Teaching Plan: Chinese Investment in Europe and European Investment in China: Trends, Risks and Opportunities

Duration: 3 hours [2 hours and 45 minutes of lesson to incorporate a 15 minute break]

Lesson Objectives:

After completing the lesson, the student will be able to:

- Describe the current changes in China's economic model;
- Describe the overall characteristics of Chinese investment abroad and in Europe;
- Analyze the strategies used by Chinese firms when investing abroad and in Europe; and
- Identify the challenges and opportunities European firms may encounter when investing in China, given its new economic scenario.

Target Audience: Masters-level business, marketing or economics students from the EU

Classroom Size: 20-40 students

Materials: Teaching Plan, PowerPoint slides, and reading materials

Student Preparation:

Before class, each student will complete the following assignments:

1) Skim ESADE China Europe Club's report *Chinese Investment in Europe 2014*.
2) Read The Economist article "Rate cut shows that even China's government doesn't believe its own data"
3) Independently read up on one of China's global companies, in order to contribute interesting elements of their strategy and development with the class as the content is developed.

0. WELCOME AND HOOK

2 minutes

❖ **[slide 1] Welcome**

8 minutes

❖ **Hook**

➢ **[slide 2-5]** Ask the students to fill in the blanks. Share the correct answers after they make a couple guesses. (ESADE China Europe Club)

1. **Q**: China is one of the world's major investors. There are approximately _____ *(how many?)* Chinese companies located abroad in _____ *(how many?)* countries.
   - **A**: 18,000; 177
   - China has climbed from its position as the 33rd largest foreign investor in 2000 to rank 3rd in 2012.

2. **Q**: As of 2015, there are _____ *(how many?)* global Chinese firms among the 500 largest in the world. (Fortune)
   - **A**: 98

3. **Q**: _____ *(which region?)* is the main destination for Chinese investment in the world. At the end of 2012, the FDI stock was _____ *(how many euros?)*.
   - **A**: The EU; €26.8 billion

4. **Q**: _____ *(what percentage?)* of Chinese FDI in Europe is concentrated in six countries. The six countries are: _____ *(which countries?)*.
   - **A**: 73.3%; Luxembourg, France, the UK, Germany, Sweden, and the Netherlands

1 minute

❖ **[slide 6] Provide the road map for the lesson**

1. [slide 7] THE INTERNATIONALIZATION OF CHINESE COMPANIES AND THEIR PRESENCE IN EUROPE

15 minutes

❖ **Content: China's position in the world & its current strategy**
Method: Engaging lecture

- **[slide 8] Ask the students to guess China's ranking in the world** (#1, #2, #3, or not in the top 3) in the below categories as you uncover the answers (Note: data published in 2013):
  1. GDP (China is #2)
  2. Population (China is #1)
  3. Export (China is #1)
  4. Import (China is #2)
  5. FDI (China + Hong Kong is #2)
  6. Reserves (China is #1)

- **[slide 9] Walk through the six priorities of China's 12th 5-year plan**:
  1) Adjust the rate of GDP growth
  2) Boost domestic consumption
  3) Improve industry innovation
  4) Save energy and protect the environment
  5) Coordinate regional development
  6) Internationalization

- **[slide 10] Review China's change in economic model**:
  1. Promoting the private sector as the economy's main driver
  2. Globalizing Chinese companies (one of the six priorities in the 12th 5-year plan)
  3. Focus on 8 strategic emerging industries: infrastructure, energy, agriculture, high-tech, environment, healthcare, agri-food, and consumer goods
  4. Protection of 8 strategic sectors: defense, generation and distribution of electricity, oil, telecommunications, steel, civil aviation, banking, and water transport

  Ask the students if they have any questions regarding the change in economic model

- **[slide 11] The boom in Chinese outbound investment**:
  1. The "Go Global" strategy first appeared in the 10th five-year plan. In 2001, China commenced the second phase of its internationalization.
  2. China has climbed from its position as the 33rd foreign investor in 2000 to rank 3rd in 2012.
  3. The Twelfth Five-Year Plan (2011-2015) includes an annual FDI growth of 17%, thus reaching a rate of $150 billion by 2015. The Economist Intelligence Unit estimates that China's foreign investment will exceed the FDI flowing *into* the country by 2017.
  4. Compared to emerging economies:
     - China is leading the boom in foreign investments by emerging countries. Its volume of investments worldwide in the last three years is ahead of Russia's, six times greater than that of India, and 29 times that of Brazil.

20 minutes

- **Content: Presence of Chinese companies in the world & in Europe**

  Method: Example-based engaging lecture

[A] Chinese companies in the world

- **[slide 12]** Show the **map** displaying the presence of Chinese companies in the world.
- **Discuss examples of Chinese companies in the world**
  - Tsingtao Beer
    - China's number one beer currently exports its product, which is adapted to Chinese consumers' taste palate, to more than 50 countries
    - Optimized positioning through an extensive network of Chinese restaurants in every one of its target countries
    - In Spain, for example, Tsingtao beer is the beer of reference in every one of the 5,000 Chinese restaurants in the country
  - Herborist
    - Chinese brand marketed as an Asian brand (not Chinese) and as a natural product
    - Selling products through a western brand (Sephora) to show it is safe

- Herborist and Sephora have a mutually beneficial relationship
  - Sephora has Herborist in 80 markets in the world
  - Herborist helped Sephora enter into the Chinese market
- In one year, Herborist became the 5th most sold brand at Sephora

- **[slide 13]** Discuss how Chinese companies aiming to catch up with top companies worldwide have **two possible strategies** (ESADEgeo):

  1) **Bid for organic globalization by opening own subsidiaries overseas (greenfield investments)** to pursue own growth and invest in research
     - Ex. Huawei Technologies
       - Created in 1987 in the Special Economic Zone of Shenzhen
       - Internationalization strategy: commitment to investment in technological research with greenfield investment and R&D centers. Huawei has opened offices in more than 100 countries.
       - At present, Huawei has more than 150,000 employees, of whom 73% work outside of China.
       - Huawei was the company which registered the highest number of patents worldwide in 2008, and it is the Chinese company with the highest level of greenfield investment in Europe.

  2) **Move up the ladder in the value-added chain through mergers and acquisitions (M&A)** involving foreign companies which are already high up the value chain, allowing the Chinese firms to make a qualitative leap. M&A benefits include obtaining the R&D of the Western firm, increasing knowledge of the market and the Western target audience, and full access to the distribution network and network of political, business and institutional contacts.
     - Ex. Lenovo
       - Founded in Beijing in 1984, and now administered from Hong Kong.
       - Purchased IBM's PC unit (the famous *ThinkPads*), thereby gaining access to a global market and to a company that played a historic role in the IT revolution in the U.S.
       - In 2011, pursuing its strategy of mergers and acquisitions, Lenovo purchased the German technology company Medion in

what was one of the largest investments by a Chinese company in Europe.

- It is through the acquisition of leading companies in the West that Lenovo has forced its way into the global markets' first division of cutting-edge technology specialists.

- **[slide 14]** Talk about how although there are 98 Chinese companies in Fortune's Global 500, **there are very few Chinese brands that are truly global.**
  - Show the brand names of the top 10 of the Chinese companies in Fortune's Global 500.
  - **[slide 15]** Display and discuss the pie graph titled "Distribution of the main transnational companies (TNCs) worldwide by country of origin"

- **[slide 16]** Show and discuss the graph showing how Chinese brands **do not own distinctive attributes**, a challenge for global Chinese brands

[B] Chinese companies in Europe

- **[slide 17]** Show and discuss the chart showing that Europe is the principal destination of investment in the world

- **[slide 18]** Show the **map** of Chinese investment in Europe
  - Ask the students what is surprising about the map
    - Luxembourg is a conduit for Chinese investment (Europe China Research and Advice Network)
      - FDI figures refer to the initial country location in which inward investments are recorded, not the final destination of the investments
      - Luxembourg is a gateway for FDI because it offers professional services and institutional support unavailable in China
      - Luxembourg can give Chinese investors the cover of another nationality; this is useful with investment from China that might be controversial, or for the purpose of reinvesting in China as a nominally foreign investor
  - Ask the students if they know examples of Chinese investment in these countries

- **[slide 19] Show and discuss the graph showing that Chinese FDI stock in Europe is increasing rapidly**
  - FDI stocks measure the total level of direct investment at a given point of time

- Ask students to think individually about **possible hurdles Chinese companies face in Europe** for 1 minute.

  Then ask students to volunteer their suggestions to the class, reaching the following collective list at a minimum:

  - **[slide 20]** Brand recognition
    - Show the bar graph showing familiarity with Chinese brands and discuss how brand recognition is a major barrier to entry that generates great concern amongst management executives of Chinese firms
  - **[slide 21]** Conceptions
    - Show the bar graph displaying how Chinese brands are seen in Europe
  - **[slide 22]** Weak points
    - Show the bar graph displaying the weak points of Chinese brands in Europe

20 minutes

❖ **Content: General characteristics of Chinese investment**

Method: Group brainstorm followed by class sharing

➢ Ask the students to get in groups of four and brainstorm for 8 minutes about two of the questions below, on general characteristics of Chinese investment (divide the questions up evenly among the groups).

Then ask the groups to share with the class, asking each group to divulge their answers to one of the questions. Their classmates may then add additional answers they may have come up with.

Join the conversation to correct any misconceptions, clarify statements, or answer any questions.

[slide 23] The questions for discussion are:

1) What are the characteristics of Chinese companies that invest abroad?
2) Why are Chinese companies investing abroad?
3) Where do Chinese companies want to sell?
4) Where are Chinese companies investing?
5) What are the challenges and opportunities for Chinese companies that internationalize?

1) [slide 24] What are the characteristics of Chinese companies that invest abroad?

- Strong companies with big marketing budgets

2) [slide 25] Why are Chinese companies investing abroad?

- To improve their position in the value-added chain of global goods production in order to make them capable of competing with the leading technology and innovation companies in the Western world (KPMG 2013)
- According to a study by IBM, Chinese companies' three primary motivations for foreign investment are (ESADEgeo):
  - Expanding their markets,
  - Acquiring new technologies, and
  - Differentiating themselves in the domestic market.
- They are buying:
  - Know-how
    - Buying patents is an easy way to get know-how.
    - Gaining experience in a mature market.
  - Brands
    - It is hard for the Chinese to construct brands because of their reputation.
    - For national pride, they want the reputation of having brands as high quality as the European brands.
    - The aim: turn into global brands that are known throughout the world.

3) [slide 26] Where do Chinese companies want to sell?

1) China
   - To the growing upper and middle class

- "When Chinese entrepreneurs invest in Europe, they are seeking to expand their markets and vertically integrate processes, not only integrating Chinese companies into the European Union markets, but also obtaining a European stamp of approval which will enable them to compete better in China." (ESADEgeo)

2) Europe & the U.S.
   - The idea is to make the brand so strong that even Germans buy it
   - The mature markets of Europe and the US are seen by large Chinese companies as a "single market" where you go forward in stages. In Europe, Germany, France, Italy, the UK, and Spain tend to be targeted as priority markets.
3) Africa
   - South Africa has been China's largest trade partner on the African continent since the 1990s.
   - Chinese direct investment in South Africa exceed $6 billion, mainly in the textile, mining, energy, machinery, and building materials sectors.
4) Chinese investment in Latin America
   - Chinese investment in Brazil has increased from $82 million a year to $25 billion a year, particularly in oil, renewable energy, iron, and soy.

4) [slide 27] Where are Chinese companies investing?

- Show and discuss the graph "Distribution of Chinese FDI stock in the world (2011) (%)"

5) [slide 28] What are the challenges and opportunities for Chinese companies that internationalize?

- Challenges
  - "Low price" image still dominates the perception of products from China
  - Required managerial abilities are different
- Opportunities
  - Choosing emerging markets as the first foothold to global expansion
  - Choosing mature markets to change perceptions and learn
  - Categories: electronics, branded products, mobile phones, and appliances

2. [slide 29] THE RENEWED ALLURE OF CHINA FOR EUROPEAN FIRMS

20 minutes

❖ **Content: The arrival of European firms into China**

Method: Engaging lecture with partner discussions and class sharing

- **[slide 30]** Share the background of how European firms originally arrived in China
  - Despite the presence of some European companies in China during Mao's period, most arrivals started after China opened economically in the early 80's during Deng Xiaoping's period.

- The accumulated European FDI in China is €118 billion.
  - 80% of European investment in China has been produced since 2000. (ESADEgeo)

- Ask the students to guess which European countries are the top investors in China.
  - The top European investors in China are:
    - Germany (e.g., Volkswagen and Allianz): German companies account for around one in three euros invested in China from the EU
    - France (e.g., Carrefour and Peugeot)
    - Italy (e.g., Pirelli and Unicredito)
    - UK (e.g., BP and Lloyds)
  - **[slide 31]** Show the graph displaying the "Main European Investors in China (2012)"

- **[slide 32]** Nevertheless, EU FDI to China remains small in comparison to flows to other world regions. Show the graph "Stock of EU Foreign Direct Investment (2012)" (ESADEgeo)
  - In 2012, the stock of EU FDI was €464 billion in Latin America and €1,655 billion in the U.S.

- Ask the students to discuss with a partner for 3 minutes about what motivated European firms to invest in China. Then ask the students to share their answers with the class.

  [slide 33] Share the following information if not already mentioned:

- Competitive labor costs
  - Manufacturing labor costs of $0.60 per hour in 2002 (U.S. Bureau of Labor Statistics)
- Huge potential market
  - Underexploited market of 1.3 billion potential customers
- Export platform to Asia
- Low firm competitiveness

22 minutes

❖ **Content: New difficulties for European firms in China**

Method: Group discussion & class sharing followed by engaging lecture with statistics and examples

➢ **[slide 34]** Tell the students that as a result of the economic development undergone in China in recent years, European firms are facing new challenges when it comes to investing and operating in China.

➢ Ask the students to get into the same groups of four that discussed Chinese investment characteristics and discuss for 3 minutes about what new difficulties European firms in China are facing due to China's economic development.

Ask groups to volunteer to share their answers.

Ask students to comment on each other's answers.

Share any contributions of your own.

Then walk through the following slides to complement the discussion with statistics and examples:

1) [slide 35] Economic slowdown

- "The Chinese economy has been losing steam and growth rates have fallen from above 9% between 2002 and 2011 to the current 'cruise control' rate of 7% (7.1% in 2015, 6.8% in 2016, and 6.6% in 2017, according to the IMF)." (ESADEgeo)
- Discuss the article that the students read in preparation for class: "Rate cut shows that even China's government doesn't believe its own data" (The Economist)

2) [slide 36] China is no longer cheap

- Labor costs are now high by regional standards (the minimum wage is $1.19 per hour, compared to $0.28 in India, $0.52 in Indonesia, and $0.73 in the Philippines). (ESADEgeo)
- Insufficient infrastructure means that business logistic costs account for 12% of GDP in China, compared to an average of 12.3% in Latin America and 10.9% in the rest of Asia, excluding Japan (ESADEgeo)

3) [slide 37] Higher competitiveness of local players

- Mature and highly competitive markets in several coastal provinces (Shanghai, Guangzhou, and Zhejiang), (ESADEgeo)

4) [slide 38, 39] Classic and persistent barriers to doing business

- Investment climate has been persistently unfavorable for decades (China ranked 90th in the World Bank's *2015 Doing Business* report), (ESADEgeo)
- Excessive bureaucracy: China is ranking 128th in the "Starting a Business" dimension in the World Bank's *Doing Business* report,
- Costs associated with operating in one of the most complex tax and legal systems in the world.

35 minutes

❖ **Content: Business opportunities for European firms in China's new economic climate**

Method: Group brainstorming & class discussion

➢ **[slide 40] Group Brainstorming & Class Discussion:**

Tell the students that the Chinese economy's "new normal" generates new business opportunities for European firms.

Ask the students to return to their groups of four and brainstorm for 5 minutes on the flipside of these new difficulties, i.e. to identify the factors that are changing in China and China's economy today which might provide new business incentives for European firms.

Ask groups to volunteer to share their answers.

Ask students to comment on each other's answers.

Share any contributions of your own, leading to the following collective set of answers, at a minimum:

1) **[slide 41] Changing model of growth and rising living standards**

- "China is changing to an economic model in which the new engines of growth are private consumption on the demand side and production activities operating on the upper end of the value chain on the supply side." (ESADEgeo)
- "The increase in disposable income, with GDP per capita growing 9.2% annually over the past 20 years, combined with increasingly Western consumption patterns, generates significant business opportunities through the emergence of new consumer groups." (ESADEgeo)

2) **[slide 42] Inland China** (ESADEgeo)

- "China has lost much of the attractiveness held by emerging markets in coastal areas such as Beijing, Shanghai, or Shenzhen, but the investment advantages that China boasted about 20 years ago are still present in the interior."
- Interior provinces offer attractive labor costs
  - Average annual salary in Beijing, the highest in the country, was $7,962 in 2012. Average salaries in Yunnan stood at about a third of this level, namely at $2,702
  - Monthly minimum wages range from $290 in Shanghai and Shenzhen on the coast to $185 in Qinghai and Guizhou in the interior
- "Official Chinese data also reveal that FDI is highly concentrated in the coastal provinces, especially in Jiangsu, Guangdong, and Shanghai (which absorb about half of total foreign investment). In contrast, provinces such as Yunnan and Xinjiang receive little foreign investment."
- French presence in distribution networks, in both coastal cities and in the hinterland, is particularly notable:
  - Carrefour opened the first hypermarket in China in 1995, and today has 238 stores spread across 73 cities, employing over 50,000 people
  - Auchan has 115,000 employees in China, more than the total it employs in Europe (excluding France)

3) **[slide 43] New industries**

- China has continued to progressively open new sectors of its economy to foreign capital.

- Strategic emerging industries include (ESADEgeo):
  - New information technologies (especially broadband, internet, and software development);
  - Value-added equipment manufacturing (most notably aerospace and telecommunications);
  - Advanced materials (rare earths and semiconductors);
  - Alternative energy (including renewables, nuclear energy, and biofuels);
  - Energy saving;
  - Environmental protection; and
  - Biotechnology (medicine and advanced medical devices).

4) [slide 44] Innovating China

- New opportunities for productive activities using high level research and knowledge, especially where R&D activities at moderate labor costs take place close to the production plants.
- Half of the graduates in China are studying science or engineering.
- The fiscal framework for intensive R&D businesses is highly favorable with a corporate tax rate of 15% (compared to the general rate of 25%) and the possibility of deductions for other R&D expenses. (ESADEgeo)

5) [slide 45] Infrastructure and a more integrated market

- "European companies can benefit from the lower costs and quicker delivery times produced by new and ambitious infrastructure projects in the region, which should produce a breakthrough in the integration of the Asian market and the integration of the Chinese market with other world regions." (ESADEgeo)
- "China is driving increased trade integration through infrastructure development, including megaprojects such as the Nicaragua Canal and the New Silk Road, which will reduce operating costs and create new incentives to use China as a production and logistics platform." (ESADEgeo)

6) [slide 46] Urban and environmental needs

- The massive growth of cities (currently 500 million more Chinese people live in cities than three decades ago (The Economist)) and environmental degradation will generate new opportunities in sectors such as infrastructure and public transportation, urban waste management, and water treatment. (ESADEgeo)

7) [slide 47] Two-way FDI flows

- "Chinese investment in the EU is growing at an explosive rate, multiplying by 41 since 2001. Minority or majority participation by Chinese companies in the EU can lead to strategic alliances and facilitate the entry of European firms in the Chinese market – using Chinese distribution and commercial networks." (ESADEgeo)

20 minutes

❖ **Content: Application of Today's Learning**

Method: Three Paragraph Paper

➢ **[slide 48]** Ask the students to think, individually, for 5 minutes about the outlook for the following three European firms who are considering investing in China. In their deliberations, they should consider all of the push, pull and policy factors described in the lesson. The three firms are:

1. A German luxury car brand,
2. A Spanish firm specialized in smart city grids, and
3. A large French producer of low-cost electronic devices.

Then ask them to write one paragraph on each firm, discussing the challenges and opportunities each might encounter when investing in China and offering recommendations.

2 minutes

❖ **Conclusion**

➢ **[slide 49]** Answer any additional questions.

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