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CHINESE FDI IN CENTRAL AND EASTERN EUROPE. AN OVERVIEW OF FACTORS MOTIVATING CHINESE MNEs IN THE CEE REGION¹

ÁGNES SZUNOMÁR

PhD, Research Group on Development Economics
Institute of World Economics, Centre for Economic and Regional Studies
Hungarian Academy of Sciences
1097 Budapest, 4 Kálmán Tóth Street
HUNGARY
szunomar.agnes@krtk.mta.hu <http://www.vki.hu>

Abstract: *The rise of multinational enterprises (MNEs) from emerging markets is topical, important and poses a number of questions and challenges that require considerable attention in the future from academia as well as business management. This rise is driven by the Asian economy, mainly China, as Chinese MNEs have become important players in several regions around the globe, ranging from the least developed countries to the developed markets, including Central and Eastern Europe (CEE). Although several components of the strategy and attitude of Chinese MNEs are in line with what can be observed for MNEs from developed countries, but some components – with regard to motivations, operational practice and challenges – are different. Therefore, this paper will focus on these specificities of Chinese outward foreign direct investment (OFDI) in order to better understand the rise of Chinese MNEs.*

Keywords: *FDI, internationalisation, Chinese MNEs, Central and Eastern Europe*

1. Introduction

The rise of multinational enterprises (MNEs)² from emerging markets is topical, important and poses a number of questions and challenges that require considerable attention in the future from academia as well as business management. Outward foreign direct investment (OFDI) from non-European emerging regions is not a new phenomenon, what is new, is the magnitude that this phenomenon has achieved over the past one and a

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² As UNCTAD uses the term "multinational enterprise" or "MNE" in its latest publications (such as World Investment Report 2016) we chose to use this terminology during the research. Under this term we mean business organization whose activities are located in more than two countries.

half decade. Chinese OFDI has increased in the past decades, however, in the last decade this process accelerated significantly. Several factors fuelled this shift, including the Chinese government's wish for globally competitive Chinese firms or the possibility that OFDI can contribute to the country's development through investments in natural resources exploration or other areas (Sauvant – Chen, 2014, pp. 141-142).

Although traditionally Chinese OFDI is directed to the countries of the developing world, Chinese investments into the developed world, including Europe also increased significantly in the past decade. According to the Clegg and Voss (2012), Chinese OFDI to the European Union (EU) increased from 0.4 billion US dollars in 2003 to 6.3 billion US dollars in 2009 with an annual growth rate of 57 per cent, which was far above the growth rate of Chinese OFDI globally. In 2016, Chinese companies invested 35 billion EUR in the EU, a 77 per cent increase from the previous year (Hanemann-Huotari, 2017, p. 4). While the resource-rich regions remained important for Chinese companies, they started to become more and more interested in acquiring European firms after the financial and economic crisis. The main reason for that is through these firms Chinese companies can have access to important technologies, successful brands and new distribution channels, while the value of these firms has fallen, too, due to the global financial crisis (Clegg – Voss, 2012, pp. 16-19).

In line with the above, the paper will focus on Chinese MNEs strategies, operation and challenges in Central and Eastern Europe (CEE). The aims of the paper are to better understand the rise of Chinese MNEs in CEE and to specify their motivations. Therefore, the research will address the following questions:

1. What are the driving forces behind the international expansion strategy of Chinese MNEs?
2. How important is the CEE region in their localization strategies?
3. What are the main factors which makes the CEE region attractive for Chinese MNEs?

In order to assess the role and importance of OFDI from China towards CEE region, it must be evaluated within a global context, taking into account its geographical, as well as sectoral distribution. Therefore, after the theory and literature review, the third chapter briefly examines Chinese foreign direct investment globally, considering trends, patterns and investors' potential motivations when choosing a specific destination for their placements. The fourth chapter describes the changing patterns and motivations of Chinese OFDI in CEE region, based on desk research, company interviews and observations with a brief case study on Chinese FDI in Hungary. The final chapter presents the author's conclusions.

2. Theory and literature review

Majority of research on motivations for FDI apply the eclectic or OLI paradigm by Dunning (1992, 1998) that states that firms will venture abroad when they possess firm-specific advantages, i.e. ownership and internalization advantages, and when they can utilize location advantages to benefit from the attractions these locations are endowed with. Different types of investment motivations attract different types of FDI which Dunning (1992, Dunning-Lundan 2008) divided into four categories: market-seeking, resource-seeking, efficiency-seeking and asset-seeking. Localization advantages “comprise geographical and climate conditions, resource endowments, factor prices, transportation costs, as well as the degree of openness of a country and the presence of a business environment appropriate to ensure to a foreign firm a profitable activity” (Resmini, 2005, p

3). Much of the extant research and theoretical discussion is based on FDI outflows from developed countries for which market-seeking and efficiency-seeking FDI is most prominent (Buckley et al., 2007; Leitao-Faustino, 2010).

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

The rapid growth of OFDI from emerging and developing countries resulted in numerous studies trying to account for special features of emerging MNEs behaviour that is not captured within mainstream theories. Although MNEs from various emerging countries differ in many respects but to some extent they share common characteristics. For example, Peng (2012) reports that Chinese MNEs are characterized by three relatively unique aspects: (1) the significant role played by home country governments as an institutional force, (2) the absence of significantly superior technological and managerial resources, and (3) the rapid adoption of (often high-profile) acquisitions as a primary mode of entry.

Extant literature suggests diverse institutional factors that influence inward FDI. In the case of CEE, the prospects of their economic integration with the EU increased FDI inflows while in CEE countries that lagged behind with implementation of transition policies, which postponed their EU accession, FDI inflows were discouraged (Bevan-Estrin, 2004).

The example of extra-EU foreign investors in CEE is presented in a study by Kawai (2006) who analysed motivations and locational determinants of Japanese MNEs. The author found that Japanese MNEs’ investment in CEE was motivated by relatively low labour and land costs, well-educated labour force necessary in manufacturing sectors and access to rich EU markets. Szunomár and McCaleb (2017) found that in the case of Chinese MNEs’ motives in CEE significant role is devoted to institutional factors and other less-quantifiable aspects: besides EU membership, market opportunities and qualified but cheaper labour important factors are the size and feedback of Chinese ethnic minority, investment incentives and subsidies, possibilities of acquiring visa and permanent residence permit, privatization opportunities, the quality of political relations and government’s willingness to cooperate.

3. Chinese foreign direct investment globally

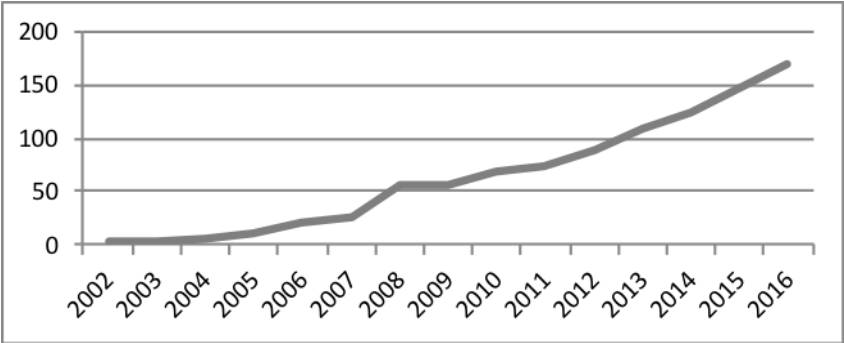
In 2000, before joining the World Trade Organization (WTO), the Chinese government initiated the “go global” or “zou chu qu” policy, which was aimed at encouraging domestic companies to become globally competitive. They introduced new policies to induce firms to engage in overseas activities in specific industries, notably in trade-related activities. In 2001 this encouragement was integrated and formalized within the 10th five-year plan, which also echoed the importance of the *go global* policy (Buckley *et al.* 2008). This policy shift was part of the continuing reform and liberalization of the

Chinese economy and also reflected Chinese government’s desire to create internationally competitive and well-known companies and brands. Both the 11th and 12nd five-year plans stressed again the importance of promoting and expanding OFDI, which became one of the main elements of China’s new development strategy.

Chinese OFDI flows and stock have steadily increased after the New Millennium (see Figure 1 and 2 below), particularly after 2008, due to the above-mentioned policy shift and the changes in global economic conditions, that is, the global economic and financial crisis. The crisis brought more overseas opportunities to Chinese companies to raise their share in the world economy as the number of ailing or financially distressed firms has increased.

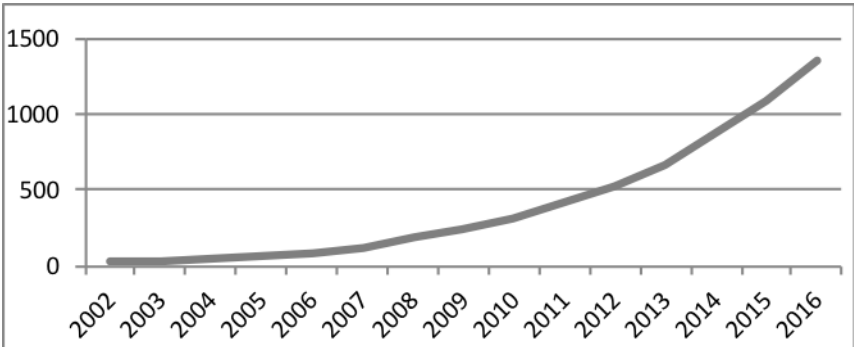
While OFDI from the developed world decreased in several countries because of the global financial crisis, Chinese outward investments increased even greater: between 2007 and 2011, OFDI from developed countries dropped by 32 per cent, while China’s grew by 189 per cent (He and Wang, 2014, p. 4). As a consequence, China moved up from the sixth to the third largest investor in 2012, after the United States and Japan – and the largest among developing countries – as outflows from China continued to grow, reaching a record level of 84 billion US dollars in 2012. Thanks largely to this rapid increase of China’s outward FDI in recent years, China also became the most promising source of FDI when analysed FDI prospects by home region (UNCTAD 2013, p. 21).

Figure 1: China’s outward FDI flows, billion USD, 2002-2016



Data source: Chinese MOFCOM / NBS (2017).

Figure 2: China’s outward FDI stock, billion USD, 2002-2016



Data source: Chinese MOFCOM / NBS (2017).

According to the *go global* strategy, Chinese companies should evolve into globally competitive firms, however, Chinese companies go abroad for varieties of reasons. The most frequently emphasized motivation is the need for natural resources, mainly energy and raw materials in order to secure China's further development (resource-seeking motivation). Mutatis mutandis, they also invest to expand their market or diversify internationally (market-seeking motivation). Nevertheless, services such as shipping and insurance are also significant factors for OFDI for Chinese companies if they export large volumes overseas (Davies, 2013, p 736). Despite China's huge labour supply, some companies move their production to cheaper destinations (efficiency-seeking motivation). Recently, China's major companies also looking for well-known global brands or distribution channels, management skills, while another important reason for investing abroad is technology acquisition (strategic asset-seeking motivation). Scissors (2014, p. 4) points out that clearer property rights – compared to the domestic conditions – are also very attractive to Chinese investors, while Morrison (2013) highlights an additional factor, that is, China's accumulation of foreign exchange reserves: instead of the relatively safe but low-yielding assets such as US treasury securities, Chinese government wants to diversify and seeks for more profitable returns.

Regarding the entry mode of Chinese outward investments globally, greenfield FDI continues to be important, but there is a trend towards more mergers and acquisition (M&A) and joint venture projects overseas. Overall, greenfield investments of Chinese companies outpace M&As in numerical terms, however, greenfield investments are smaller in value in total as these include the establishment of numerous trade representative offices.

4. Changing patterns and motivations of Chinese OFDI in CEE region

The change of CEE countries from centrally planned to market economy resulted in significant research on FDI flows to these transition countries. However, most of the studies focus on the period before 2004 which is the year of accession of the eight CEE countries – the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia – into the EU (Carstensen and Toubal, 2004; Janicki and Wunnawa, 2004; Kawai, 2006). Investors, mainly from EU-15 countries, were attracted by relatively low unit labour costs, market size, openness to trade, and proximity (Bevan and Estrin, 2004; Clausing and Dorobantu, 2005).

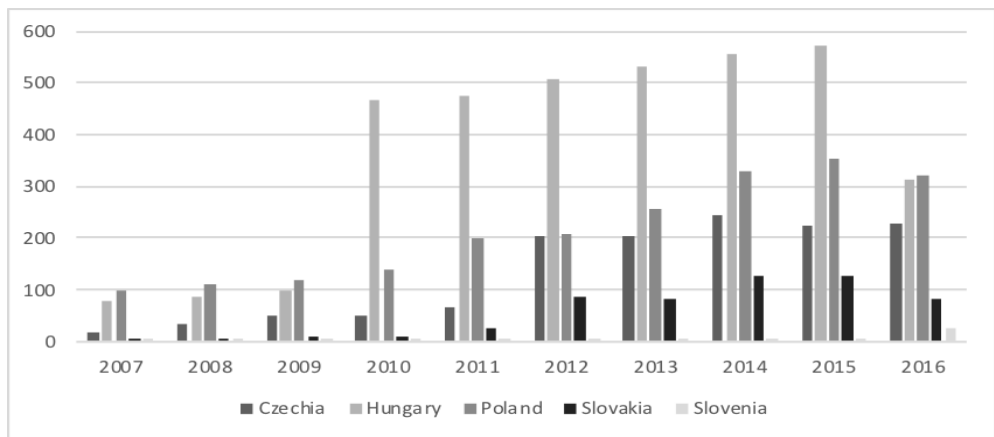
Extant literature suggests diverse institutional factors that influence inward FDI. In the case of CEE countries, the prospects of their economic integration with the EU increased FDI inflows while in other CEE countries that lagged behind with implementation of transition policies, which postponed their EU accession, FDI inflows were discouraged (Bevan and Estrin, 2004).

When analysing the impact of institutional characteristic of CEE countries such as form of privatization, capital market development, state of laws and country risk, the studies show varying results. According to Bevan and Estrin (2004, p 777) institutional aspects were not a significant factor impacting investment decisions of foreign firms. Carstensen and Toubal (2004) argue that they could explain uneven distribution of FDI across CEECs. Fabry and Zeghni (2010, p 80) point out that in transition countries institutional weaknesses such as poor infrastructure, lack of developed subcontractor network, and unfavourable business environment may explain FDI agglomeration more

than “positive externalities”. Campos and Kinoshita (2008) based on a study of 19 Latin American and 25 East European countries in the period 1989-2004 found that structural reforms, especially financial reform and privatization, had strong impact on FDI inflows.

Although the countries of the CEE region differ in many respects, they have some common features as well. They have been in the process of economic catching up over the last decades, their development paths are defined mainly by the global and European powers, rules and trends and FDI has a key role in restructuring of these economies. Most of the above-mentioned countries started to get more interested in Chinese relations – more properly in attracting Chinese investments and boosting trade relations – since the new millennium, however, the economic and financial crisis of 2008 drew the attention of these six countries more than ever to the potential of Chinese economic relationship.

Figure 3: China’s outward FDI stock in selected CEE countries, 2007-2016, million USD



Source: MOFCOM/NBS (2017).

When calculating the percentage share of Chinese FDI in selected CEE countries to all the invested capital, using UNCTAD’s statistics on total inward FDI stock as well as MOFCOM data on Chinese FDI in selected five CEE countries, we found that only 0.22 % of total inward FDI in selected CEE countries were from China. The highest percentage is in Hungary: 0.4%, in other countries it is even lower (the lowest is in Poland with 0.17%). When using the data of China Global Investment Tracker (CGIT) instead of MOFCOM, as CGIT tracks back data to the ultimate parent companies, we found that 2.08% of total inward FDI in selected CEE countries were from China: the highest percentage is again in Hungary: 7.84%, while the lowest (below 0,5%) in Slovakia and Slovenia.

As detailed above, the role of Chinese capital in CEE – compared with all the invested capital here – is still very small, but in the last one and a half decade this capital inflow accelerated significantly. In the case of the selected countries – with the exception of Hungary – there is a growing demand for attracting Chinese companies in the last nine to ten years. In Hungary this process has already begun in 2003.

Chinese investors typically target secondary and tertiary sectors of the selected five countries. Initially, Chinese investment has flowed mostly into manufacturing (assembly), but over time services attracted more and more investment as well, for example in Hungary and Poland there are branches of Bank of China and Industrial and Commercial Bank of China as well as offices of some of the largest law offices in China, Yingke Law Firm (in Hungary in 2010, in Poland in 2012), Dacheng Law Offices (in Poland in 2011, in

Hungary in 2012). Main Chinese investors targeting these six countries are interested primarily in telecommunication, electronics, chemical industry, transportation and energy markets. Their investments are motivated by seeking of brands, new technologies or market niches that they can fill in on European markets.

4.1. Macroeconomic and institutional factors influencing Chinese companies in CEE

When searching for possible factors which make the region a favourable investment destination for China, the quality and the cost of labour is to be considered first. A skilled labour force is available in sectors for which Chinese interest is growing, while labour costs are lower in the CEE region than the EU average. However, there are differences within the region – and the selected five countries, for example, in terms of unit labour costs.

The change of institutional setting of CEE countries due to their economic integration into the EU (in 2004 and 2007) has been the most important driver that spurred Chinese OFDI in the region, especially in the manufacturing sector. Majority of Chinese firms that invested in CEE countries after their EU accession were motivated mainly by accessing the old EU-15 markets and CEE or CEE markets were of secondary importance. CEE countries' EU membership allowed Chinese investors to avoid trade barriers and the countries served as an assembly base due to the relatively low labour costs.

Chinese investment in CEE in the years 2004-2006 were dominated by firms from electronics sector, especially LCD TVs producers as their exports to the EU were restricted by quota. The examples of such investors are: TCL, Victory Technology, Digital View in Poland; Hisense in Hungary; Changhong in the Czech Republic. There are already cases of companies from renewable energy sector such as Orient Solar in Hungary and media news inform about some companies from the solar sector that consider investing in Poland. The motive of overcoming trade barriers shows similarity with Japanese investments in the region in the second half of the 1990s. Japanese MNCs established assembly plants here, but sold their products mainly in the affluent Western European markets (Woon, 2003).

Another aspect of the EU membership that is inducing Chinese investment is institutional stability (e.g., protection of property rights) as one of the drivers of Chinese OFDI is unstable institutional, economic and political environment of their home country (e.g., Morck *et al.*, 2007). It is in line with the findings of Clegg and Voss (2011, p. 101) who argue that Chinese OFDI in the EU shows “an institutional arbitrage strategy” as “Chinese firms invest in localities that offer clearer, more transparent and stable institutional environments. Such environments, like the EU, might lack the rapid economic growth recorded in China, but they offer greater planning and property rights security, as well as dedicated professional services that can support business development”.

In their investment decisions in CEE countries Chinese firms might also be attracted by Free Trade Agreements between the EU and third countries such as Canada, the USA (being negotiated), and the EU neighbouring country policies etc. as they claim that their CEECs subsidiaries are to sell products in the host, EU, Northern American or even global markets. For example, Nuctech (Poland), security scanning equipment manufacturer, sells also to Turkey; machinery producers such as Shantuo Agricultural Machinery Equipment (Romania) for which were planned as important export markets Canada, Russia, USA; and Liugong Machinery subsidiary in Poland that targets the EU, North American and CIS

markets. This driver might also explain some of the Chinese investment in Bulgaria and Romania before their EU accession, such as SVA Group in Bulgaria. However, this type of institutional factor requires further research. Besides, there are cases of Chinese companies following their costumers to CEE countries, like in the case of Victory Technology (supplier to Philips, LG and TPV) or Dalian Talent Poland (supplier of candles to IKEA).

Moreover, Chinese firms' CEE subsidiaries may allow them to participate in public procurement. Example is Nucotech company that established its subsidiary in Poland in 2004 and initially targeted mainly Western European market. In 2011 the company stated that the old-EU market became saturated and it focused now more on CEE which benefit from the EU aid funds. However, in case of government procurement one of the conditions is "Made in the EU" and Nucotech's Polish manufacturing plant allows it to meet this requirement.

Recently Chinese firms interested in investing in countries of the CEE region became more inquisitive about food safety standards and certificates. They would be interested in exporting agricultural products with EU safety certificates to China where food safety has been a problem.

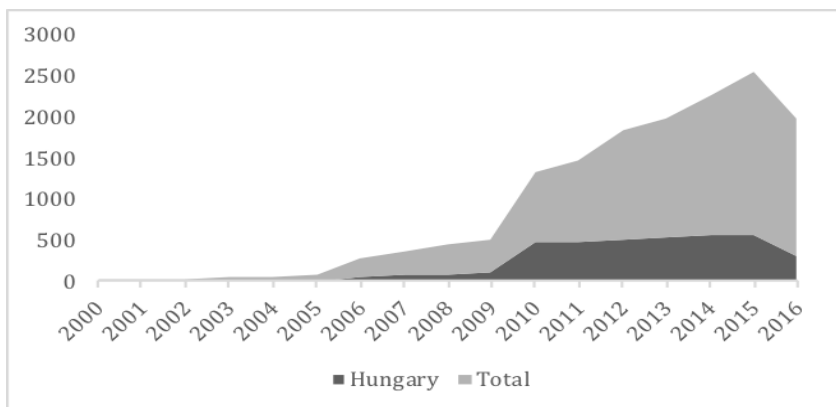
4.2. A special partner: Hungary?

Before their integration with the EU, CEE countries were mostly focused on fulfilment of the EU entry criteria and generally neglected relations with countries from other regions, except for Hungary. Only since the aftermath of the global financial crisis can we observe increased interest of the CEE (as well as other CEE) governments in attracting Chinese investors. For example, Poland started actively promoting itself with Chinese firms only at the EXPO 2010 in Shanghai.

Hungary is a country where the combination of traditional economic factors with institutional ones seems to play an important role in attracting Chinese investors. Hungary has had historically good political relations and earlier than other CEECs, since 2003, intensified bilateral relations in order to attract Chinese FDI. Hungary is the only country in the region that introduced special incentive for foreign investors from outside the EU, which is a possibility to receive a residence visa when fulfilling the requirement of a certain level of investment in Hungary. Moreover, Hungary has the largest Chinese diaspora in the region which is an acknowledged attracting factor of Chinese FDI in the extant literature, that is a relational asset constituting firm's ownership advantage (Buckley *et al.*, 2007). Example is Hisense's explanation of the decision to invest in Hungary that besides traditional economic factors was motivated by "good diplomatic, economic, trade and educational relations with China; big Chinese population; Chinese trade and commercial networks, associations already formed" (CIEGA, 2007).

Although Hungary is not a priority target of the intensive Chinese FDI outflows of recent years, since the turn of the millennium Chinese investments show a growing trend here. Chinese investment to Hungary started to increase significantly after the country joined the EU in 2004. According to Chinese statistics, it means a really rapid – more than a hundredfold – increase from 5.43 million USD in 2003 to 571.11 million USD in 2015 (see Figure 2). According to Chen (2012), in 2010, Hungary itself took 89 percent of the whole Chinese capital flow to the region. Although this share has been decreasing since then as other countries of the CEE region became also popular destinations for Chinese FDI, but the amount of Chinese investment in Hungary has continued to increase and it is by far the highest in the CEE region.

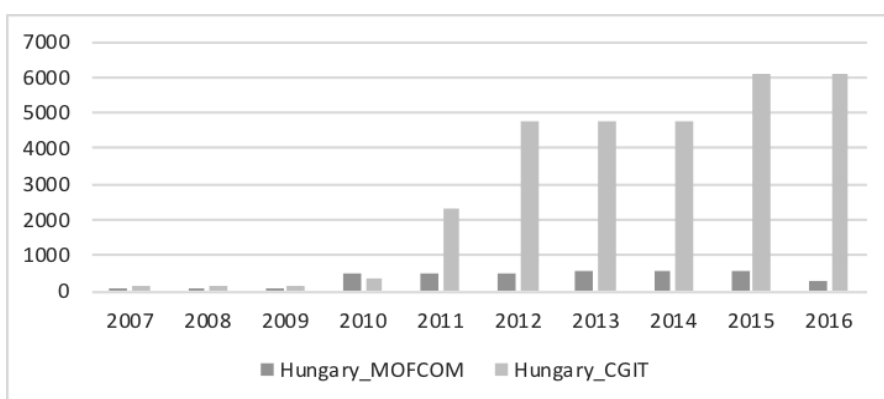
Figure 4: China's OFDI stock in Hungary compared to Chinese OFDI stock in CEE, 2000-2016, million USD



Data source: MOFCOM/NBS (2017).

As mentioned above, according to Chinese statistics, Chinese OFDI stock in Hungary was 571.11 million USD in 2015 but – due to disinvestments – turned to 313.7 million USD in 2016. Nevertheless, this amount is far greater when taking into account cumulative Hungarian data, since a significant portion of Chinese investment is received via intermediary countries or companies, therefore it appears elsewhere in national (Chinese and Hungarian) statistics. According to the Hungarian National Bank's statistics, Chinese investment in Hungary by 2016 was about 1,8 billion USD, while China Global Investment Tracker indicates a stock of more than 6 billion USD (see Figure 5). More than 1.5 billion USD from that is the investment of the Chinese chemical company Wanhua, which acquired a 96 percent stake in the Hungarian chemical company BorsodChem through its Luxemburg subsidiary in 2010 and 2011. This subsidiary also made some investment for the development of BorsodChem later. It is the largest Chinese investment in CEE so far.

Figure 5: Comparing MOFCOM and CGIT statistics – China's OFDI stock in Hungary, 2007-2016, million USD



Data source: MOFCOM/NBS (2017) and CGIT (2017).

Although Chinese multinational companies represent a relatively small share of total FDI stock in Hungary, they have saved and/or created jobs and contributed to the economic growth of Hungary with their investments and exports during the crisis.

Furthermore, many of them (e.g. Lenovo, ZTE, Huawei, Bank of China) have turned their Hungarian businesses into the European regional hub of their activities (Szunomár *et al.*, 2014).

In addition to the chemical industry, the investment of Chinese companies in Hungary covers industries such as manufacturing, telecommunications, trade, wholesales or retails, banking, hotels and catering, logistics, real estate and consultancy, etc. According to Hungarian statistics, more than 5000 Chinese companies operate in Hungary, most of them being small businesses operating in the service or retail sector: restaurants, perfumeries, and so called ‘Chinese shops’, selling everything from shoes and clothes to plastic toys.

Beijing government often emphasizes that it treats Hungary as a hub for Chinese products in the European Union. In order to do so, it plans several infrastructure-related investment recent years: they want to transform Szombathely airport into a major European cargo base, develop the infrastructure and the services of the Debrecen airport and – as a part of the Belt and Road initiative – they support and finance the modernization project of the Belgrade-Budapest railroad connection.

5. Conclusion

As mentioned above, while Chinese OFDI in emerging or developing countries is characterized more by resource-seeking motives, Chinese companies in the developed world are rather focusing on buying themselves into global brands or distribution channels, getting acquainted with local management skills and technology, so-called strategic assets. Regarding modes of entry, investments shifted from greenfield investments to mergers and acquisitions currently representing around two-thirds of all Chinese OFDI in value. This shift is driven by the financial crisis, however it also seems to be a new trend of Chinese FDI to the developed world, while greenfield investment remains significant in the developing world with some cases in Central and Eastern Europe, too.

China’s OFDI has also become more diversified in the past years both in terms of sectors as well as geographically. From mining and manufacturing they turned towards high technology, infrastructure and heavy industry, and lately to the tertiary sector: business services and finance but also health care, media and entertainment. Asia continues to be the largest recipient, accounting for nearly three-quarters of total Chinese OFDI, followed by the EU, Australia, the US, Russia and Japan but numbers might be misleading though due to round-tripping phenomenon. As for Chinese OFDI to the European Union, the Eurozone crisis attracted Chinese investors due to falling prices. Here, Chinese investors prefer “old European” investment destinations not only because of market size but also because of well-established, sound economic relations with these countries.

Chinese investment in CEE constitutes a relatively small share in China’s total FDI in Europe and is quite a new phenomenon. Nevertheless, Chinese FDI in the region is on the rise and expected to increase due to recent political developments between China and certain countries of the region, especially Hungary, Czech Republic and Poland.

The investigation of the motivations of Chinese OFDI in CEE shows that Chinese MNEs mostly search for markets. CEE countries’ EU membership allows them to treat the region as a ‘back door’ to the affluent EU markets. Chinese investors are attracted by the relatively low labour costs, skilled workforce, and market potential. It is characteristic that

their investment pattern in terms of country location resembles that of the world total FDI in the region.

Analysing the difference in motivations before and after the global financial crisis it can be assessed that although it did not have an impact on Chinese-CEE relations from the Chinese side directly but it did have indirectly because the crisis had an effect on the whole CEE region as most of them (not only the selected CEE countries) started to search for new opportunities after the crisis in their recovery from the recession. Country-level institutional factors that impact location choice within CEE countries seem to be the size of Chinese ethnic population, investment incentives such as special economic zones, resident permits in exchange for given amount of investment, privatization, but also good political relations between host country and China. For example, Hungary's Eastern opening policy was initiated after (and partly as a result of) the crisis. China just took these opportunities, which can be the reason of the wider sectoral representation of Chinese firms in CEE in recent years. Another reason for this higher representation can be the diversification strategy because recently Chinese global investment strategy places great emphasis on the diversification in all respects. A good example for that is China's 16+1 initiative which provides a joint platform for all Central and Eastern European countries and China, as well as the Belt and Road initiative, which provides more and more connections for Chinese businesses.

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