroad by merely informing about it to officials. Formerly the engagement in ODI required a lengthy process to receive the official approval (Bank of Finland, 2014). Regardless of the rapid increase of Chinese ODI in Europe in the recent years, the development of investment will be more gradual process.

The most popular investment destination in 2014 for Chinese ODI was the United Kingdom receiving investment for USD 5.1 billion , followed by Italy USD 3.5 billion and the Netherlands USD 2.3 billion respectively (Baker McKenzie, 2014). The British property market attracted Chinese capital and the sector alone received USD 2.6 billion investment. Italy received the second place mainly to State Grid Corp that made USD 2.8 billion acquisition of CDP Reti, an energy-grid holding company. Recently China has invested more heavily on the private assets in Europe's weaker periphery. Over the past decade, the trend was the opposite and 70 percent of all the investments were places in economies that were less-severely affected by the financial crisis. Additionally majority of the investments are clustered in Central Europe with easy access to major European consumer markets. Overall, the investment trend of Chinese companies in Europe resembles the ODI pattern of other commercially driven economies.



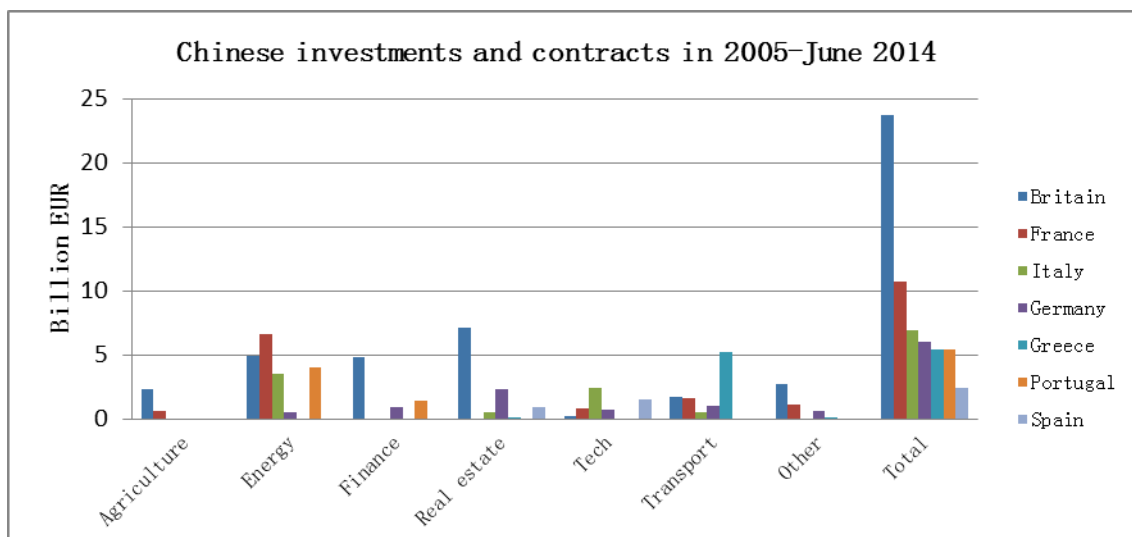


Figure 5. Chinese investments and contracts in 2005-June 2014 (Heritage Foundation, 2014).

Chinese investment is flowing into several European countries and industries, with targets varying from German machinery makers to Portuguese electricity Italian energy industry and British real estate (See Figure 5). Chinese investment is spread over all sectors with a focal point on technology, brands, skilled workforce and sales channels for higher-value added products are services (Hanemann, 2012). In 2014 the main sectors for Chinese ODI was agriculture and food attracting USD 4.1 billion, followed by energy USD 3.7 billion and real estate USD 3 billion respectively (Baker McKenzie, 2015).

#### 4.1.3 Chinese Outward Foreign Direct Investment in Finland

Finland is at current among the minor recipient of Chinese ODI in Europe. Finland's outstanding advancement and expertise in high technology and innovation, however has attracted Chinese capital. Consequently Finland is among the main source of FDI and technology in Northern Europe (MOFCOM, 2013). In order to enhance the existing commercial relationship Finland and China made a new agreement on expanding bilateral co-operation between countries on technological innovation, clean energy, urbanization and sustainable energy in 2013. The trade and investments between countries is expected to increase in the future (Xinhua, 2013).

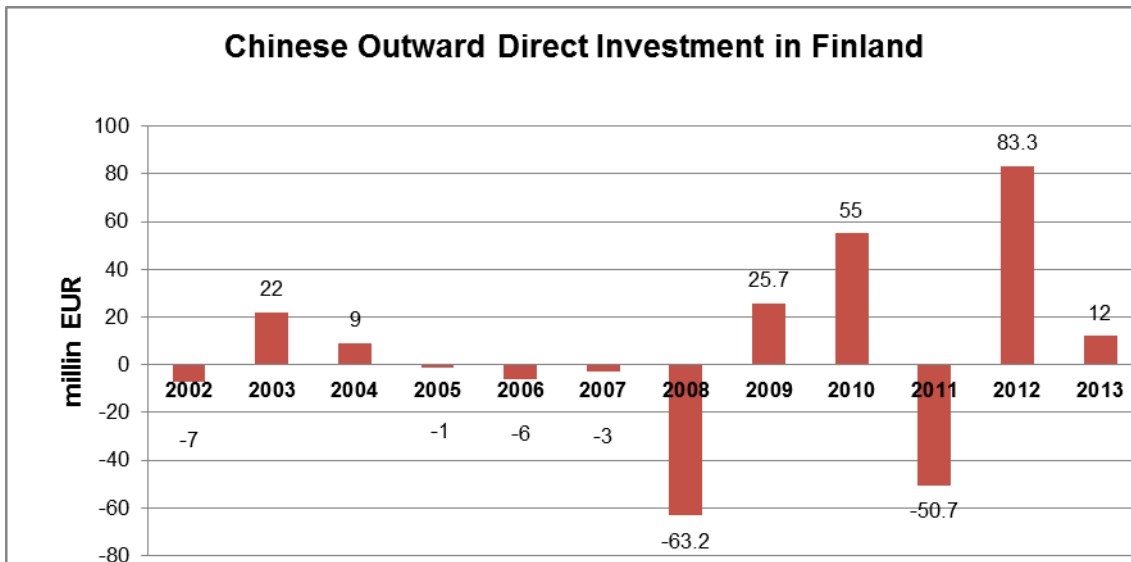


Figure 6. Chinese Outward Direct Investments in Finland (Statistics Finland, 2015).

The Chinese investments began to embark to Finland after economic reforms were adapted in early 2000s. The first 6 years of Chinese investment the stream of investments were modest, with only two surplus investment years (See Figure 6). The investments took a downward slope during the global economic crisis in 2008 and the Chinese investment was 63.2 million euros in deficit. European financial crisis in 2011 50.7 million euros in deficit. Due to the financial crisis asset prices lowered and Chinese investors were encouraged to invest in Europe. In 2012 Chinese invested the historically most in Finland and the investments were 83.3 million surplus. As exhibited in the figure in the recent years there has been positive development in the interest that Chinese investors have displayed towards Finnish companies, namely in ICT, cleantech and technology industries. The economic regression in 2013 diminished Finnish exports and foreign direct investors' interest towards Finnish market. The trend is reflected in the reduced number of Chinese investments in 2013.



Figure 7. Chinese Affiliates in Finland by sector (MOFCOM, 2014).

At the end of 2013 there were 16 Chinese affiliates located in Finland. The majority of the affiliates with 37.5 percent were in sales and marketing (See Figure 7). The companies operate in the fields of telecommunications, ICT, wholesale. The second largest group of affiliates with 25 percent operated in administration and service. The companies operate in fields of telecommunications, ICT, aviation and the car industry. The minor share of affiliates, both with 18.7 percent operate in fields of manufacturing and R&D. The companies work within the ICT, medical technology and mobile technology. Finnish exports to China are an indicator of the industries, which can prompt Chinese investment. At the end of the year 2013 the largest export good group was motors and special machinery for industries with 27.2 percent share of all exports. Wärtsilä, Metso Group and Kone are well represented on the Chinese market. Consequently Finnish technological innovations and quality are known in China. The second largest export good group is pulp with 14.5 percent respectively. UPM-Kymmene, Stora Enso and Ahlstrom have established significant operations in China. The long tradition of Finnish expertise in forestry could attract Chinese capital in especially in R&D for creating more energy-efficient and emission-free solutions for rapidly expanding Chinese forestry and paper industry. The third largest export group is fur. The number of upper middle class and affluent Chinese is at constant growth creating a lucrative market niche also for fur products.

## **4.2 Chinese investors motives for investing in Finland**

The respondents' answers on motives behind Chinese investments in Finland will be reviewed in the light of Dunning's taxonomy of FDI motives. Majority of Chinese investments in developed countries are clustered in the categories of market, efficiency and strategic asset seeking motives. This currently describes the state of Chinese investment in Finland. Overall, the Chinese interviewees find Finland as a good investment destination due to safety and stability, which they name important investment decision factors. The general impression of Finnish business environment is found pleasant and Finnish business people easy to collaborate with since they are honest and trustworthy.

### **4.2.1 Resource-seeking FDI**

Chinese has not been actuated to invest in Finland for resource seeking motives. The interviewees found resource seeking motives as the least probable motive for Chinese investment. The investments that are placed to gain access to unskilled labor are excluded. Additionally agricultural product seeking investments are unlikely. Finnish mining industry was raised as a prospective sector to attract Chinese investments. The Finnish resources that have attracted foreign investment are chrome, nickel, cobalt, gold and silver. Finland is significant producer of gold and nickel on European standards. Chrome is globally scarcely found natural resource, yet Finnish chrome reserves are notable. Finland is also rich in industry minerals such as dolomite, quartz and feldspar. Majority of Finnish mines are in foreign companies holding. The Chinese investment in Finnish mines is a minor phenomenon. Currently there is only one Chinese investment in Finnish mining industry. In 2010 Jinchuan Group, the largest producer of nickel, copper and PGM in China, acquired a share of Finnish Nickel Ltd. Finnish mining is raising increasing amount of interest among Chinese investors. For instance Chinese investors were well represented in the Europe's largest mining technology trade in Tampere. Chinese investors have displayed a great interest in Finnish mining and processing equipment companies and exploration project for producing mines. The prospects for attracting Chinese investment in mining sector will further increase with the exploration of opening up new mines and development of more efficient enriching technologies.

#### **4.2.2 Market-seeking FDI**

For majority of Chinese investment in Finland at least one of the motives has been marketing seeking. All the interviewees agreed that market seeking motives were the main motive behind the Chinese investors in Finland. Great share of the market seeking investments in Finland has been placed to cover larger geographical area. The Chinese investments in Finland serve also Baltic and Nordic countries. Haosion Arts & Crafts Co. started a business in Finland due to geographical closeness to Russia and Baltic countries. The company finds Finnish infrastructure, logistical network and business environment good. Investments have been placed to Finland also to solely enter foreign markets. For instance Finland has been chosen as an investment destination for the gateway to Russia and CIS countries. One of the interviewee mentions that some of the investors have chosen to penetrate to those countries via Finland due to the ease of doing business in Finland, the transparency and integrity of Finnish companies, highly-skilled labor and linguistic skills. The Chinese interviewees find Finland as a good investment destination due to safety and stability, which they name important investment decision factors. The general shared impression of business environment is found pleasant and Finnish business people easy to collaborate with since they are honest and trustworthy.

Highly educated and skilled labor is singled out as one of Finland's main assets. Finnish talent in ICT, cleantech and medical technology was raised as main attraction for Chinese in the interviews. Historically Nokias' mobile phone industry was the key attraction for Chinese investors. One of the interviewees believes that downsize of Nokia has provided an opportunity for Finland. Several Chinese companies have actively taken action to recruit the released talent. In 2012 encouraged by the change in industry, Huawei, a leading Chinese ICT provider, made EUR 70 million investment in R&D in Finland. They considered the investment already in 2009 but were hesitant due to market competition. The motive for investment was the ideal environment for the mobile device technology testing.

Some of the Chinese investment has been placed in Finland due to limitations, difficult market penetration and intense competition in the domestic market. Finnish market has been entered additionally due to a good copyrights, legal protection and legislation. One

of the interviewees presented Songs Lab, a medical technology company, as a case study company that invested in Finland. The reason for Songs Lab to invest abroad was it did not have a niche in Chinese market due to competition. Out of the European countries only Nordic countries accept gamma radiation as medical treatment. Out of these countries, Finnish market was the only competition free market.

The increased competition in Chinese market pushes the companies to become more innovative. Several Chinese companies have entered Finnish market to improve product development. The interviewees share consistent opinion that Chinese companies have benefitted of Finland innovative environment. They also think the innovation seeking investment will increase in the future. Chinese companies are seeking solutions and innovations especially in ICT and cleantech industries. Finland is expected to increase its attractiveness among Chinese investors through promotion of Zhang Jiang Hi-Tech Park and Borderless Healthcare Group's Innovation Centre, which are located in Shanghai. The increased use of Finnish energy-efficient, low-emission methods in Chinese mining industry, are also considered to increase market-seeking investment in Finland. Finnish expertise can be utilized to create better clean technologies and thus improve people's living conditions.

#### **4.2.3 Efficiency-seeking FDI**

The investors engage to efficiency seeking investments in order to save in production costs by using cheaper labor force or to achieve greater productivity. These motives are scarce among the Chinese investors to invest in developed countries. Finland has received only a number of efficiency seeking Chinese investment. There was only one case mentioned in the interviews that mentioned efficiency seeking motives for Chinese to invest in Finland. One Chinese company expanded its R&D unit to Finland in order to improve its productivity.

#### **4.2.4 Strategic asset-seeking FDI**

Strategic asset seeking motives was raised together with market seeking investments as the most common motives for Chinese investments in Finland. The investments often have more than one motive and in some of the interviews strategic asset and market seeking motives were connected together. The interviewees mentioned ICT and medical technology

companies that have established operations in Finland to have access to technologies and brands. Being present in the Finnish market was also strategically important for the companies since it advances their competitiveness in European market.

Innovation and adaption of new technologies was motive for several companies. The interviewees mentioned the companies wanted to gain competitive edge to the competitor companies in domestic market. Dong Feng Investment Management Center invested EUR 35,5 million to Confidex Oy that creates smart identification solutions, which can be applied to several type of usage. It can be utilized for instance in automotive industry, public transportation ticketing and marking surgical medical equipment. In China the train tickets have simple code patterning, which makes them vulnerable for copying. The implication of smart identification will increase the security against copying and reduced lost revenue. It will also increase the revenue through new service offering and lower maintenance cost in comparison to magnetic ticket system. The smart identification can be implemented also on the surgical equipment. The number of equipment is calculated by the identification before the operation and can easily be rechecked afterwards. This way the mistakes of leaving equipment inside the patients' body can be prevented. The identification can benefit the medical industry in China to become more efficient and secure. Baidu, the largest search engine in China, invested USD 10 million in IndoorAtlas, an indoor mapping software, in late 2014. The software utilizes magnetic positioning for creating more accurate maps. The investment can benefit Baidu's long-term competitive position in Chinese market.

#### **4.2.5 Other motives for Chinese investment**

Some of the significant Chinese investment decisions have been affected by emotional tie. According to the interviewee Chinese are in increasing number going overseas for education to high tuition fee countries. Majority of the students come from affluent and influential families. The positions are often inherited in Chinese corporate worlds and when the graduates enter business they commonly receive high managerial positions with political influence power. These business influencers' investment decisions are often affected by the emotional tie they have to the country of study. UK and Switzerland among other countries have attracted a vast amount of investments from companies where one of the decision maker have emotional tie to the country. The

investment decisions are also impacted on the pleasant travel memories or such experiences. For instance Tsingtao, the second largest brewery in China, decided to locate their European head quarter to Paris due to the CEO's wife was fond of Paris. The interviewee does not see high prospects that Finland could receive this type of investment since Chinese students in Finland have scientific background and when they enter corporate world, they do not have big influence power.

## **4.3 Obstacles in investing in Finland**

### **4.3.1 Finnish business environment**

Unfamiliarity of Finland was the common theme in majority of the obstacles that are connected with investing in Finland. The absence of Finnish companies was raised as a major hinder in the interviews for attracting Chinese investment to Finland. The Chinese ODI stock in developed countries is often in correlation with the FDI stock in China. The common experience among the respondents was that if Finnish companies would be present in the Chinese market, the investors would be more confident to enter the market. In addition Finland's country promotion is at early stage in China and the visibility is very limited. The prospect to familiarize with the products, corporate culture, and management style has an effect on the investment decision. Many Chinese investors require to have had previous experience with the company before initial investment. During the interviews Sweden was raised as a comparison country to Finland. The Chinese ODI stock in Sweden is triple in comparison to Finland. The main factors behind the phenomenon were named as Sweden's outstanding FDI stock in China, visibility of Swedish companies in China, strong country brand as well as sales and marketing skills.

Chinese investors in Europe are often seeking destinations where they can produce the whole solution. The lack of ability or capacity to produce the whole solution in Finland refrains some of the Chinese investors from investing in Finland. According to the interviewee, it is common for Finnish companies to be able to produce only one part of the solution.



The lack of knowledge of Finnish business peoples' linguistic skills was raised as an obstacle in the interviews. Chinese are comfortable doing business in English and majority of the Chinese investment in developed countries are stocked in English speaking countries. Chinese investors may not necessarily have experience of doing business with Finns or knowledge that English can be generally used as a business language in Finland. The feeling of uncertainty and discomfort due to the fear of common language were named as hindrances.

The differences in corporate culture and decision making may create hindrances for Chinese investment. Chinese investors find Finnish business people conservative and risk-averse. The cautiousness is reflected in situations where a number of companies are hesitant to expand to the Chinese market, even after the bilateral collaboration have been established. The Chinese investment decision, making is more prompt. The investors are willing to engage in investment even if there is some uncertainty regarding the investment. The interviewees agreed that the number of Chinese investments in Finland would increase if Finnish companies would be better represented in Chinese market.

#### **4.3.2 Country conditions**

The ease of getting permanent residence stay and visas were raised as factors for attracting investment in the interviews. The openness to foreigners in terms of legal permits has a highlighted importance especially on private owned Chinese family businesses. These companies are moving all or part of their assets to foreign countries. In Europe the most popular region is Southern Europe, namely Greece, Italy and Spain. For instance in Spain anyone who purchases a property gets a conditional permanent residence stay. Therefore several Chinese businesses have clustered in Spain.

Climate is a driver of Chinese FDI. Investment climate features that were raised are investor-friendly regulations and temperate and subtropical climate that are equivalent to Chinese climate conditions. English speaking countries were taken as an example to illustrate the climate factors. Australia has attracted more Chinese investment than Canada, even though both countries are so called immigrant countries. The interviewee

regarded this to be due to climate conditions. Finnish nature is clean, yet for majority Chinese the temperature is too cold.

#### **4.3.2 Financial factors**

The restrictions of exchange of foreign currency and transfer of foreign currency were named as an obstacle for ODI. A Chinese citizen can exchange annually maximum of 50000 USD to Chinese RMB. However, there is no limit to the amount of foreign currency holding in Chinese banks. The interviewee mentions that the policies are currently under reviewing. The government is trying to encourage foreign currency reserves in order to stabilize Chinese currency rate, so China would have a better standing in foreign debt business. However, currently every Chinese company that wants to engage in FDI has to get an approval from a number of Chinese governmental agencies, which is a time consuming process.

Foreign currencies can be transferred into China, without restrictions by foreigners. However, the receiver of all the amounts exceeding 10 000 USD per transfer need to send an application form the bank and state the money source and purpose. Due to international laws Chinese banks need to report the information to anti-money laundering organizations. The restrictions on exporting currency from China are stricter than importing currency. Every Chinese citizen can transfer maximum of 50 000 USD per day. If the same person continually transfers money from the same Chinese bank account, the foreign currency administration will suspend the persons' bank account. Due to these restrictions the interviewees had experienced failures in the prospective investments opportunities.

The easy access to liquid cash and corporate loans are attractive factors for investment. The interest rate for corporate loans in China is fixed to 7-8 percent, whereas in Europe the median interest rate is 2 percent. Financing of business operations is a challenge for many Chinese small and medium sized companies (SMEs). The big corporations and government owned businesses can receive funding from banks. However, most of the SMEs need to borrow from friends and acquaintances or underground banks, which ask 15 percent or even higher interest rate. The difficulty of finding affordable financing has

a direct effect on the survival rate of SMEs. Many companies want to seek financing from overseas, yet the borrowing from abroad requires a registration to foreign currency administration.

#### **4.3.4 Legislative and governmental factors**

Taxation is one of the key factors that affect where investment are stocked. Several Chinese companies have their holding in the areas where the tax rate is low. Finland has among the highest corporate tax rate in Europe. The European tax havens where the corporate tax does not exist at all, are Cyprus, Malta and British Virgin Island. They have attracted a significant number of Chinese investments. Additionally, there are several locations in Europe, where the tax rate is low, such as Zug in Switzerland. UK has received the most investments in Europe, however part of the investments consist of companies that have their holding in British Virgin Island. The number of investments registered in British Virgin Island, Cyprus and Malta are unknown, yet it is estimated 60 percent of Chinese investments are located in these areas. According to the interviewees the number of investments would increase if Finland could offer lower tax rates for foreign companies. One of the interviewees however, noted that in cultures such as in Finland making this kind of decision would be complex.

The Chinese government has launched a great number of incentives for foreign direct investments. The local governments have strived for rapid development of industries through incentives. The cost of incentives was high in the initial years, yet the cost was not considered as a major factor since the main priority was to build the industry. Once the industry was built, the area would begin to attract more investment. Finland has not made incentives for foreign countries before. However, European competitor countries make significant amount of incentives annually to attract investment. For instance London offers free office space, usually one or two office desk, for foreign companies for the first half a year in order to have a lower operating cost in the beginning of the investment. Some UK regions offer office space even up to one year. Once a country has gathered a number of foreign direct investments the flow of investments will increase. The interviewees mention that incentives have a direct effect on Chinese investment decisions. Large enterprises are often considered well established and that they do not need incentives. However, large enterprises are often divided into sectors

and incentives can play significant role in the decision making process. For instance Huawei is divided into country departments in each continent. The departments compete against each other on the cost of operation and revenue among other factors.

Table 3. A summary of the main investment obstacles

<b>The main obstacles to attract Chinese investment to Finland</b>
<b>Business environment and country conditions</b>
- Unfamiliarity of Finland
- Absence of Finnish companies in Chinese market
- Lack of country promotion
- Lack of sales and marketing skills
- Immigration bureaucracy
<b>Financial and legal factors</b>
- Foreign currency restrictions
- Limited access to loans and liquid cash
- High taxation
- Lack of governmental incentives

Table 3 contains the main obstacles interviewees found most challenging in the current investment environment in Finland. The majority of the obstacles derived from the unfamiliarity of Finland among the Chinese investors. The lack of knowledge about the investment opportunities were considered to be mainly due to lack of country promotion and Finnish companies' absence in Chinese markets. The main local Chinese factor that has a negative impact on investments is the strict foreign currency policy that limits the amount of currency that can be exchanged annually. Additionally, the difficulty to access affordable loans for SMEs was named as a hindrance.

## **5. DISCUSSION**

This final chapter discusses and analyses the main findings in the light of Dunning's taxonomy of FDI motives. The objective of this study is to determine what are the underlying motives behind the Chinese ODI in Finland. Since Finland is among the minor recipients of Chinese ODI in Europe, the second objective is to discover what hinders Chinese investors from investing in Finland. Finally the suggestion for further research is proposed.

## **5.1 Discussion and conclusion of the main findings**

The Chinese ODI has become a prominent global phenomenon and Chinese capital streams abroad are rapidly increasing. However, Chinese investors have entered the EU market only in the recent decade. The overall investment to the region is at current level still small when compared to Chinese investment stock in the United States, UK, Korea and Japan. However, Chinese investors have displayed increased interest in the EU region since the European economic turmoil have diminished the competition and lowered the asset prices. Since 2010 the Chinese direct investment in Europe has tripled. Finland however, has not been on the investors' radar and is ranked as a minor recipient of Chinese ODI.

### **5.1.1 The main motives to invest in Finland**

At the international level, Chinese outward direct investment is dominated by resource-seeking and market-seeking motives. The predominant motive for Chinese companies invest abroad has historically been the acquiring of natural sources, which have maintained the manufacturing industry and the building of infrastructure. In developed countries Chinese ODI is dominated by strategic asset-seeking and market-seeking motives. This supports Dunning's theory that suggests that developed countries serve as a platform to profit from foreign markets and as a source of acquiring new technological innovations. The majority of the findings in this study confirm Dunning's demonstrate that Chinese investment in Finland is prompted by mainly strategic asset-seeking and market-seeking motives.

The largest share of the market seeking -investments in Finland are clustered in ICT and software sector. According to Dunning the presence at the local market improves the possibility of attracting ODI to domestic market. Additionally, all the interviewees stressed the importance of being present in the Chinese consumer market. Several Finnish companies that are present in the Chinese market have been able to attract Chinese investment in return to Finland. Dunning suggests that the underlying motive is to capture new markets and maximize the profit. Consequently, Chinese investors' market-seeking motives often included an aim of serving larger geographical areas than Finland. The majority of these companies wanted to expand to either the Baltic region

or Scandinavia. Finnish market alone has small purchasing power and highly saturated market on a global scale, which limits the prospective investments.

Chinese companies have entered the Finnish market due to the limitation in domestic and foreign markets. For instance, medical technology field had attracted Chinese capital due to legal restrictions and severe competition. This finding supports Dunning's theory that states that one of the reasons to seek new markets is limitation in the domestic country. As the results reveal, the current Chinese market-seeking investment patterns in Finland to a considerable extent follow Dunning's theory. There are however some of the characteristics of Chinese market-seeking investments are unique. The interviews reveal that some companies have expanded to Finland due to transparent corporate culture and highly skilled labor in order to operate in CIS countries.

Majority of Chinese strategic asset-seeking motives similarly to market-seeking motives are concentrated on ICT and software sectors. The interviewees reveal that Chinese investments are often motivated by more than one factor, which partially explains the clustering to ICT and software sectors. The companies have invested in the Finnish market to develop their core competencies and achieve long-term strategic objectives. This supports Dunning theory which states companies often acquire assets from foreign companies in order to develop their core competences. The strategic asset-seeking investment to Finland has been prompted mainly to gain innovations and adapt new technologies.

### **5.1.2 The main obstacles in investing in Finland**

Despite the openness to overseas investment since adaption of new economic reform in 2000, there are still restrictions that limit the possibilities to go overseas. The foreign currency exchange policy has set the upper limit to USD 50 000, which the individual investors can exchange annually. The financing of business operations is a common obstacle for Chinese companies and several SMEs cannot survive the competition. If Chinese companies had easier access to liquid cash and affordable corporate loans, the number of Chinese ODI would increase.

Taxation and governmental incentives have a direct impact on where Chinese investment is stocked in Europe. The investments are clustered in tax havens and areas with low tax rates. UK, Cyprus and Malta are among the largest recipients of Chinese capital due to these factors. Finland cannot compete with these countries since Finland has one of the highest corporate tax rates globally and the government does not support foreign investors with incentives.

The essential factor in capturing Chinese ODI is well-executed country promotion. Therefore the recipient country's active role in marketing and branding is emphasized. Dunning and Lundan's theory underpins the idea. The country brand, promotion and visibility on the Chinese market were also prominent themes in the interviews. The results suggest the current main obstacle in attracting Chinese is capital invisibility and modest number of Finnish companies on the Chinese market. Thus, the Finnish country brand is unknown among the majority of Chinese investors. Finland is mainly recognized for Nokia and consequently as an aftermath of acquisition to Windows, some Chinese investors have entered the Finnish market in search of ICT talent and promising ventures that former Nokia employees have established. This phenomenon supports Dunning and Lundan's theory as well as Chinese investors' behavior. The lack of country promotion has resulted in the misled impression of Finland among some of the Chinese investors. The interviews reveal that many investors were afraid of the business environment due to the misconception of the ease of doing business.

Overall, at current the Chinese ODI in Finland is very limited and there are several factors that challenge receiving the prospective capital inflow. However, the well-established political relationship and Finland's positioning as the first official trade partner with China in the 1950s provide a foundation for further increased bilateral trade and investment cooperation. The economic relationship was fostered in 2013 with the adaption of renewed trade agreement. Simultaneously Finland is fostering its country brand and increases its presence in Chinese market. Team Finland has adapted new China strategy, which aims to enhance the bilateral trade and investment. The results of the improvements are still unknown and will prevail in the near future. The interviewees were optimistic about Finland's future as a recipient of Chinese investment under the conditions that Finland increases its visibility on the Chinese market.

## **5.2 Suggestion for further research**

The Chinese investment stock in Europe is still modest compared to Japan and United States. Chinese investors have displayed an increased interest in the European market in the recent year, mainly due to the economic turmoil that has decreased asset prices. The record high investment inflow was attracted to the European region in 2014. Finland still at current has not been able to leverage from the investor capital at full extend. China is constantly increasing its global dominance in investment and trade. Analyzing the motives behind the second largest investor in the world is worthwhile in order to recognize the dynamics behind the investment decisions.

The study reveals that the traditional investment theories, such as Dunning's taxonomy of FDI motives, are formulated on the scope of advanced Western economies and cannot fully determine the motives behind Chinese investments. The characteristics of the political and economic situation in China directly influence and determine FDI streams. At current there is no recognized theoretical framework that could sufficiently cover the phenomena. A theory that could explain the push and pull factors of Chinese outward direct investment without being exposed to the limits of existing theories would improve the current perspective on Chinese investment motives.



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# APPENDICES

## Appendix 1. Interview questions for companies

### 1. Background information

- Branch of business
- Main product and markets
- Has the company invested in other Nordic countries? *If the answer yes in which countries?*
- Role and importance of Finland *(not important, medium, high, very high)*
- Main operations of the subsidiary *(for instance sales and marketing, R&D, manufacturing)*
- What type of foreign investment is your firm seeking? *(Resource, market, efficiency, strategic asset)*

### 2. General information about the target country

- Please, talk through your view of Finland as a foreign direct investment destination
- What are the factors that make Finland attractive for your company/foreign investor? *(For instance market potential, innovation, regulatory & institutional environment)*
- How did you obtain information about investing in Finland?

### 3. Relationship with the public sector

- How do you find the efficiency and transparency of Finnish government?
- Has the functionality of the public sector had any impact on the investment decision?
- Have you encountered any obstacles related with taxation or legislation, such as obtaining visa or immigration?
- How could the public sector and related organizations make Finland more attractive destination for foreign investments?

### 4. Relationship with the companies and market

- Did the company have any operation in the target area before the investment, such as exporting?
- What are the main motives for investing in Finland?
- Does the company have many suppliers/customers in the country?
- Is the company renowned in the investment destination and has the investment generated more impact?

## **5. Future**

- How do you see future prospects for the investments in the target country?
- Is the company planning to make new investments/expand the current investment in the future?