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## Working Paper Series

**#2009-041**

### **Internationalization of Chinese firms in Europe**

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# INTERNATIONALIZATION OF CHINESE FIRMS IN EUROPE

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## ***Abstract:***

Since end of the 1990s, the world has been witnessing a phenomenon of internationalisation of Chinese companies. This internationalisation is often understood through FDI inflows, whereby multinational companies establish their presence in a form of subsidiaries overseas. However, lately many companies (and Chinese firms in particular) started to use strategic alliances and M&As as a pair of tools of internationalisation. Despite the growing body of literature on this topic in the context of advanced western economies, use of strategic alliances in the internationalisation of Chinese firms remains an under-researched topic. In the paper we investigate the potential benefits for Chinese companies to internationalise through strategic alliances and M&As, and specifically in comparison to the traditional forms of outward FDI. By using the data from Thomson SDC database, we specifically focus on the Single European market as a new prospective location for Chinese companies and provide a quantitative overview of Chinese firms' alliances as well as M&As in Europe. To illustrate the optimal pattern of internalisation of Chinese firms in Europe, we additionally use a case study of Chinese automotive manufacturer Chery Automobile Co. Ltd.

***Keywords:*** strategic alliances, emerging economies, China, Europe, internationalisation

***JEL:*** F23, M10, L62, O3

- An earlier version of this paper was presented at the International workshop "Chinese direct investment in Europe – data, patterns and strategies", organised by the German Institute of Global and Area Studies / Institute of Asian Studies, Hamburg, Germany, 28-29 June 2009. The authors are grateful to participants for comments and suggestions.

- This paper is accepted for presentation at the 6th International Conference on Innovation and Management (ICIM 2009), Sao Paulo, Brazil, 8-10 December 2009

**UNU-MERIT Working Papers**  
**ISSN 1871-9872**

**Maastricht Economic and social Research and training centre on Innovation and Technology,  
UNU-MERIT**

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## 1. Introduction

China's spectacular economic growth and unprecedented success in attracting inward foreign direct investment (FDI) has drawn much attention of both academic scholars and policy-makers alike. As China becomes a hotspot of global market, Chinese domestic companies are increasingly internationalized by establishing a network of subsidiaries abroad. The internationalisation started by entering less-developed economies, particularly the neighbouring Asian ones. Since recently, Chinese companies started pursuing the internationalisation strategy by aiming to enter advanced western economies.

In this strategy of internationalisation, Europe represents a particular case, mainly due to the European integration. Firstly, by entering only one member state, Chinese companies *de facto* get access to the entire Single European market. Secondly, EU member states are highly idiosyncratic, particularly, a difference in markets is highly pronounced between the western "Old Europe" and the new EU member states of Central and Eastern Europe. Recently, several studies emerged on the Chinese outward foreign direct investment (OFDI) in Europe (Nicolas and Thomson, 2008), with particular reference to the distinction between the west and the east (Filippov and Saebi, 2008). Despite the growing interest, the understanding of this new phenomenon remains still rather limited. Lack of reliable and comparable data is the main impediment in the scholarly research on the strategies of Chinese companies investing in Europe.

Since recently, a new trend is taking shape. Certain Chinese companies prefer to enter Europe not only through FDI but also by establishing strategic alliances with European partners. In contrast to FDI, strategic alliances provide for more flexibility and less commitment in entering a new and unfamiliar market. Traditionally, scholars in the area of strategic alliances have focused on strategic alliances between Western partners, from the perspective of Western firms. Since recently, the research has also addressed alliances between the Western and Chinese companies, in the Chinese domain, i.e. the alliances were aimed at the Chinese market and this cooperation was initiated by the Western multinationals.

However, lately the story changed, as the Chinese companies started to have motivation to go abroad and initiated strategic alliances actively with Western multinationals with the purpose of access of European market. Due to novelty of this phenomenon, it remains greatly under-researched academically. Publications on this topic are limited to a few consultancy reports. This paper aims to fill this gap in the literature and investigate alliance management of Chinese companies in Europe.

On the basis of the strategic alliance literature (Section 2), we develop an analytical model (Section 3) to explain strategic motivations and behaviour of Chinese companies establishing strategic alliances with European multinationals and gaining access to the European market. In the section 4 we provide an overview of the magnitude of the phenomenon of Chinese corporate activity aimed at entering Europe, either through greenfield, acquisitions or strategic alliances. We strongly emphasise the catching-up nature of Chinese internationalising companies (especially those without the governmental support). We use the case of Chery automotive company to illustrate the conceptual framework (Section 5). The case is chosen since Chery is a young and dynamic company, actively using

strategic alliance to enter European market. It may serve as an excellent example for other Chinese companies. Finally, the paper provides managerial implications both for Chinese and European companies (Section 6).

## **1. Firm Internationalisation: Strategic Alliances vs. Foreign Direct Investment**

### **2.1. Emerging multinationals: theoretical insights**

Firm internationalisation has traditionally been understood through FDI (either greenfield investment or acquisition of a domestic firm) leading to establishment of overseas subsidiaries / affiliates<sup>1</sup>. Academic literature first addressed this issue starting from the late 1950s, looking at the internationalisation of US companies and their penetration to Japanese and European markets, i.e. “North-North” flows. The theory has originated from the seminal works by Penrose (1959), Hymer (1976), Vernon (1966), Caves (1971), Buckley and Casson (1976), Hennart (1982). Dunning (1977) combined many of these contributions in his eclectic paradigm, or OLI (Ownership – Location – Internationalisation) model for analysing MNCs’ internationalisation patterns. The eclectic paradigm has been widely used to describe the strategic behaviour of MNCs.

Later, as the multinationals from advanced economies started internationalisation to developing countries, “North-South” flows, a whole stream of research emerged within the framework of “development studies”. The issue of FDI spillovers has become an established area of research with a multitude of studies (industry-context, country-context) (Blomström & Kokko, 1997, 1998).

A recent trend that became pronounced at the end of the 1990s – early 2000s is the internationalisation of companies from developing / transition / emerging economies. As these companies go global, their presence not only showed in developing countries (“South-South” flows), but in advanced economies too (“South-North” flows). A nascent stream of literature has analysed in-depth this issue, with the debates essentially centring around the question whether this kind of internationalisation represent a qualitatively new phenomenon or multinational companies from emerging economies simply stand at the early stage of their development (Ramamurti and Singh, 2009).

Bartlett and Ghoshal (2000) argue that companies from developing countries internationalise in order to seize the opportunities abroad even if they do not necessarily have unique ownership advantages based on superior technology or competitive products. In other words, in order to address their lack of specific competitive advantages (a key prerequisite in conventional explanations of internationalisation) the firms from emerging economies invest abroad to take advantage of the new context (Sauvant, 2005; Goldstein, 2007; Buckley *et al*, 2007; Gammeltoft, 2008).

Matthews (2006) underscores that the strategic goal of the latecomer multinationals is to catch-up with the incumbent multinationals, and move as fast as possible from imitation to innovation. This strategic goal is achieved

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<sup>1</sup> MNCs can own various types of entities abroad, including subsidiaries (enterprises incorporated in host countries in which the MNCs directly own more than a half of the shares), associate companies (enterprises incorporated in host countries in which the MNCs own at least 10%, but not more than half, of the shares), and branches (wholly or jointly owned unincorporated enterprises, such as offices of the MNCs). These three types of entities together are referred to as foreign affiliates (UNCTAD, 2008, p. 249). This study focuses on subsidiaries, the units most directly controlled by MNCs.

through linkages with the global value chains, leveraging of their capabilities, and repeated practice facilitating the appropriate learning. While these approaches and processes are often characteristics of acquisition of assets in advanced economies, they can also be performed in the form of a strategic alliance.

The phenomenon of strategic alliances started to gain significance in the global business since the 1990s, and the academic literature on strategic alliances has burgeoned over time. Presently, more and more western companies engage in strategic alliances. Strategic alliances were born from collaboration between multinationals from advanced countries (“North-North”). As the literature in this field has developed, scholars start looking also at the collaboration between western multinationals and companies from emerging economies (e.g. Duysters *et al*, 2007), however these studies remain scarce.

It should be noted that these two strands of literature (investments by multinationals from emerging economies and strategic alliances with companies from emerging economies) remain rather isolated from each other. In the next section we shall elaborate on the nature and features of strategic alliances and further provide a comparative analysis between FDI / subsidiaries and strategic alliances.

## **2.2. Strategic alliances**

Definition of strategic alliances evolved for a long time since it emerged in the 1960s. A large number of studies have provided examples of strategic alliances in forms of internal ventures, joint ventures, minority investments, co-operative agreements and R&D partnerships as well as franchising. Technically, these forms are classified into three categories full-equity ownership, partial ownership and no ownership controls.

Yoshino and Rangan (1995) define three necessary & sufficient conditions of strategic alliances to be as the academic basis of strategic alliances’ definition. (1) Two or more firms or organisations try to realise a set of common goals they agreed on; (2) Partners have control over the alliances and share in the generated advantages; (3) Partners continuously contribute to one or more strategic areas of the alliance.

Scholars followed these three conditions and there has been an agreement that strategic alliances are used to denote a variety of inter-firm relationships (Osborn and Hagedoorn, 1997); or intensive cooperative arrangements between two legally independent entities, aimed at realising competitive advantage for both partners (De Man *et al*, 2001); or temporary cooperative agreements in which two or more firms share reciprocal inputs to realise improved competitive positions for the partners involved while maintaining their own corporate identities (Heimeriks, 2004). In summary, strategic alliances can be defined as *agreements between two or more partners as a cooperative form towards a common goal by sharing necessary resources as well as coordinating activities.*

Strategic alliances are considered as the most flexible mode of collaboration. They can be patterned in terms of collaboration with suppliers, customers, competitors, organisations that offer similar products in different markets, organisations that offer different products in similar markets, non-profit organisations, governments, universities, and others. Based on the degree of integration, strategic alliances vary from service agreements and licensing and franchising to technology exchange agreements to outsourcing and collective research organisations and to highly structured joint ventures.

Any firms especially the technology- and knowledge-based ones face a series of difficult decisions, such as whether to develop certain product independently or to collaborate with partners. Collaboration enables firms to achieve the goal at faster rate and at less cost or risk, compare to what can be achieved alone. It is widely acknowledged in the strategic alliance studies that firms preferring independent development have to pay for much more cost and higher risk than that in the collaborating manner.

Firstly, opportunities can be offered by inter-firm strategic alliances to obtain *the complementary competence, skills or technology in the fastest way* because fewer companies are able to develop all the necessary skills in-house and expand cycle time to develop complementary capability internally. Secondly, strategic alliances provide companies with *dramatic flexibility* and help them *reduce the commitment* in their assets. This is rather important in today's technology-oriented markets where innovation is the primary determinant of success. Companies that are committed to the fixed asset will be ultimately washed out. Thirdly, strategic alliances are accompanied by knowledge exchanges between collaborating partners and it offers companies an important chance to *execute organisation learning*. Close contacts with other firms can facilitate the transfer of knowledge especially the tacit knowledge between firms and the creation of new knowledge that individual firms could not have created alone (Mowery et al, 1998). Fourth, since technology development is characteristic of expensiveness and uncertainty, *R&D cost and risk sharing* become the objective that companies have to achieve. Finally, the establishment of industry technology standard promotes the alliances-based collaboration in order to expand technology standard at the commercialisation stage (the compatible and complementary products *follow the unified standards*). In certain industry network-formed alliances are established to prevent from the multiple competing standards being emerged.

Strategic alliances additionally provide participants with opportunities to (a) access market; (b) accelerate the return on investment; (c) access resources such as complementary technology; (d) create efficiencies through economies of scale and scope or through rationalisation; (e) open up otherwise unattainable investment options; (h) co-opt competition.

The significance of strategic alliances is explained by the fact that alliances promote the capability growth not only by leveraging existing skills, but more also by quickly and flexibly accessing the capabilities of others.

### **2.3. Strategic alliances versus FDI**

In this paper we seek to look at these two ways of firm internationalisation (FDI versus strategic alliances) as two sides of one coin, and to provide a comprehensive comparison between them (Table 1).

Firstly, there is a fundamental difference between the goals and motives of establishment of subsidiaries and formation of strategic alliances, which translate into the flexibility and managerial control. Subsidiaries are established as part of the corporate group, with a particular motive (serving host country market, producing in the most cost efficient way, seeking strategic assets as knowledge), these motives are not mutually exclusive and may be combined in the strategy of a particular subsidiary. The fact that subsidiaries are established by a parent company entails that the HQ holds a certain percent of equity in this daughter company. Besides, establishing a subsidiary



(particularly a manufacturing one) may be very costly. Therefore, a newly established subsidiary is framed within a long-term corporate strategy of the corporate group.

**Table 1 Comparative analysis of strategic alliances and foreign direct investment**

	FDI / Subsidiaries	Strategic alliances
Goals and motives	Establishing corporate presence in a particular country with a specific motive (resource-, market-, efficiency, asset-seeking)	Securing presence on a particular market through collaboration with a partner
Flexibility	Subsidiaries established through FDI are part of the long-term strategy of the MNC parent company. Subsidiaries evolve over time (scope of functions, competence, etc)	Very flexible. Strategic alliances are formed for achieving a specific goal and once this goal is achieved, the alliance agreement ends
Managerial control	A company is qualified as part of MNC if the HQ has more than 10% of stake in it. As a rule, MNC HQ seeks to retain full control over subsidiary operations.	Both sides retain managerial control over their respective companies

Source: authors

As for the strategic alliances, they are established on a temporary basis in order to achieve specifically defined common goals of two independent companies. Once this common goal has been achieved, the need for this specific strategic alliance vanishes. The allying companies remain independent and do not establish a new entity (as it is the case with joint ventures).

The choice between strategic alliances and FDI can be explained by the transaction-cost theory. This approach has been used to explain many facets of strategic alliances (Young-Ybarra and Wiersema, 1999). According to the theory, organisation units were considered to be much more individual and self-fulfilling, and alliances were viewed as separate business cases, or single transaction that used to overcome market failure and industrial constraints. The advantages of alliances are frequently interpreted by transaction-cost theory. However in recent times, by introducing *information asymmetry argument and indigestibility argument*, a number of studies have contributed to further theory-building in transaction-cost theory framework (Balakrishnan and Koza, 1993; Reuer and Koza, 2000).

*Information asymmetry* argument maintains that information about the quality and performance characteristics of the relevant assets is not a common knowledge, and the information provided by the present owners may be opportunistically biased, causing adverse selection problems. Internationalisation in terms of outward FDI is more likely to induce these problems, additionally due to cultural gap and geographical distance. "*Indigestibility*" normally occurs in FDI projects when multinational companies have to incorporate acquired assets, such as local manufacturing or service units, into their supply chain. Depending on the balance of bargaining power between the foreign multinational company and a domestic firm (target for acquisition) as well as host country government, the

multinational may be forced to incorporate a number of unwanted players in the host economy, “attached” to the acquisition target. Such situation will definitely lead to high management costs for the multinational company; and these costs may be hard to offset by higher yields since the “attached” actors and assets may be unrelated to the core business of the investor. Furthermore, the situation can be aggravated by the differences in organisational and national culture.

To sum up, these two arguments are complementary to each other. Information asymmetry is most useful in explaining the prospective partner firms that have little firsthand or second hand information about each other. On the other hand, indigestibility argument focuses on the differences in assets of collaborative partners, and additionally it can explain the difficulties of fully investment in other country.

## **2. Analytical Framework of Chinese Companies’ Entry into Europe**

While the trend of internationalisation of companies from emerging economies and their entry in advanced markets is not entirely new (Gammeltoft, 2008), it is only recently, that the attention of scholars have been drawn specifically to the activities of Chinese internationalising companies in Europe. Recently, a number of studies (Di Minin and Zhang, 2008; Nicolas and Thomsen, 2008; Milelli *et al*, 2009) have identified a new trend whereby Chinese companies increasingly seek to enter the European Union and establish their presence in the Single Market. In order to describe this emerging phenomenon, Filippov and Saebi (2008) coin a term “Europeanisation”, meaning *“sustained efforts to enter competitive European markets, to strengthen the presence in Europe with the goal of getting access to superior technologies, know-how and competence”*.

While Chinese companies, as a rule, pursue only one motive in developing countries (e.g. resource-seeking one in some African countries, or efficiency-seeking in others), there are numerous indications that the strategies of Chinese companies in relation to the European markets are multifaceted and driven by a variety of motives. These motives include access to markets, technology, knowledge, management skills, brands, as well as searching for efficiency gains.

The new stream of studies on internationalisation of Chinese companies has traditionally looked at the foreign direct investment (either greenfield investment or acquisition) as the main way of entering foreign market. However, as the previous section highlighted, strategic alliances emerge as a reasonable alternative to FDI flows for companies wishing to internationalise and enter competitive foreign market. Therefore we consider FDI and strategic alliances combined.

We explicitly take into consideration the regional economic integration in Europe. Membership in the bloc may affect countries’ locational advantages. Previously “outsider” economies become “insider” economies. They must reorient their economies to the supra-national norms established by the core countries (Benito and Narula, 2007). Even more so, the European integration has brought benefits to multinational companies that can now reorganise their network on a wide-European scale without being constrained by national borders.

Many multinationals have developed and implemented pan-European strategies (Morrison, 1990; Chesnais *et al.*, 2000; Rugman, 2000). In particular, several scholars in-depth investigated responses of Japanese multinationals

to the European integration (Balasubramanyam & Greenaway, 1992; Yamawaki, 1993; Ford and Strange, 1999). Overall, the disappearance of borders among a group of countries implies for multinational companies that they can serve the whole economic bloc from only one subsidiary based in the bloc, instead of serving fragmented national markets separately. The interrelation between the regional economic integration and the capabilities and competences of multinational companies was neatly summarised by Pearce and Tavares (2000: 26) who argue that *“the best activation of MNE’s capabilities and talents might be within a regional grouping”*.

In a similar manner, emerging economies’ multinationals and Chinese companies in particular, have realised the benefits of entering the entire Single Market through only one member state. Filippov and Saebi (2008) define two types of Europeanisation: the 1st type of Europeanisation – entering the EU through Western European member states, and the 2nd type of Europeanisation – targeting new EU member states in Eastern Europe. In the same vein, strategic alliances can be formed either with Western European companies, or with companies operating in Eastern Europe.

Combination of two types of Europeanisation (Western Europe and Eastern Europe) and three different types of internationalisation (greenfield investment, acquisition and strategic alliances) yield six potential scenarios of Chinese companies’ access to Europe:

- Scenario A – greenfield investment in Western Europe
- Scenario B – greenfield investment in Eastern Europe
- Scenario C – acquisition of a domestic company in Western Europe
- Scenario D – acquisition of a domestic company in Eastern Europe
- Scenario E – formation of a strategic alliance with a company in Western Europe
- Scenario F – formation of a strategic alliance with a company in Eastern Europe

Scenarios A, B, C and D have been in-depth studied in the nascent strand of literature on internationalisation of Chinese companies. For instance, Filippov and Saebi (2008) argue that while Chinese investors eye Western Europe as a repository of technology and know-how and hence the dominant business strategy is mainly acquisition of existing (engineering and manufacturing) companies (Scenario C), Eastern Europe represents a slightly different case. It is a destination for efficiency-seeking foreign direct investment, with the purposing of establishing manufacturing base and exporting to the West duty free within the boundaries of the Single European market. The European regulations require that more than half of the value of parts and labour used in the production must come from within Europe. The rest may come from China, so that Chinese companies may capitalise on their low-cost base. Manufacturing costs even in the new EU member states are much higher than in China and yet, the fact that goods produced within the EU borders may be sold duty-free across the Single market justifies manufacturing inside the EU over import of these goods from a home base in China. This strategy – moving a key part of supply chains closer to customers – enables to decrease transportation costs and avoid tariffs.

Overall, the distinction between six different scenarios is summarised in the Table 2.

The choice for particular scenario is determined by a number of factors, such as business ownership, international diversification, and international experiences. Greenfield investments and acquisitions (scenarios A, B, C and D) are preferred by companies having rich inward international experience and/or government financial support. On the other hand, strategic alliances (scenarios E and F) are favoured by firms having relative less experience in internationalisation and government incentives.

**Table 2 Strategies of Chinese multinationals entering Europe**

	Western Europe	Eastern Europe
Greenfield investment	Scenario A Establishment of small-scale subsidiaries with basic functions, such as support to trade, sales representation, etc	Scenario B Establishment of subsidiaries with basic functions, as well subsidiaries engaged in assembly and low-cost manufacturing
Acquisition	Scenario C Acquisition of engineering companies possessing strong competence and know-how. Use of this competence not only in the newly established subsidiary but also in other units of the corporate network.	Scenario D Acquisition of manufacturing units, with the purpose of manufacturing at lower cost than in Western Europe.
Strategic alliances	Scenario E Chinese companies prefer to enter in technology alliances with Western European companies	Scenario F Chinese companies form logistics and marketing alliances that can help them understand the market conditions in Europe and adapt to the European standards and technological requirements

*Source: authors*

Furthermore, the “demonstration effect” is involved in the international alliances initiated by Chinese side. Even though this effect is originally proposed by the inward FDI theory where host country firms may copy behaviours of foreign investors in way of manufacturing, marketing, and management, we argue that this effect is also possible applied to the internationalisation of host country’s company.

Emerging economies’ companies such as Chinese firms imitate the behaviours and emulate strategies of their advanced countries’ partners who established their presence host country. Thus Chinese companies start making use of strategic alliances that were originally used only by their advanced partners in Chinese domestic market. Similarly, Chinese firms use strategic alliances in foreign markets in order to smoothly access the market, gain control over strategic assets, and build advantageous collaborative network. However, on the other side, it is Chinese

firms who initiate the outward alliances, aiming to further obtain superior technologies and access to advanced market.

There are indications that in Eastern Europe (Scenario F), Chinese companies form logistics and marketing alliances that can help them understand the market conditions in Europe and adapt to the European standards and technological requirements. And on the other hand, they prefer to enter in technology alliances with Western European companies (Scenario E). This strategy can be explained by distinction between – tacit skills in Eastern Europe and codified knowledge in Western Europe.

To sum up, Chinese firms wishing to enter Europe and establish their presence on the continent, have six possible scenarios at their disposal (as well as their combination in various forms). These strategies of Chinese companies in Europe are determined by a number of factors effects, such as industry-specific, ownership-specific and presence of prior experience. For example, state-owned Chinese companies have a natural advantage in terms of availability of cash, and therefore they might prefer to acquire a European company in order to obtain full control. On the other hand, cash scarce private firms may find it difficult to enter Europe through FDI, and hence strategic alliances seem to be a natural option. In term of prior experience, companies going abroad for the first time, might engage in partnership with European partners (strategic alliances), rather than pursuing internationalisation on their own. And on the other hand, Chinese companies that have already accumulated experience of working in Europe may be more decisive and pursue active investment strategy.

In order to support the proposed conceptual framework, we present an overview of strategic alliances initiated by Chinese companies in Europe; further, we shall study the case of a Chinese automotive producer Chery which relied heavily on strategic alliances in its internationalisation strategy.

### **3. Overview of Chinese Companies' Entry into Europe**

Traditionally, western companies have sought partnership with their Chinese counterparts. By establishing such strategic alliances, western companies get an opportunity to tap into the enormous 1.3 billion consumers market. Since recently, however, a reverse trend is increasingly taking shape. This is labeled as “Chinese outward alliances” – strategic alliances initiated by Chinese firms as a goal to access overseas markets, technology, managerial know-how and so on.

For our analysis, we chose Thomson SDC as a source of strategic alliances and M&A, as (1) SDC is the alliance & M&As database that has been most commonly used in empirical studies and quite identified in 42 articles published in top strategy journals such as *Academy of Management Journal*, *Administrative Science Quarterly*, *Management Science*, *Organization Science*, and *Strategic Management Journal* between January of 1990 and June of 2008 (Chilling, 2008); (2) half of the alliances reported in SDC are accounted for research and technology alliances that play a prominent role in both industry and research; it provides information over a wide range including global new issues, securities trading, mergers and acquisitions, and a very wide range of agreement types such as joint ventures, research and development (R&D) agreements, sales and marketing agreements, supply agreements, and licensing and distribution pacts; (3) The SDC database covers the widest range of sectors. It reports

at least one alliance for each of 1,059 four-digit Standard Industrial Classification (SIC) codes between 1985 till now. The agreements between industrial partners and universities & public research institutes are incorporated as well; (4) SDC database has extensive searching ability. Through SDC, researchers could easily search for 200 data elements associated with the name, SIC code, nationality of participants, the terms of the deal, and deal synopsis for each alliance agreement. The data searched in SDC can easily exported in a user-defined format such as Excel spreadsheet. Also, it provides users with a reference to the data sources, enabling the users to verify information offered by the database.

The SDC database provides a large number of data about alliances participated by Chinese side. From 1<sup>st</sup> Jan. 1985 till 31<sup>st</sup> Dec. 2008, we can find 9533 alliances participated by Chinese firms. Of these 9533 alliances, 1745 technological alliances were conducted in high-tech industries such as biotechnology, computer equipment, electronics, communications and others; 548 alliances are R&D agreements; 320 alliances are about technology transfer. In the same time range, the SDC database offers 19323 M&A involved Chinese side, of which 10886 M&As are ones that Chinese side was target firms.

However through our study, we argue that the results obtained from it should be treated with caution. We identify that the number of Sino-foreign alliances collected by SDC database for Chinese case is not as complete as it is in reality. Especially recently, when many international alliances were initiated by Chinese side, a large number of them were not recorded immediately. It can be explained by the fact that language used to announce alliances was Chinese and these announcements did not appear in the international media. Hence, an international database such as SDC could not collect this sort of data as soon as possible. Furthermore, the data missing is might due to the different understanding about alliances. In China, most companies consider collaboration in the same way as alliances. And to large extent, they are more likely to announce alliances publicly in terms of inter-firm collaborations. The definition of alliances was not deeply understood by Chinese entrepreneurs, or even Chinese academic scholars. We argue another reason might be the cultural-oriented customer in releasing information. According to our roughly investigation, only at most 5% of Chinese firms have official website oriented towards in international customers and partners (in European language), and of these 5% the major part are the firms that have already internationalised. This situation is a reflection of the fact that Chinese firms are still learning techniques and approaches how to inform stakeholders and wider audience worldwide about their strategies and collaborations.

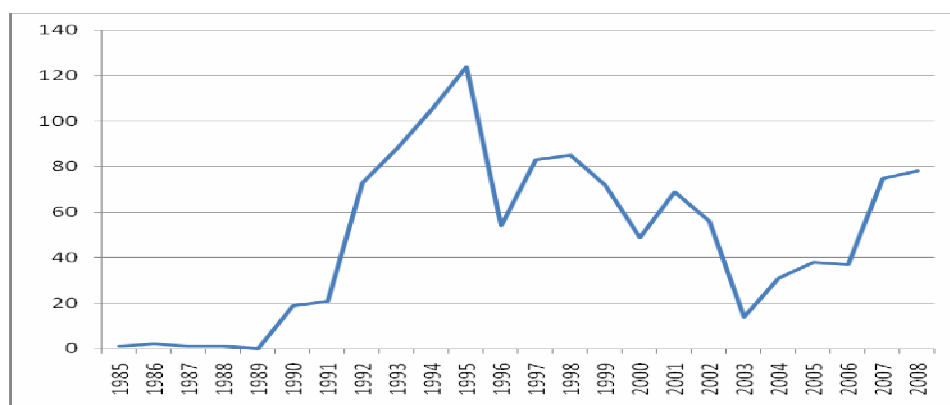
#### **4.1. Chinese outward alliances**

Despite the absolute numbers provided by Thompson Reuters SDC database should be treated with caution, we may have confidence in relative numbers and in the general trends. As Figure 1 indicates, this phenomenon of Chinese outward alliances has its roots back in the mid-1980s.

Comparing to the total number of strategic alliances formed worldwide annually (around nine thousand), the number of Chinese outward alliances is quite small. Nevertheless the data clearly indicate that the outward strategic alliances by Chinese companies are a fact and reality, deserving its full theoretical and empirical investigation.

Regarding global alliance activity with regard to China, inward alliances (by foreign firms to China) account

for the main part, however outward alliances from China are attracting much more attention. In the traditional understanding, outward alliances are defined as the alliances initiated by Chinese firms with foreign companies either located in China or overseas. In order to clearly look at the trend of outward alliances that Chinese firms conducted with foreign side and overcome the drawbacks of SDC database, in this study we purposively define outward alliances as alliances established between Chinese and foreign side but happened outside of China. The advantage of this definition is that it implicates the location in which alliances happened, and on the other hand indicates the extent of initiation of Chinese firms to participate overseas alliances. Moreover, it implicitly underwrites that the firms that have this chance to conduct outward alliances must be the ones that have sufficient technology capability or international experience.



**Figure 1 Total number of Chinese outward strategic alliances formed worldwide**

*Source: Thompson SDC database, calculated by authors*

According to our definition, the trend of Chinese outward alliance since 1985 (Figure 1) is overviewed. The trend is unstable, but since 2003 it follows the up way. This is caused by the increased competition in China’s home market as well as strong government encouragement to Chinese firms going abroad, and Chinese firms’ desire to learn from abroad. Some drastic changes in the trend are associated with changed in China’s macroeconomic environment. For example, the sharp increase from 1992 with its peak in 1994 was caused by the strong government support. At that time, the companies that having outward alliances were mainly the ones that had government as a major stakeholder. The wholly or partially state-owned companies became the first group of firms going abroad.

The remarkable increase in outward alliances is recorded from 1999 to 2001, and can be explained by the government-led “go global” policy initiated in 1999. During that time, private firms were the second group of companies going abroad because both private and state-owned companies realized that the previous policy of “market-exchanging-technology” should be adjusted. Chinese firms also needed to technologically learn from their foreign partners and expand market to overseas for knowledge acquisition. Even in the period of Asian Financial Crisis in the end of 1990s, outward alliances were still the main mode for Chinese firms to execute learning process. Our another finding regarding China’s inward alliances is that especially in the economic crisis when inward M&A and alliances were decreasing, outward alliances from Chinese side were not impacted so much. Around 2001, outward alliances faced another peak, due to China’s access to WTO. One significant dropping of outward alliances

in 2003 was exactly caused by SARS epidemics exploding at that time. Since 2004 till now, outward alliances have kept rising.

#### 4.2. Sino-European strategic alliances

The Figure 1 provided a global view on the outward Chinese alliances. A sizeable part of these alliances are taking place in Europe. We use the database Thompson SDC database to study the pattern of formation of strategic alliances between Chinese companies and European partners. We select four five-year time periods to show the magnitude of the Sino-European alliances. These time periods are 1989-1993, 1994-1998, 1999-2003 and 2004-2008. The results are presented in Table 3. The first column of each period represents the number of strategic alliances, established in a specific country, in which a Chinese firm is part of. The second column is the number of strategic alliances, established in a specific country, in which a Chinese firm is a part and another partner is local firm. The difference between the columns is that the last column includes alliances only between Chinese and local partners (i.e. a firm registered in the respective country). While the number in the second column provides a total number, including alliances concluded between a Chinese firm and any other firm, might well be, it is itself a foreigner on the target market. As the data shows, the majority of Chinese firms prefer to establish alliances for specific markets with domestic firms.

**Table 3 Overview of Sino-European strategic alliances**

	01.01.1989 - 31.12.1993		01.01.1994 – 31.12.1998		01.01.1999 – 31.12.2003		01.01.2004 – 31.12.2008		Total alliances
EU15	22	21	61	44	12	10	5	2	100
EU12	4	3	1	1	2	2	4	2	11
EFTA	0	0	3	3	0	0	0	0	3
US	29	27	79	70	39	34	22	22	169
Japan	37	34	67	64	19	17	9	9	132
Canada	2	2	5	5	5	5	10	5	22
Australia	0	0	15	11	23	19	17	16	55
EU27	26		62		14		9		111
<b>Total developed</b>	<b>94</b>		<b>231</b>		<b>100</b>		<b>67</b>		<b>492</b>
Share of EU15, %	23.40		26.41		12.00		7.46		
Share of EU12, %	4.26		0.43		2.00		5.97		
Share of EU27, %	27.66		26.84		14.00		13.43		
<b>Total outward Chinese alliances</b>	<b>201</b>		<b>451</b>		<b>281</b>		<b>259</b>		<b>1192</b>

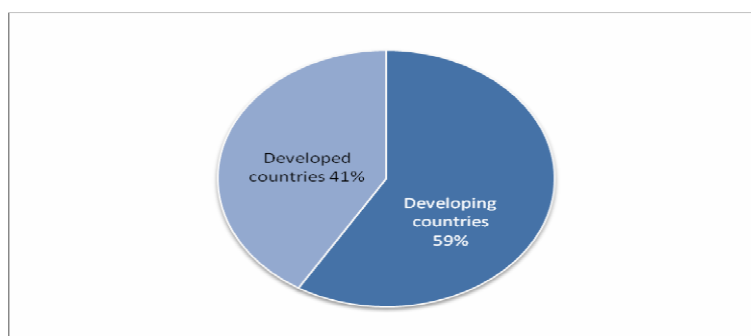
Source: Thompson SDC database, calculated by authors

Note: EU 15 is defined as a total number for Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, Portugal, Spain, Sweden and UK. EU12 is defined as a total number for Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia and Slovenia. EU27 is the sum of EU15 and



EU12. EFTA (European Free Trade Area) is defined as a total number for Iceland, Norway and Switzerland. This is the present regional grouping; for consistency of analysis we use the same groups throughout the four time periods since 1989 till 2008. “Developed economies” is the aggregated number for EU27, EFTA, US, Japan, Canada and Australia.

The outward Chinese alliances in Europe reflect the general trend: slight increase in the first period, growth in the second period (the mid- / late 1990s), and much smaller number in the third and fourth period (up until the year of 2008). Chinese firms form alliances with partners in different locations, dominated by the South-East Asian region due to geographical and cultural proximity. Overall, over the period of 1989-2008, developing economies attracted 59% of Chinese outward alliances, while the developed economies – 41% (Figure 2).

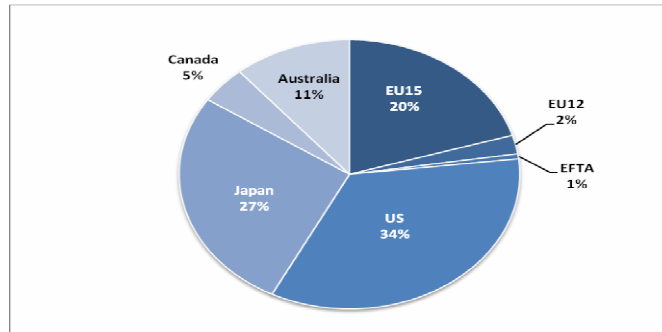


**Figure 2 Destinations of Chinese outward alliances, 1989-2008**

*Source: Thompson SDC database, calculated by authors*

For our analytical reasons we focus only on developed countries, mainly on the three poles (the Triad) – Europe, Northern America and Japan (Figure 3). Unsurprisingly, US (34%) and Japan (27%) emerge as the leading spots for Chinese outward alliances in developed world. The United States is the technological and financial global and hence Chinese firms seek to tap into the technology and know-how there, as well as access the market. Japan is the favourite destination for the same reasons, and furthermore the geographical and cultural proximity is an additional advantage. Europe is next in this ranking and has a consolidated weight of 23% (EU15 – 20%, EFTA – 1% and EU12 – 2%). The ranking is concluded by Australia (11%) and Canada (5%).

What is more interesting is that in the dynamic perspective (Table 3), the role of EU12 (Eastern Europe) is rising, particularly since the year 2004, when the eastward European enlargement took place. Within the EU15 group, France, Germany and UK emerge as the top destinations, as the largest number of alliances was established there. This ranking confirms technological advancement of the European economies. Within Eastern Europe (EU12), it is Czech Republic, Poland, Bulgaria and Romania that are the attractive for Chinese outward alliances.

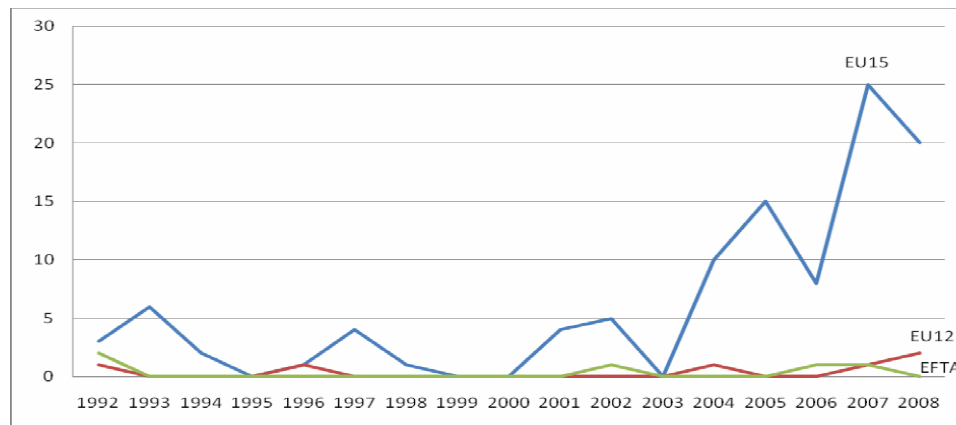


**Figure 3 Destinations of Chinese outward alliances in developed world, 1989-2008**

*Source: Thompson SDC database, calculated by authors*

#### 4.3. Selected Chinese investment projects and acquisitions in Europe

Chinese investment in Europe is on the rise, and not only in the advanced European economies, but in the East too. For example, according to CzechInvest – Czech investment promotion agency, it negotiated 213 greenfield investment projects in 2008, out of which 3 belong to Chinese investors, with a total investment of 5.14 million USD, and creation of 239 jobs (incl. 37 – for university graduates)<sup>2</sup>. While Chinese companies invest in greenfield, they more actively engage in acquisition of European firms. Figure 4 present an overview of the amount of acquisitions, where Chinese companies were the acquiring side. We look at the number of deals since the value of the deal is not available for all cases.



**Figure 4 The trend of outward M&A formed in Europe**

*Source: Thompson SDC database, calculated by authors*

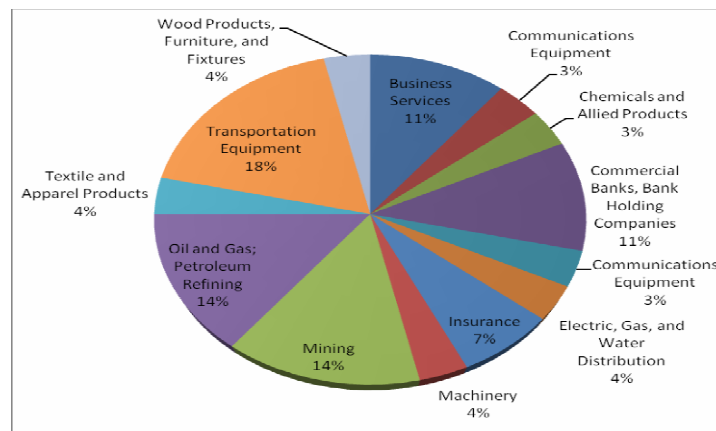
Analysis of the Figure 4 shows that the acquisition activity of Chinese firms intensified roughly after the year 2003. This is due to the impact of China's access to WTO in 2001 (time lag of two years) and the corresponding Chinese government policy to encourage domestic firms going abroad. From the data it can be seen that the majority of Chinese investments was located in Western Europe (and particularly in UK, Germany, France and Italy). This is not only because these countries are technological leading ones in the Europe but also due to the nature of M&A, i.e.

<sup>2</sup> <http://www.czechinvest.org/data/files/ci-investice-2008-priloha3-zeme-en-1348-en.pdf>

direct acquisition of foreign assets. It is, on one hand, consistent with the result that we found from alliances distribution, and on the other hand additionally confirms that in terms of M&A, Western Europe is more attractive for Chinese firms than Eastern Europe.

In order to find the specific reasons, we looked into the detailed information about the industries to which the acquired companies belonged. In Eastern Europe, Chinese firms mainly invested in mid-technology industries such as energy, machinery, and communication equipment, aiming to access East European market through low-cost competitive advantage.

However in Western Europe, Chinese firms investments appeared more diversified. In addition to mid-technology industries that targeted also in Eastern Europe, Chinese firms actively intensively invested in technology-oriented industries such as communication, software, chemical, electronic, and medical etc. Another small part of industries that Chinese firms acquired is mainly located in service section, including insurance, transportation, etc.



**Figure 5 Sectoral distribution of acquisitions in Western Europe (1992-2008)**

Chinese companies that invested in Western Europe are mainly characterised by full or partial state ownership (e.g. COSCO) or Chinese government policy support (e.g. Haier and TCL). Overall, Chinese firms investing in Western Europe are seeking to bypass stringent trade barriers or avoid export barriers, to compensate their competitive disadvantages and to seek sophisticated technology or advanced manufacturing know-how.

We illustrate this claim in a case study taking Chery Ltd Co as an example.

#### **4. Chery Catching-up model**

The phenomenon of the Chinese direct investment in advanced market has been studied quantitatively. The findings have been often supported qualitatively, using a number of case studies. However, scholars have tended to focus only on a number of Chinese companies, “success cases”. For example, Chen and Tong (2003) used a detailed case study on Huawei to show the R&D internationalisation pattern of Chinese companies but without comparing the different cases. Duysters *et al* (2009) provide an in-depth investigation of the case of Chinese company Haier.

In this paper we focus on the internationalisation strategy of Chery Automobile Ltd. Co, a young and dynamic private company; presently it is the largest independent Chinese auto manufacturer and one of the fastest growing automakers in the world. Its internationalisation strategy is characterised by late starting-up, fast growing-up and sharp entering into international market. The company has been very successful in acquiring advanced technology and establishing entrepreneurial culture. Chery's internationalisation path advanced without the government encouragement and government financial support. Therefore, Chery is able to serve as a good example of young generation of Chinese firms that develop rapidly technologically.

The general inclination in the case studies of Chinese companies successfully internationalising to advanced Western economies is to focus on political motivation and incentives. For instance, the internationalisation strategies of both Lenovo and Haier were political supported by the Chinese government, and a number of other firms successfully operating abroad are directly controlled by the Chinese government (entailing not only political but financial support too). Therefore these companies preferred to engage in the greenfield and acquisition. As for Chery, its case suggests that there is still an opportunity to internationalise for Chinese private companies (not able to get easy access to capital). And this opportunity is realised through the active use of strategic alliances.

In the research of Chinese firms' catching up, Chery path is indispensable. Within the literature related to catching up, there is no research that has ever mentioned the similar model. This is might be because this group of firms is the Chinese young generation, which international academic research has not involved in. But the significance is that it represents a young generation of Chinese entrepreneurs' globalisation mindset and from another perspective reflects a creative transition from an original equipment manufacturer (OEM) to an original design manufacturer (ODM) and later to own branding and manufacturing (OBM).

### **5.1. Company Profile**

Chery Automobile Co., Ltd. was founded in 1997 by five of Anhui's local state owned investment companies with an initial capitalisation of RMB 3.2 billion. Plant construction commenced on 18 March 1997 in the locality of Wuhu, China's Anhui Province. The first car came off the production line on 18 December 1999. And on 22 August 2007, the one-millionth car of Chery rolled out the assembly line successfully, which signifies that Chery has already achieved its first-stage goal in the process of building a successful independent Chinese brand, and is now on its way to create a world famous brand through opening and innovation<sup>3</sup>.

In 2006, Chery achieved a total sales volume of 305,200 units, representing an increase rate of 61.5% over 2005; and in 2007, the annual sales volume of Chery reached 381,000 units, increasing by 24.8% compared with 2006. In 2007 also, Chery achieved an annual export volume of 119,800 units. As a result, the overseas sales of Chery had doubled again with an increase rate of 132%, ranking 1st for 5 consecutive years in car export in China<sup>4</sup>.

Chery is catching up not only in terms of car sales, but also technologically. Since 2003, it has applied and received 2452 patents at the State Intellectual Property Office of P.R.China. This number includes 715 inventions,

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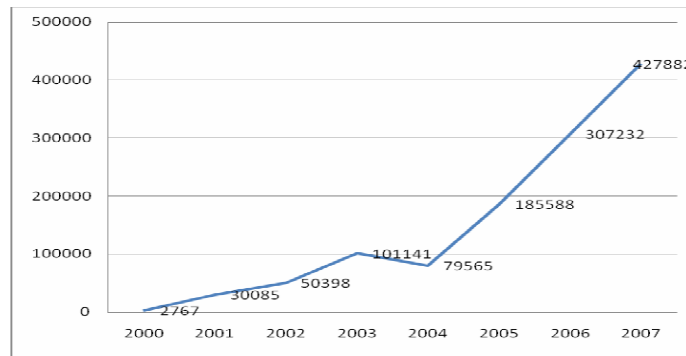
<sup>3</sup> <http://www.cheryinternational.com/node/15>

<sup>4</sup> <http://www.cheryinternational.com/node/15>

628 utility models, and 1109 external designs<sup>5</sup>. This shows that Chery is focusing on incremental innovations and market-oriented innovations.

Now it has become China's top car exporter and the biggest Chinese local automaker. Chery has seven assembly plants in Egypt, Indonesia, Iran, Russia, Ukraine, and Uruguay and only in year of 2008 it has sold 135000 cars to more than 80 countries/regions. Besides being active in the overseas market, Chery's products such as Tiggo, Eastar, QQ, and A5 are also very popular in domestic market. Chery is the only one automaker which embraces its own technology in producing motor engine, car parts and autos in China. Its success is a miracle and it provides us many valuable experiences.

The annual growth of Chery's cars worldwide is illustrated on Figure 6.



**Figure 6 Chery's global car sales**

Source: <http://www.oica.net>

## 5.2. Chery's Cooperation Strategy

Chery's development was accompanied by frustration, setbacks and failures. In the initial stage of company development, Chery had virtually no competitive advantages (no government support, sufficient funding source, technology, or skilled and educated workforce). Chery was established by a small panel of young people and was a latecomer automotive manufacturer in a small town that had never been paid as much attention by government as other industrial-oriented cities such as Beijing, Changchun, Shanghai and Wuhan. Chery's success was attributed to three major transitions, which were accompanied by persistent international cooperation.

The first took place at the initial stage when Chery failed to find buyers of its branded motor engine and had no choice but to manufacture car under its own brand. In order to rapidly grasp the basic knowledge of designing automotives, Chery collaborated with a number of European and Taiwanese companies. Through this cooperation, Chery's engineers absorbed basic skills to design car or motor-engines.

The second transition was caused by Chery's failure in purchasing a production line. The inferior knowledge in automotive manufacturing caused Chery spending \$ 20 million on purchasing a second-hand manufacturing line

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<sup>5</sup> <http://www.sipo.gov.cn>

that was actually obsolete. Chery learnt lessons and started to establish collaborations with professional technological consultant companies from technologically advanced countries.

The collaboration led to some positive results, but due to the cultural differences and financial problems, the initial Sino-foreign collaboration was not as successful as expected. However, the technological knowledge that Chery learned from prior foreign partners made Chery successfully transform to a car designer. According to the preference of middle class Chinese customers, Chery successfully introduced the models of *Chery QQ* & *Chery Feng Yun* (low emission vehicles at the lower price). They quickly dominated Chinese passenger-car market.

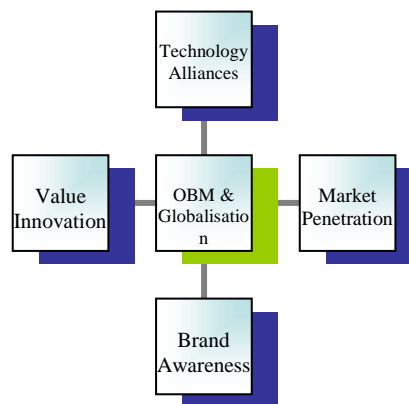
After that, Chery entered into the third transition by which it successfully entered the international market. Chery's intention in entering overseas markets was stimulated by its motivation to improve technological capabilities through a network of international collaboration. In order to obtain the latest car model and upgrade the capability of Chery's R&D team, Chery therefore established a series of technical cooperation with Italian design companies (e.g. Pininfarina S.p.A) and other Western European firms such as AVL List GmbH. In order to enter the European and North American markets, Chery consecutively collaborated with Western European and North American firms. Chery's R&D was therefore forced to accord with European and North American's latest emission standards.

To penetrate into bigger and more developed market, Chery applied a conservative strategy. It did not enter West European market directly as other Chinese firms, but firstly accessed Mid East and East European Markets for market nurturing with purpose to incubate Chery's products quality and reducing the entering risk. In the collaboration with foreign side, Chery persisted in the ownership of its intellectual property, which makes its ODM position become possible. To improve brand awareness, Chery established cooperation with well-known auto-vehicle manufacturers such as Chrysler.

To sum up, Chery's internationalisation comes from many significant factors as indicated in Figure 3. However, the most important element is its persistence in international strategic cooperation. Chery could therefore obtain the basic technological knowledge and access the foreign market. With collaborating with leading players in the automotive market, Chery successfully increased their marketing skills and technological capability. With strategically accessing Eastern European market primarily through collaborating with local logistic and marketing partners, Chery successfully avoided high-risk and grasped the chances to nurture market and improve the product quality. Chery's catching-up path is significance in a way that it provides the evidence that Chinese start-ups may have a strong initiative and decisiveness to improve their technological capabilities. It represents a departure from a traditional growth pattern whereby capability improvement of small- and mid-sized companies must depend solely on FDI.

Today, Chery has become an important player in the international automotive market. Comparing with the situation before, Chery has additionally applied alternative strategies such as merger and acquisition. Because of

incredible popularity of Chery's car model, many advanced economies' MNCs signed agreements with Chery and Chery also started selling its successfully model to others. In 2008, Chery sold its Chery A1 (Chery A1, beside well known QQ model, will be the next economic model in the European market), as well as in the USA and Asia. Chery signed an agreement with Chrysler AG. Under this agreement, the car is to be sold in Europe under Dodge or Chrysler brand, which will be determined individually by each country. The target group is young people, appreciating style and individualism. Although it is a typical city car (dimensions: 3,700 / 1,578 / 1,527 mm) there are a lot of technically advanced elements: McPerson pillars, two-girth brake system, two air-bags, three-points seatbelts, DVD player, GPS, remote control central locking, electric windows and mirrors, rear park sensors. Chery's car had passed a lot of road and crash tests at European standard. The car has already met three conditions of two companies: international technology standards, service, and sale, which set as necessary to start sale on overseas markets.



**Figure 7 Chery Caching up Model**

Our analysis above is consistent with the business principles stated by Chery's management<sup>6</sup>. Chery underlines export and serving the foreign markets as a clear strategic priority. Chery follows five fundamental principles in the international activity.

- Developing country first, then the developed country
- CKD (Complete Knock Down) exports prior to vehicle exports
- Reasonable arrangement and regional radiation
- Cooperation first, then joint venture
- Establish wholly owned subsidiary, control overseas marketing channels

<sup>6</sup> <http://www.cheryinternational.com/node/aboutus>

### **5.3. Chery's Business Principles and Competitive Advantage**

Chery's case tells about the competitive advantages of most Chinese firms. As acknowledged, products made in China have advantage of low-cost. In addition, today's Chinese firms are making effort to upgrade their technological capability through international cooperation. The case of Chery tells us that Chinese firms have large potential to serve customers in different markets. As example of penetrating Europe market, Chinese firms prefer a relatively safe way, preferring entering less-developed Eastern Europe through strategic alliances at first in order to become familiar with local market rule, serve customers who welcome low priced products, and simultaneously establish local network with partners in view of marketing, logistics, and technology design.

This strategic behaviour can be described as "double progressing", which means not only competing with local competitors in terms of low-cost, but also preparation for serving advanced markets in the future. Chinese firms have a large distinctive competitive advantage from those advanced economies multinational companies in terms of entering into foreign market. The low-cost advantage, together with their rapid learning capability through an intensive network of international cooperation provides them with many opportunities to enter into advanced market.

The global economic crisis seemingly affected most economic sectors, with the automotive sector being on the most hit. The demand for cars is shrinking worldwide, and in China too. In developed economies it put the leading automotive manufacturers at the edge of bankruptcy. In these circumstances, these companies seem to be an attractive object for acquisition. In February 2009, Shanghai Daily (2009) reported that Chery is considering acquisition of some European auto companies with long histories. It was further reported that Ford Motor Co had approached Chery as it tried to sell its Sweden-based Volvo Car unit. Chery received a 10 billion USD loan from the Import-Export Bank of China, and hopes to use these financial resources to achieve its goal. It indicated that the economic crisis is in fact a perfect time for emerging (latecomer) multinationals to advance in the world economy by acquiring assets from advanced economies.

To sum up, success of Chery's internationalisation strategy can be explained by a harmonic combination of strategic alliances, M&As and acquisitions to achieve its strategic goals and motivations.

## **5. Conclusions**

This paper contributes to the growing stream of literature on the entry and activities of Chinese companies in Europe. This topic is of mounting importance for scholars, European businesses and policy-makers. However, this general issue is still underdeveloped by academics whereas the available information is either too aggregated or, when accessible at a micro-level, largely anecdotal or fragmentary.

We develop a conceptual framework incorporating regarding FDI and strategic alliances as alternative, yet complementary vehicles of internationalisation and entering European market for Chinese firms. In fact, the FDI inflows from emerging economies have greatly overshadowed the popularity of strategic alliances among Chinese firms. The paper aimed to underline the role played by this form of business activity in the strategies of Chinese



companies. In terms of managerial implications, the paper sought to emphasise the nature of strategic alliances and portray them as an alternative way of entering the European Single market.

The paper has some limitations, as this is almost always a case with the emerging phenomenon, due to the scarcity of data. We use Thompson Reuters SDC database to identify the general trends and numbers of Chinese outward alliances. Because the data provided by the database are not full, we strongly call for establishment of a comprehensive database that focuses specifically on Sino-Foreign alliances as well as M&As. Such information should be collected from local Chinese media sources and local company reports. In this way, scholars should get a fuller picture of the phenomenon under examination.

Our main findings suggest that internationalisation of Chinese firms is a gradual process, whereby they integrate technology and marketing/logistics alliances in an optimal way. The advantage of this integrated strategy is to leave sufficient time for companies from emerging economies to learn and absorb skills and technology, or tacit and codified knowledge. Strategic alliances play a vital role in this integrated strategy. They offer a win-win situation for both partners as well for the governments.

The role of governments is importance, since acquisition of assets in Europe by newcomers – companies from emerging economies or even prospects of such acquisition has stirred up controversies for a variety of reasons. Commonly cited concerns include the potential of political leverage by home governments and alleged dubious managerial practices.

In fact, the phenomenon of emerging multinationals has raised an old problem of “good” and “bad” FDI, in other words, its developmental and detrimental impacts, yet this time in the context of developed economies as recipients. It has been assumed that costs of FDI from emerging economies outweigh their benefits for host countries. Nevertheless, investment promotion agencies of many European countries particularly target these investments. For example, a number of German *Länder* set up dedicated offices for Chinese investors, AsiaCenter, a trade and business centre for Asian investors opened in March 2003 in Budapest, Hungary, and Polish investment promotion agency PAIiZ annually publishes an investment guide in Chinese for Chinese investors.

However, other governments still show a certain degree of concern and reservation. Strategic alliance may be better received, as they offer an alternative means of internationalisation for emerging multinationals, and, if managed properly, may lead to a win-win situation because they do not entail the loss of ownership control yet allow for technology learning and market access (Filippov, 2009).

Although the precise nature of the policy response is yet to be investigated and designed, it is critical that policymakers should resist calls for more protectionism and other policies that restrict free flows of FDI. In these times of global economic crisis, with FDI flows on the global scale set to decrease, investments by emerging multinationals may prove beneficial for European nations (Filippov, 2009).

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