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Chinese SMEs in Germany: An exploratory study on OFDI motives and the role of China's institutional environment

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Abstract

Purpose – This paper aims to use the institutional perspective to jointly explore the underlying motives that drive Chinese private SMEs to invest in the developed economy of Germany and the role China's institutional environment is playing in this context.

Design/methodology/approach – Given the lack of recent in-depth studies, the authors employ multiple case study method to present rich insights from elite interviews with executives belonging to seven Chinese SMEs and industry experts, as well as the study of firm documents, social media, and the latest governmental policies.

Findings – The results indicate not only market-, resource- and strategic asset-seeking motives, but contrary to the literature, also efficiency-seeking goals. Further driving factors are the integration in global value chains and high degrees of entrepreneurial orientation. The second major finding is that China's institutional environment induces widely divergent effects. Its ministries established new OFDI support measures that are beneficial for some SMEs' post-entry operations. However, some firms are not aware of any support measures or suffer from discrimination that hinders innovation and from which they try to escape by investing abroad.

Originality/value – This paper considers different levels of analysis (firm, entrepreneur, institutional environment) to investigate Chinese SMEs' motives in Europe's largest market. By examining why and how these firms use OFDI to a developed economy, the authors address an essential question for China's economy that is of primary political and academic concern ("How can China get that improved innovation that often seeds entrepreneurial growth?", Ahlstrom *et al*., 2018). In addition, the study contributes to the growing discussion of institutional escapism in emerging markets (Deng and Zhang, 2018) by revealing five institutional hardships Chinese SMEs are facing and how this relates to their internationalization.

Keywords China, SMEs, Internationalization motives, Institutional environment, Innovation, Hidden Champions

Paper type Research paper

1. Introduction

Small- and medium-sized enterprises (SMEs) from emerging economies are increasingly active in international markets, and substantially contribute to economic growth and social development (Yamakawa *et al.*, 2013; Yan *et al.*, 2018; Zhang *et al*., 2016). Given their importance, scholars are increasingly interested in studying their internationalization and the roles of motives and institutional environments (Boisot and Meyer, 2008; Deng and Zhang, 2018; Wu and Deng, 2020). In China, SMEs account for more than 60% of the national GDP (State Council of China, 2018), and the "Go Out Policy" (走出去), launched in 1999, has marked the start of unprecedented economic growth and internationalization (Deng *et al.*, 2017). In 2019, China was the world's fourth-largest outward investor (UNCTAD, 2020). Large parts of its outward foreign direct investments (OFDI) found their way in developed economies (DE) such as Germany (Athreye

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and Kapur, 2009). Within the last 20 years, Germany received the second-highest Chinese investments in Europe (UNCTAD, 2020). Academic debates mainly focused on OFDI determinants in contexts of state-owned (SOEs) and large multinational enterprises (MNEs) (Buckley *et al.*, 2007; Deng *et al.*, 2017). This stream of research argues that besides seeking new markets, China's OFDI to DE is particularly driven by strategic asset-seeking motives. The aim is to acquire advanced technological and managerial expertise to enhance competitive capabilities and catch up with Western counterparts (Zheng *et al*., 2016).

However, little is known on why China's private SMEs invest in DE like Germany. While this is understandable, as this phenomenon is rapidly evolving and relatively new per se, it now calls for closer attention due to these firms' rising global impact. SMEs are the backbone of China's industry (Deng and Zhang, 2018). "Given that millions of SMEs in China have not yet entered the international market (…)" (Yan *et al*., 2018, p. 633), Wu and Deng (2020) recently called for a better understanding of the factors that motivate Chinese private SMEs to go overseas.

In this domain, previous research mainly addressed "how" Chinese SMEs internationalize, for example, by looking at collective take-off routes, marketing capabilities, or social networks as a facilitator in the internationalization process (e.g., Lew *et al.,* 2016; Li, 2020; Sandberg and Jansson, 2013; Yan *et al.,* 2018; Zhang *et al.,* 2016). There is a lack of primary research when it comes to the "why" of internationalization. In specific, studies frequently presuppose motivations (Holtbrügge and Berning, 2018; Sandberg and Jansson, 2013) or adopt constructs from earlier research on large Western or Chinese state-owned firms (Cardoza and Fornes, 2011; Liang *et al.*, 2014; Wei *et al.*, 2014), but do not adequately challenge if these motives hold true for Chinese private SMEs and if possibly new factors play a role. For example, Wei *et al.* (2014) adopted and quantitatively tested a construct on a sample consisting mainly of Chinese private SMEs, which derived from a previous study of Buckley *et al.* (2008). This article, however, derived its

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conclusions largely from data of government-owned or controlled Chinese MNEs. In a recent well-structured study, Holtbrügge and Berning (2018) did not directly address motives but investigated the relationship between market entry strategies and performance of 556 Chinese SMEs in Germany. "Performance" was operationalized with the concept of "productivity", which was measured by "sales per employee". However, what if the goal of the examined firms was not an increase in sales at all? Here one underlying issue could be the adoption of a (mainly) Western concept and understanding of performance. However, China's economy's unique history and characteristics require considering a Chinese view and theories of management that can adequately explain phenomena in such context (Barney and Zhang, 2009; Tsang, 2009).

Addressing this issue is particularly important since China's private SMEs fundamentally differ from large firms in central elements such as ownership structures, strategies, and fewer resources (Deng and Zhang, 2018; Yan *et al.,* 2018; Zhang *et al.,* 2016). This corresponds to the reasoning of Wu and Deng (2020, p. 337), who rightly pointed out: "(…) the arguments based on large-resource rich SOEs which often benefit significantly from state promotion policy in target industries can hardly be applicable to private SMEs which often face significant domestic institutional hardships (Child & Marinova, 2014; Deng, Delios, & Peng, 2020; Shi, Markoczy, & Stand, 2014)." This is in line with Ahlstrom *et al.* (2018, p. 311), who synthesized in their 2018 *MBR SI* article that the still prevailing discrimination of Chinese private SMEs is an area in need of further research.

Due to this fundamental difference and based on institutional theory (North, 1990; Scott, 2013), Wu and Deng (2020) argue to take institutional factors into account that motivate SMEs differently in their internationalization. To fully understand these motives, it is thus essential to jointly examine all the different level of analysis which interact (Vanderstraeten *et al.*, 2020): the firm, the entrepreneur, and the role China's institutional environment is playing.

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Thereby, we address both institutional hardships and the latest OFDI support policies, which recently shifted its attention to SMEs (MIIT, 2017, 2018). The Ministry of Commerce of China states Germany as a politically desired investment destination (MOFCOM, 2004). Germany provides an attractive environment for Chinese firms due to its large market, high innovativeness, strong brand reputation, and technological knowledge (De Massis *et al*., 2018). Germany has the highest per capita share of Hidden Champions in the world – highly specialized small to medium-sized businesses, which are global leaders in their niche markets (Simon, 1996, 2009; Audretsch *et al.,* 2018). Their success factors, such as a focus strategy with continuous innovation, serve as a blueprint and strategic fit for Chinese firms (Deng and Wan, 2006; Lei *et al*., 2020). As a result, Germany has become one of the top destinations for Chinese OFDI in Europe (UNCTAD, 2020). Chinese SMEs increasingly invest in the German market (Holtbrügge and Berning, 2018). Therefore, this paper will close the gap in research and provide firm-level research on the "why" of Chinese SMEs' investments in the German economy and on the role China's institutional environment is playing.

Empirically, we employ a multiple case study method to examine a cross-industrial sample of Chinese SMEs in Germany. We derive our findings from conducting elite interviews with senior executives (Harvey, 2011) and from the review of company documents, social media, and recent Chinese governmental policies on OFDI. Additionally, we interview industry experts for triangulation.

Our study delivers the following contributions: First, it refines OFDI theory by presenting up-to-date drivers for Chinese SMEs' investments in a developed market. This directs future research efforts into rewarding channels and increases their rigor. Second, this study sheds light on the puzzling effects of China's institutional environment. As suggested by Ahlstrom *et al.* (2018), it addresses and delivers thick descriptions of how Chinese private SMEs are still being

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discriminated and how this is related to their internationalization. In this way, the results propel and contribute to the recently growing discussion of institutional escapism in emerging markets (e.g., Deng and Zhang, 2018; Wu and Deng, 2020).

To answer these research questions, we have structured the paper as follows: We first review prominent and relatively unique FDI theories and assess them from the perspective of Chinese SMEs. Next, we outline the research methodology, followed by a presentation and discussion of the findings. In its finality, we outline the paper's contributions to theory and address limitations, as well as practical implications.

2. Literature review

Industrial SMEs in China are defined as up to 2000 employees, annual sales within CNY 300mn, or € 38mn, and assets not exceeding CNY 400mn, or € 50mn (National Bureau of Statistics of China, 2011). The majority is privately owned (Deng and Zhang, 2018), and entrepreneurship plays an important role (Ahlstrom and Ding, 2014). Among these firms, one can broadly differentiate between traditional manufacturing SMEs and high-tech companies (Petti *et al.*, 2017; Xu and Li, 2019), which are at the global forefront in industries and technologies such as artificial intelligence, e-commerce, and digitization (Simon, 2019). In terms of SMEs' internationalization patterns, Cerrato *et al.* (2016) identified different archetypes, such as internationalization from the demand side, the business network, resources located abroad, geographical scope, international orientation, and financial internationalization. As we strive to develop a holistic understanding of possible motives, and since the Chinese Communist Party (State Council of China, 2021) recently emphasized a reorientation toward the manufacturing industry in the "14th Five-Year Plan for Social and Economic Development" (经济和社会发展第十四个五年规划), we consider the possibility of different archetypes within the broader scope of manufacturing SMEs in this study.

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These firms contribute a large part to China's GDP and exports (Yan *et al.*, 2018). Many of them are deeply affected by China's rising manufacturing costs and transformation towards a knowledge- and innovation-driven economy (Liu *et al.*, 2017), as exemplified in the ambitious "Made in China 2025" (中国制造 2025) initiative. Hence, why and how SMEs use OFDI to DE like Germany is an essential question for China's economy, which is of primary political and academic concern (e.g., "How can China get that improved innovation that often seeds entrepreneurial growth?", Ahlstrom *et al.*, 2018, p. 309; Liu *et al.*, 2017).

A growing body of knowledge emphasizes that entrepreneurial ambitions and characteristics are an important antecedent of firm internationalization (e.g., the *SI* of Vanderstraeten *et al.*, 2020). Especially in small firms, where key decision-makers directly shape the agenda, their motivations and orientation are of central importance (Peschken *et al.*, 2016). Yamakawa *et al.* (2008) considered entrepreneurial orientation (EO) an important firm-specific capability and factor for OFDI decisions. EO is the willingness to innovate and take risks, act autonomously, and the tendency to be aggressive toward competitors and proactive to market opportunities (Lumpkin and Dess, 1996). Internationalization is a pro-active, risky act (Yamakawa *et al.*, 2008), and Chinese OFDI is described as an entrepreneurial and person-driven phenomenon (Yan *et al.*, 2018; Zhang *et al.*, 2016).

According to Dunning's (2000) eclectic paradigm, firm's OFDI are driven by market-seeking, resource-seeking, efficiency-seeking, and strategic asset-seeking motives. Strategic assets are firm-specific capabilities that are scarce, difficult to imitate, and help secure or build competitive advantage, including organizations' knowledge (Pananond, 2015).

Subsequent studies illustrated the emergence of new strategies, showing that emerging economy (EE) firms' motives to expand overseas are different from those of DE (Buckley *et al.*, 2007; Luo and Tung, 2007, 2018). While the latter are more likely to exploit competitive

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advantages established in their home market (Dunning, 2000; Audretsch *et al.*, 2018), EE latecomers are more likely to explore foreign assets to enhance innovation capabilities at home. They use OFDI as a springboard to quickly access strategic resources (Luo and Tung, 2007, 2018), base their internationalization on the search for new resources and the ability to link, leverage, and learn (LLL) (Mathews, 2006, 2017), or pursue the strategic intent to acquire capabilities to offset competitive weakness (Rui and Yip, 2008).

While we believe that these perspectives are of high value to explain the internationalization of many emerging market MNEs and SOEs, there are two theory-driven reasons why these lenses might not be applicable to fully explain the why and how of China's private SME's global expansion:

First, in IB studies, most authors define China as EE, but as Peng *et al.* (2018) remarked, use the term EE loosely without specifying which definition they follow. From existing definitions, "mid-range EE" by Hoskisson *et al.* (2013), characterized by low institutional and high infrastructure and factor development, probably comes closest to contemporary China, as it considers its strong economic development. However, there are still distinctive features that make China an outstanding example. Comparing Chinese multinationals to their peers from other EE, OFDI flows took place much faster, and large parts found their way sooner into DE (Athreye and Kapur, 2009). Moreover, China's political system is unique and cannot be compared to other EE, exemplified by the extent to which communist-socialist politics interfere in China's economic system (Andreosso-O'Callaghan and Gottwald, 2013; Weil, 2017).

Second, institutional theory (North, 1990; Scott, 2013) suggests that institutional contexts play a vital role in shaping a firm's strategic choices. At a most fundamental level, institutions consist of three dimensions – regulative, normative, and cognitive (Scott, 2013). However, the role of institutions in IB is more often dubious than clearly evident, requiring a nuanced

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perspective that takes institutional diversity and its effects into account (Aguilera and Grøgaard, 2019; Bruton *et al*., 2010). This is particularly true for China, where firms' options are conditioned by the environment and state policies they operate in (Cardoza *et al.*, 2014, p. 189).

Novel approaches are captured in the institutional fragility (Shi *et al.*, 2017) and institutional escape (Deng and Zhang, 2018) perspectives. While the concept of Shi *et al.* (2017) focuses on the institutional frictions at home that could push larger Chinese firms abroad, Deng and Zhang (2018) address Chinese private SMEs directly. As an integral part of institutional theory, Wu and Deng (2020, p. 338) define this view as "conceptualized as an escape response to the actual and perceived misalignment between firm needs and home country institutional environments, institutional escape perspective appears to be a relatively unique approach which is better equipped to understand the internationalization of private SMEs in emerging markets (Boisot & Meyer, 2008; Deng & Zhang, 2018)." Previous studies indeed indicated that EE firms' global expansion is partially due to home country institutional constraints (Boisot and Meyer, 2008; Witt and Lewin, 2007). For example, the favorable state policies that support large Chinese SOEs (Bruton *et al.*, 2015; Sun *et al.*, 2015) at the same time discriminate and limit the perceptions and chances of SMEs, who escape and invest abroad for possible institutional alternatives (Child and Marinova, 2014; Huang, 2008; Morck *et al.*, 2008; Deng and Zhang, 2018). Filling such institutional gaps, China's private firms can obtain non-discriminative treatments and often access better financial resources in international markets (Kurlantzick, 2016; Morck *et al.*, 2008; Shambaugh, 2020; Wu and Deng, 2020).

Building on a previous study (Deng and Zhang, 2018) and introducing institutional arbitrage ("the situation where a firm is able to exploit institutional differentials across national borders") as a functioning mechanism for escapism, Wu and Deng (2020, p. 339) recently shed light on the spatial behavior of 319 Chinese SMEs in terms of choice of location and entry mode. Their results

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showed that when SMEs internationalize to escape, they are likely to select a host country with different institutional environments than their home country and choose a lower-resource entry mode. Based on a surprisingly high proportion of 37.7% sample firms that have been motivated by institutional escapism in their OFDI, the authors concluded that escapism is an important yet largely ignored phenomenon for SMEs, especially in China.

3. Methodology

This study is exploratory as it examines a less studied phenomenon in a dynamic environment: the investment motives of Chinese SMEs in the DE of Germany. This calls for primary research of inductive nature (Yin, 2018). Hence, we aimed for rich, in-depth understanding through multiple case study method, which allows theorizing from cases and can identify new variables and causal explanations (Eisenhardt, 1989; Welch *et al.*, 2011).

We followed a purposive, phenomenon-driven sampling strategy (Patton, 2015; Fletcher *et al.*, 2018) targeted at conducting interviews with multiple Chinese SMEs that invested in Germany. Case selection sought to capture a range of SMEs from different industries and sizes to broaden our understanding of the various institutional contexts and motives for internationalization and were selected according to industrial SME criteria per Chinese definition (National Bureau of Statistics of China, 2011). Cases are contrasted by firms that already invested in a greenfield subsidiary in Germany, firms that actively plan to invest, and firms that plan no investment but still do much business with the German market. Capturing successful firms, at least in doing international business in Germany (one case describes its investment in Germany as unsuccessful from post-perspective, but still engages in profitable business through imports and exports), we are aware of the survival bias, which could be addressed in further studies that look on the cases who tried, but failed to invest or engage in business. Nonetheless, through the above-described

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various angles, this study can contribute with rich sets of motives and an in-depth understanding of the institutional environment's influences that trigger OFDI (Benito, 2015; Siggelkow, 2007).

In line with Dikova and van Witteloostuijn (2007), we define a greenfield subsidiary as established from scratch by a Chinese parent firm that controls 100% of the shares (fully-owned foreign subsidiary), excluding mergers or take-overs. We focused on greenfields because, within 2010-2018, Chinese greenfield investments were more frequent in Germany than M&As (Germany Trade and Invest, 2020). We identified cases by consulting China International Promotion Agency (CIPA) in Frankfurt, as well as via the Markus and Zephyr databases provided by Bureau van Dijk, which contain detailed information about firms in Germany, including financial indicators, corporate structures, and shareholders and subsidiary information as filed at the German Federal Gazette (German Bundesanzeiger). Out of the initially identified cases, we continued snowballing (Patton, 2015; Fletcher *et al.,* 2018), i.e., we asked the interviewed senior executives for contacts of other Chinese industrial SMEs, which established or plan to establish subsidiaries in Germany.

Experiences from research on Chinese firms show that it is, in general, best to gain sensitive information about strategies via face-to-face interviews (Ahlstrom *et al.*, 2008). To collect data (Table I), we carried out semi-structured elite interviews (Aberbach and Rockman, 2002; Harvey, 2011) prepared with a guideline of open-ended and possible follow-up questions.

[Table I near here]

We conducted eleven interviews with nine executives, the average interview lasting 69 minutes. Additionally, we studied firm documents (presentations, brochures, websites), leading social media in China as this can reveal clues about the entrepreneur's attitudes (WeChat), as well as recent Chinese governmental policies on OFDI of SMEs (MIIT, 2016, 2017).

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For triangulation, we conducted nine interviews with industry experts, managers of German-Chinese business associations, and specialized Chinese lawyers and overseas investment consultants, who frequently accompany Chinese OFDI in Germany. Holding these interviews further improved our data quality since these experts have close contacts and insights into numerous Chinese organizations investing in Germany. To facilitate open and unbiased discussions, all respondents were guaranteed anonymity.

Data collection was carried out between April 2019 and January 2021, both in China and Germany. To allow a more accurate and free expression of ideas, the interviews were conducted in the native language of the participants (Chinese, English, or German) by a trilingual researcher, taped, and subsequently transcribed. The interviews resulted in 371 pages of transcripts. Toward the end of the interviews, we repeatedly experienced the same topics, and no new insights were emerging from the data. At this point of theoretical saturation (Strauss and Corbin, 1998), we stopped the data collection process.

For the data analysis of the interview notes, we used QSR International's NVivo. Thereby, we continuously reviewed interview transcripts as data collection advanced. This assisted us in identifying emerging ideas and specific topics that guided subsequent data collection. We employed the *open, axial, and selective coding* schemes suggested by Strauss and Corbin (1998). During open coding, we identified essential concepts applying in-vivo codes (i.e., emergent codes derived from the text based on keywords and short phrases used by the interviewees). Initially, this resulted in 147 in-vivo codes.

In the next step of axial coding, we repeated the coding process in a second and third cycle to increase accuracy and relabel and merge the codes that share the same meaning. We then grouped the remaining 108 in-vivo codes into higher-level concepts named *first-order categories* based on their underlying similarities. Subsequently, we used selective coding seeking for

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relationships among the first-order categories and assembled them into overarching *second-order themes*. Thereby, as Gioia *et al.* (2013) remark, our coding was not linear but recursive, analytic, and process-oriented. We carried this process on until no new relations in data were found.

In the online appendices, we illustrate our in-vivo codes, first-order categories, and the second-order themes which emerged from the data.

[Table II near here]

4. Findings and discussion

Motives for OFDI

Our interviews with the seven Chinese industrial SMEs analyzed in-depth (Table II) found that different factors trigger their motivations to invest in Germany. In line with prominent approaches for conducting analyses through cases study research (Eisenhardt, 1989; Yin, 2018), our results are structured according to sets of investment motives and other essential topics (second-order themes) that emerged during the analysis process:

(1) resource-seeking, (2) market-seeking, (3) strategic asset-seeking, (4) efficiency-seeking, (5) EO, (6) GVC, and (7) the role of China's institutional environment. Addressing the first part of our research question, Table III presents the overarching internationalization motives of the examined Chinese private SMEs via OFDI and illustrates representative interviewee quotes. Figure 1 shows the conceptual framework based on our findings. Specifically, there are different firm-internal and external factors that motivate Chinese private SMEs to invest in Germany. From an institutional perspective, we identified five key obstacles that still discriminate and drive some of these firms to invest abroad: unfair competition, lack of access to financing, unequal enforcement of IP rights, different standards within China, and unpredictable institutional

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environment. The interviews have shown that these barriers hinder innovation and can lead to non-market motives such as escapism or establishing a "second-leg abroad".

Industry-based factors that drive OFDI are a high degree of rivalry in the domestic industry, the pursuit of new markets, and the integration in GVCs. Firm-internal RBV factors are resource seeking, strategic-asset, and efficiency-seeking motives, as well as high degrees of EO. Interestingly, government support did not provide decisive influence or trigger the examined SMEs to start their internationalization process, but for some firms, it provided valuable support in their post-entry operations.

[Table III near here]

[Figure 1 near here]

The role of China's institutional environment

We found evidence in three cases (alpha, beta, epsilon), where China's central and provincial government has provided noticeable support in their post-entry operations. The manager of case alpha shared:

> "There (supporting policies) are a lot. I only know it as I have to report back all costs we have for internationalization (…) they are partly refunded by the provincial government - for example, participation at trade shows." (Interview 2)

Our analysis indeed revealed multiple supporting policies that are specifically tailored for SMEs in recent years. For example, an updated 'SME promotion law' assures support in foreign exchange

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(MIIT, 2017, Article 42). A 'Five-year action plan for SME promotion', jointly launched with the Bank of China, and an 'SME internationalization development plan 2016-2020' specify further actions to support their OFDI (MIIT, 2016).

[Figure 2 near here]

Following this direction, China's ministries (MOFCOM, MIIT) implemented a versatile support network at home and abroad. In Germany, this institutionalized in the foundation of CIPA Germany, which promotes the cooperation between SMEs in China and Europe and establishes exchange clusters around the key industries of China's "Made in China 2025" (CIIPAG, 2020). However, in contrast to the above, several interviewed cases have not been aware of or received any supportive measures. The manager of case beta commented:

> "It seems our firm is too small; they don't take note (…) We know that the government has such a policy (…). Maybe our firm is too small." (Interview 4)

The same was evident in the case of delta. Here their owner reported:

> "If a firm establishes overseas a branch like in Germany, I really do not understand too much. (…) The (supporting) policies right now, I fail to understand." (Interview 7)

Next to this, the interviews also exposed various hardships Chinese private SMEs are struggling with:

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"There is a lot of pressure. Regulative laws impose limitations for us smaller firms. Of course, their starting point is right. They are for working and fire safety, environmental protection (…). There are central standards in China, but some local governments treat them more lenient, for example, Anhui. For us in Jiangsu, it is different. The standards are rigorous. Therefore, our costs are comparatively speaking higher, and firms from other areas have a competitive edge." (Interview 18)

"Another serious problem for us small firms are the rising labor and factory rental costs." (Interview 18)

"The traditional companies, SMEs, (…) many of them are still at the low end of the value chain, meaning simple manufacturing stuff. They are under pressure. As a matter of time, they will go extinct." (Interview 13)

"They (production cost in China) get much higher than ever. When they (Chinese SMEs) want to remain competitive, they need to upgrade their technology." (Interview 12)

However, moving up the value chain by enhancing technology and innovativeness, we observed further obstacles:

"If you develop new products, high-technology, there are two words: 模仿 (copy). Now in China, there are intellectual property rights (知识产权), but they fail to protect us smaller firms and only protect the big brands. (If rivals copy), they can sooner or later make the same, but they don't have R&D costs." (Interview 18)

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Probing further into this issue revealed cultural-cognitive factors playing a role:

> "We have four words for that: 拿来主义 (the attitude of borrowing ideas). This is a legacy of Deng Xiaoping's thoughts (…) we cannot do it, no problem, let's take it to us. For example, Zhejiang province, which is now very developed and skilled, adopts this and buys one product at the leading manufacturer, taking it apart and studying each piece in detail. At present, China does not have an (effective) policy on this, so the economic development is facing a bottleneck." (Interview 18)

> "Our government leaders always talk about helping SMEs, but at the bottom, at the province, at the local cities, these ideas change, they fail to implement." (Interview 16)

One explanation for this failure is provided in the following statement:

> "This is due to our legacy in China. Why do policies from the top do not perform in the local areas? Because there they have their own thoughts. The big leaders' ideas are not necessarily shared by the smaller ones, as some mainly consider themselves. For example, for the smaller firms, like the sprout of a small tree, you need to nurture them, maybe five years, ten years (…). However, within this time, the local government official already left. Hence, they focus on attracting big firms (to get promoted)." (Interview 18)

Further difficulties when it comes to investments into innovation and internationalization are found in the access to financing capital:

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> "Another problem is the restrictions on capital access for SMEs (…). Specifically for young entrepreneurs, as they do not have lots of resources or guarantees. When they like to start firms, they should have some financial support, right? But financing costs are extremely high. (…) There are different channels: You can borrow from friends or non-governmental channels (民间借贷). But there, the interest rate is up to six times higher than those of the banks, for example, 30%. And the banks, they only focus on the firms with money, but do not provide help when its needed most (只有锦上添花，没有雪中送炭)." (Interview 18)

The above illustrated institutional hardships also show further effects on private SMEs' internationalization and institutional arbitrage:

> "Our discussed points all have effects on internationalization. (…) Our problems in China here and there are too many, so if you, for example, go to Germany or France to invest, you can avoid some." (Interview 18)

A story told by case gamma reveals further insights into such motives, which are not primarily oriented on pursuing business opportunities abroad (non-market motives). The owner shared that a few years ago, a befriended, privately-held Chinese business has been involuntarily taken over by a Chinese state-owned firm, which subsequently acquired a high-tech company in Europe through the earlier privately-held one. This incident caused deep concerns of case gamma's owner, which influenced his decision to invest in a developed economy overseas (process of which they initiated in the months after this incident). A specialized Chinese lawyer who accompanied numerous Chinese firms in their investments to Europe added:

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> "Many of China's private firm's owners are wealthy and do not just want to stay in China. They also would like to buy property abroad. It's not so important whether the interest is three or four percent. They would like to invest and safeguard their money in Germany. For example, they buy a hotel. As they cannot run it by themselves, they establish a small company and hire personnel as manager and administration. There are many ways (…) what I said just now is typical." (Interview 14)

The interviews also revealed that normative factors play a different role regarding firm size and market position. While the examined larger SMEs such as alpha or zeta possess a strong position and are market-leaders in their industry, the smaller firms such as gamma or delta critically assessed their weak market and brand positioning as follows:

> "In our industry, all Chinese brands are the same and unknown, except global leaders from the US (…). When you speak of air compressor manufacturer, nobody will think of a specific Chinese brand name, like Haier. We hope we can become a global brand." (Interview 1)

> "Especially in the field of B2B manufacturing, Germany is the 'go-to' place for Chinese investors." (Interview 13)

> We invest in a greenfield subsidiary in Germany to create a new brand with a German image and name. (…) we strive to differentiate ourselves from the competition. You can say that basically, we mainly invest in Germany to sell more in China." (Interview 7)

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Investing in Germany's developed economy helps these firms establish legitimacy at home (Ahlstrom *et al.*, 2008) by creating a "halo effect" (Deeds *et al.*, 2004; Yamakawa *et al.*, 2008). In line with Yamakawa *et al.* (2008, p. 72), legitimacy is "(…) a generalized perception that the actions of an entity are desirable and appropriate within some socially constructed norms, values, and beliefs (Zimmermann & Zeitz, 2002)". By associating with high-prestige partners, locations, and activities, particularly the examined smaller cases try to enhance legitimacy.

Discussion of theoretical contributions

The findings provide several key contributions to research. First, they advance and refine OFDI theory by presenting up-to-date, underlying drivers for Chinese private SMEs' investments in Germany. Market-seeking and strategic asset-seeking motives that previous research on Chinese SMEs' foreign direct investment has identified (Lu *et al.*, 2010; Wei *et al.*, 2014) also manifested in our sample. In contrast to the study of Wei *et al.* (2014) in a similar setting (private Chinese SMEs expanding via OFDI) and research efforts by Buckley *et al.* (2008), Deng *et al.* (2017), and Zheng *et al.* (2016) in different Chinese settings (larger firms, often government-controlled and acquiring foreign firms), we also found efficiency-seeking motivations.

For example, in the quantitative sample of Wei *et al.* (2014), all OFDI SMEs pursued either strategic asset-seeking or market-seeking strategies, and over 70% adopted both strategies. The authors concluded that most Chinese firms with OFDI aim to simultaneously achieve asset exploration and market expansion by expanding to OFDI. While four out of our seven examined SMEs also pursue simultaneous aims of market-seeking and strategic asset-seeking nature (alpha, gamma, delta, epsilon), three of them also strive for efficiency-seeking goals. Our case analysis indicates that a possible explanation for this finding is the desired movement of Chinese SMEs up the "smile-curve" of value-added (Ahlstrom *et al.,* 2018, p. 313; Meng *et al.*, 2020). After

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Deng Xiaoping started to gradually open China's economy to international trade in the 1990s, many of China's smaller firms successfully followed an OEM trajectory in global markets by leveraging comparably low-cost labor force producing simpler products. As a result, and as Ahlstrom *et al.* (2018, p. 311) pointed out, China still rests largely at the lower middle of the bowl-shaped smile curve in many industries. However, in light of China's increasing factor costs, it appears inevitable to move up the curve by internalizing higher value processes such as design, research, or branding because these activities are the most difficult, unique, and reward-carrying. As our findings revealed, some SMEs actively pursue to move up the value chain by expanding to OFDI in a developed economy and are increasingly integrated in GVC (Meng *et al.*, 2020; Su *et al.*, 2020). This is exemplified by case zeta, which generates 92% of their sales outside of China, and case delta, which integrates innovative quality components from leading European suppliers into their own designs, thereby seeking cost efficiencies by streamlining their European purchase activities in their subsidiary in Germany. This indicates for future research that we need to broaden our understanding of efficiency-seeking motives, which in a Chinese context (e.g., Buckley *et al.*, 2008; Lu *et al.*, 2010) has been mainly dominated by focusing on production-related efficiencies abroad, such as lower labor and factor costs.

The above-discussed findings also suggest necessary refining of OFDI motives by integrating the factor of GVC in the context of Chinese SMEs in DE. This connects and supports the latest research efforts of Giroud and Mirza (2015) and Su *et al.* (2020). The results also indicate non-market motives such as institutional escapism and building a private "second-leg" abroad, underpinning previous findings (Boisot and Mayer, 2008; Deng and Zhang, 2018; Witt and Lewin, 2007; Wu and Deng, 2020) and the relevance of this research stream in the context of emerging market SMEs' internationalization. Building future research efforts on a sound fundament of the various possible motives ("starting points") increases their rigor. Relatively little attention has

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been paid to this important issue, and hence, this paper contributes empirically to the growing stream of research on the internationalization of China's SMEs.

Second, our study sheds light on five institutional obstacles that hinder innovativeness and international development (unfair competition, lack of access to financing, unequal enforcement of IP rights, different standards in China, and unpredictable regulative environments). Contrasting this to previous research of Zhu *et al.* (2012), who examined institution-based barriers for Chinese SMEs nearly a decade ago, our findings still reveal the same issues. In 2012, the most frequently mentioned barriers were competition fairness, access to financing, unclear/missing laws and regulations, tax burden, and public support systems. Except for the issue of excessive taxation, all other barriers have also been repeatedly stated by our interviewees. This could indicate that the promulgated R&D tax credit policy (Zhu *et al.*, 2012, p. 1139) shows some effects. However, several obstacles still exist, such as access to financing or unequal regulative treatments (working-, fire safety- and environmental standards) that differ in their enforcement between advanced and less-developed regions. This is significant, as investing in these standards leads to higher costs, which is why one interviewed business owner considers moving from Jiangsu to another less strict region. However, recent studies on Chinese SMEs (Du and Yin, 2015; Wang and Zhao, 2020) have shown that precisely such improvements of international process and environmental standards (ISO 14001 and ISO 9000) are positively related to growth and internationalization performance. Compared to larger firms, SMEs are still discriminated (Ahlstrom *et al.*, 2018; Zhu *et al.*, 2012) as several owners stated that their local government officials mainly support big companies that create higher industrial outputs and, in this way, strive to fulfill their personal promotion schemes that are mainly based on the key performance indicator of short-term industrial output increase, at the expense of fostering young entrepreneurial firms.

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Third, by inductively exploring the underlying motives that drive Chinese SMEs overseas, our findings contribute to the growing academic discussion on home country's governments and institutions (Aguilera and Grøgaard, 2019; Cardoza and Fornes, 2014; Hernández *et al.*, 2021) and institutional escapism in emerging markets (e.g., Deng and Zhang, 2018; Wu and Deng, 2020). Here, the regulative dimension (Bruton *et al.*, 2010) of China's institutional environment plays an important role. Non-market motives such as escapism and establishing a "second-leg" abroad derive from missing trust in fair, predictable, and transparent legislative and judicial systems, as the story of the involuntary firm take-over vividly exposed. In specific, the findings illustrate that the discussed institutional hardships of private SMEs can trigger them to escape by investing abroad and, in this way, seek institutional arbitrage (Jackson and Deeg, 2008) in a DE. The results are of particular value because Wu and Deng (2020, p. 339) noted that so far, findings in the scholarly discussion were derived from deductive analysis or country-aggregated data, lacking firm-level empirical investigation. As this paper derives its results from inductive analysis on firm-level, it extends this novel field of research by revealing how escapism emerges, i.e., which underlying institutional obstacles can lead to Chinese SMEs' decision to escape by OFDI.

Limitations and future research

Several limitations can be discussed. First, the fact that many of the interviewed executives stated that they were unaware of home government support and incentives can also be interpreted differently as it could indicate that these firms, by purpose, try to work around the government, for example, when pursuing non-market motives. While we see a legitimate possibility for such concern, especially in domestic operations, it is limited when it comes to foreign direct investments because when a Chinese private firm would like to invest overseas, the application

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has to be processed and approved by various governmental institutions on local and regional levels and hence will be noticed.

Another limitation may be the extent to which our findings are driven by the specific empirical setting of greenfield subsidiaries with full ownership. The results of Wu and Deng (2020) showed that when Chinese SMEs internationalize to escape, they are likely to choose a lower-resource entry mode. As acquisitions require higher financial resources and often face costly post-integration failures due to cultural or organizational misfits (Dikova and van Witteloostuijn, 2007), greenfield investments can provide a lower-resource entry mode. In this context, full ownership could indicate that as no other partners are involved, public exposure is limited, which could be of interest for cases pursuing non-market motives.

A third limitation involves our chosen methodology. To answer the research question, we adopted an inductive posture and qualitative research method. Hence, our findings naturally cannot be generalized for all Chinese or emerging market SMEs. Following the idea that the applied case study approach is the "(...) best possible bridge from rich qualitative evidence to mainstream deductive research" (Eisenhardt and Graebner, 2007, p. 25), future studies can build on this work, for example, by verifying its findings on a larger panel of Chinese SMEs in Germany, Europe or North America, and different modes such as M&As and Joint Ventures.

5. Implications and conclusion

Our study also has practical implications. For business owners, establishing a subsidiary in a DE like Germany can help to link, leverage, and learn (Mathews, 2017) and stimulate a company's innovative capabilities and creativeness. The firm can also gain valuable foreign resources such as industry experts and international networks and open up the large European market using Germany as a gateway. Applying the success principles of Hidden Champion firms Simon (1996,

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2009) demonstrated, for example, a narrow-market focus with continuous innovation and closeness to customers, foreign investments expand the potential market size that originally is relatively small due to the niche focus and enable the necessary close interaction with customers. This can be an attractive option, particularly for uprising small to medium-sized firms striving to become Chinese Hidden Champions and global leaders in their niche markets.

For policy-makers, this study's practical implications are twofold: Firstly, the central government's new direction to foster SMEs and their OFDI resonates with the interviewed firm owners' needs. However, albeit the existing top-down support, only a few OFDI-interested SMEs knew about it. This juxtaposition is surprising given China's state-controlled economy and might be explained by fragmented authoritarianism (Lieberthal and Oksenberg, 1988). This theory posits that due to China's fragmented bureaucratic system, political outcomes often bear little resemblance to policy-makers' original intent as various interests and bureaucratic actors down the line from Beijing to the provinces and local townships interfere (Brødsgaard, 2017, p. 3). Our interviews have shown that in some cases, local governments indeed follow different interests compared to each other and the central government, and sometimes even try to hold back OFDI.

Secondly, and probably even more critical, SMEs are the backbone of China's economy (Deng and Zhang, 2018). To foster the needed innovation (Ahlstrom *et al.*, 2018) within China's desired transformation to an innovation-driven economy, it appears inevitable to address the identified institutional hardships effectively. Still today, the problematic enforcement in China's legal system (Ahlstrom and Bruton, 2006; Alexiou *et al.*, 2016) poses a significant problem for private SMEs' intellectual property (IP) rights. In specific, the findings indicate that it is not the lack of IP rights in China but missing enforcement that creates an obstacle for smaller firms to invest in R&D. In contrast, larger firms possess both the needed financial resources and political influence to assert their rights. These obstacles limit SMEs' motivation to invest in R&D.

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Adopting a clear focus and pursuing an innovation strategy, however, are one of the critical success factors of Hidden Champion SMEs – independently from where they are coming from (Simon, 1996, 2009; Audretsch *et al.*, 2018; Lei *et al.*, 2020). As such, the identified issues present a major challenge for the realization of China's desired economic transformation away from the "workbench of the world" towards a leading knowledge- and innovation-driven global economic powerhouse (Petti *et al.*, 2017; Simon, 2019; Xu and Li, 2019).

To summarize, our central aim was to explore Chinese private SMEs' motives in Germany and the role China's institutional environment is playing in this context. To answer these questions, we considered the different levels of analysis (firm, entrepreneur, institutional environment) that interact and interviewed executives from seven Chinese SMEs as well as industry experts. We could reveal that Chinese SMEs in Germany pursue market-, resource, and strategic asset-seeking motives, and also efficiency-seeking goals. Further factors that drive OFDI are the integration in GVCs and high degrees of EO. The findings also showed that Chinese private SMEs are deeply affected by China's rising manufacturing costs and that the institutional environment induces divergent effects. On the one hand, the Chinese Government (MIIT, 2016, 2017) established new OFDI support policies that benefited some SMEs in their post-entry operations. On the other hand, some owners have been unaware of any support measures or suffer from discrimination at home that hinders innovation and from which some firms try to escape by investing abroad. By examining why Chinese private SMEs use OFDI in Germany, we addressed an essential question for China's economy of primary political and academic concern. In addition, the study extended the growing discussion of institutional escapism in emerging markets (Deng and Zhang, 2018; Shi *et al.*, 2017; Wu and Deng, 2020) by shedding light on five key institution-based barriers Chinese private SMEs are still facing and how this affects their internationalization.

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Table I. Overview of data collection

Type of data	Pilot study	Main data collection
Documents studied	10	76
thereof websites	*2*	*34*
thereof presentations	*1*	*6*
thereof catalogues	*3*	*16*
thereof social media	*2*	*13*
thereof laws or policies	*2*	7
Semi-structured interviews	1	10
Expert interviews	1	8
Time period of data collection	April - July 2019	February 2020 – January 2021
Total = 106	12	94

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Table II. Case companies and interview partners

Case (founded)	*Main products and markets*	*Geographical scope*	*Size (2020)*	*Ownership*	*Status in Germany*	*Since*	*Position of interview partner(s)*	*Nationality interview partner(s)*	*Employer interview partner(s)*
Alpha (1999)	Brine-derived substances for the chemical industry (such as used in flame retardants)	Worldwide sales, two subsidiaries in the USA, Germany	1600 employees (medium-sized)	Privately-owned	Greenfield subsidiary	2015	CEO Vice President	German Chinese	Subsidiary Parent firm
Beta (1998)	Production and processing of mainly organic vegetables; sold to large supermarket chains	Worldwide sales, own subsidiaries in Germany and Japan	1300 employees (medium-sized)	Privately-owned	Greenfield subsidiary	2019	CEO	Chinese	Subsidiary
Gamma (2007)	Fluid delivery and control, metering, and exhaust gas treatment systems; sold to broad industry	Mainly domestic sales in China, one subsidiary in Germany	14 employees (small-sized)	Privately-owned	Greenfield subsidiary	2018	Owner and General Manager	Chinese	Parent firm
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Zeta (1998)	Outdoor power equipment like integrally powered hedge trimmers; sold to OEMs and large chain stores	Worldwide sales, own subsidiaries in Luxembourg, UK, USA, HK	1000 employees (medium-sized)	Privately-owned	Germany as one of global key markets	2008	Owner and CEO	Chinese	Parent firm
Eta (1999)	Machinery for printing and lamination industry, powder metallurgy, heat treatment; sold to broad industry	Almost exclusive focus on the domestic sales in China	33 employees (small-sized)	Privately-owned	Germany as one of global key markets	2000	Owner and CEO	Chinese	Parent firm

Table III. Internationalization (OFDI) motives and representative quotes

Motive	Cases	Representative quotes
Resource-seeking	Alpha Gamma Delta Epsilon	"We have close cooperation with the operating company of the leading chemical parks in Germany and their former directors. They retired, but still have the expertise. We engaged the former head, who serves as our external expert on-site (in China)." (Interview 2)
		"The aim is to set up a vocational training center according to the German dual-training model. (...) he shall set up the curriculum and organization (...), which is missing in China. Skilled workers and their training." (Interview 2)
		"One of the additional tasks of our company in Germany is to attract investors in Europe." (Interview 2)
		"The traditional companies, SMEs, (...) many of them are still at the low end of the value chain, meaning manufacturing simple stuff. They are under pressure. As a matter of time, they will go extinct." (Interview 13)
		"They (production cost in China) get much higher than ever. When they (Chinese SMEs) want to remain competitive, they need to upgrade their technology." (Interview 12)
		"We started from hardware manufacturing, but entered into different areas of surrounding or adjacent business segments, such as engineering technology like upstream and downstream (...) So (via OFDI) it's kind of expand into another area (...) along the value chain." (Interview 6)
		"I think those who realize there's a real risk at the horizon (...) have already started to internationalize to find a way out. (...) there are millions of SMEs, as they do not go on media to announce that they are going global, not like the big ones. I think that's exactly the value of your work. I do know that many Chinese small companies are establishing a presence overseas. R&D, manufacturing, so all types of activities around value chains." (Interview 13)
Market-seeking	Alpha Beta Gamma Delta Epsilon Zeta	"Goals are to increase the international sales, (...) as the markups and hence profits are higher than selling on the highly competitive, low price Chinese market." (Interview 1)
		"We mainly do business outside of China. We manufacture here, but 92% of our sales are abroad, mostly in developed economies, including Germany, France, the UK, and the USA. (...) For our products, we are one of the global market leaders." (Interview 9)
		"Give them (customers in Europe) a fresh view of Made in China. This is our philosophy. Let them see totally different Chinese fabrication." (Interview 4)
		"In our industry, all Chinese brands are the same and unknown, except global leaders from the US (...). When you speak of air compressor manufacturer, nobody will think of a specific Chinese brand name, like Haier. We hope we can become a global brand." (Interview 1)
		"We invest in a greenfield subsidiary in Germany to create a new brand with a German image and name. (...) we strive to differentiate ourselves from the competition. We plan to sell our products in Germany, other European markets, as well as South-East Asia and our home market China. You can say that basically, we mainly invest in Germany to sell more in China." (Interview 7)

Motive	Cases	Representative quotes
Strategic-asset seeking	Alpha Gamma Delta Epsilon Eta	"To convert more technology into commercial purpose, we set up an R&D factory in Germany." (Interview 6) "To cooperate (…) more closely with German companies, with suppliers, technology suppliers, with institutional partners (…), for example, engineering bureaus, with universities, (…). And with this kind of joint R&D result, we can commercialize that in China, in the Chinese market, or overseas globally." (Interview 6) "I think, first of all, they are constantly looking for opportunities to grow. To grow, they want to have access to state-of-art technology (…) expertise. Especially in the field of B2B manufacturing, Germany is the 'go-to' place for Chinese investors." (Interview 13) "We need to establish that German and Chinese Hidden Champions cooperate, (…) that the Chinese Hidden Champions learn from the German. We try to arrange a Hidden Champion summit every year in China, inviting German Hidden Champions (…)." (Interview 2).
Efficiency-seeking	Alpha Delta Gamma	"Unique material which is produced in Germany. We have then sourced it here and sold it to (our) group in China. This was lower in cost compared to buying it in China through distributors." (Interview 2) "For some of our key components like motors (…), we use European suppliers like Siemens. (…) (Having a firm in Germany) can be more convenient and helps us develop." (Interview 1) "At present, it is difficult to communicate or be very close. We (…) use our German subsidiary as a quality center, who is managing our cooperation with our many German suppliers to reduce costs, enhance efficiency and jointly develop products." (Interview 7)
EO	Alpha Beta Gamma Delta Zeta Eta	"As a founder, I think you have a strong willingness to take risks. Since at this time, you have nothing to lose, right?" (Interview 8) "(His) managers in China say the Chinese market is big enough; we don't need international markets. And then he (the Owner and President) flips out (…) That is totally out of the question for him (…) His big goal is to internationalize and become world market leader." (Interview 2) "He is very venturesome and risk-taking. As soon as he faces a problem, he turns it into opportunity and business. (…) If he sees many accidents in environmental protection, he founds an organization that improves the entire chemical park." (Interview 2)
GVCs	Beta Delta	"What I know from conversations with Chinese SMEs (GVC integrations into Germany) happens. (…) productions are relatively rare. They often follow the lead firms to be close to their existing key customers and provide technical support." (Interview 17) "In 2017 we started cooperation with a big German supermarket chain (…). Before delivery, we have to process our products locally and used a third-party firm (…), but found many problems. (…) we discussed to evolve into a full-service provider. They liked this very much. (…) In 2019 we decided to invest in a production facility in Germany." (Interview 4) "I think they now re-align and buy directly from us is kind of a trend, a result of globalization (in supply chains) and (…) the best way for their resource allocation." (Interview 4)

Figure 1.
Conceptual framework: The motives for OFDI

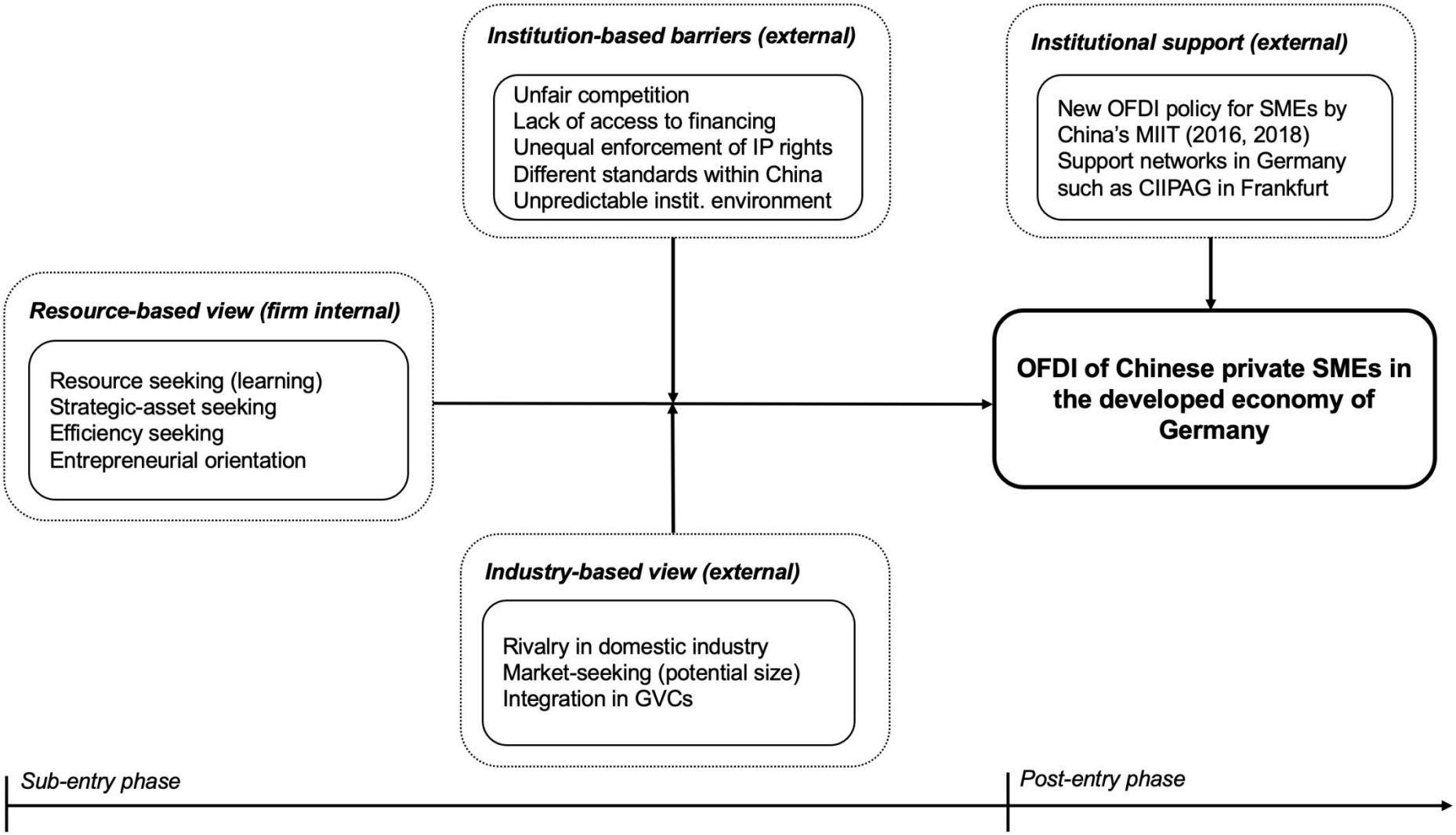

Figure 2.
SME internationalization development plan (MIIT, 2016, Chapter 4, Article 6)

六、中小企业国际化促进专项行动

VI. Special Actions to Promote the Internationalization of SMEs

发挥中小企业双边多边对外合作机制作用。继续深化与美国、德国、韩国和欧盟、东盟、APEC、金砖国家等双多边合作，探索合作共赢方式，深化在促进政策、贸易投资、科技创新等领域的交流与合作，促进中小企业发展。加快中小企业“走出去”和“引进来”。鼓励有条件的中小企业到境外建立原材料基地、研发设计基地和营销网络，支持中小企业收购境外先进技术和最新科研成果，并购、参股境外创新型中小企业，支持中小企业技术、品牌、营销、服务“走出去”。

We will give full play to the role of bilateral and multilateral foreign cooperation mechanisms for SMEs. We will continue to deepen bilateral and multilateral cooperation with the United States, Germany, South Korea, the European Union, ASEAN, APEC and BRICS countries.

We will speed up the "going out" and "bringing in" of SMEs. Encourage qualified SMEs to set up raw material bases, R&D and design bases and marketing networks abroad, support SMEs to acquire advanced technology and latest scientific research achievements abroad, merge and acquire foreign innovative SMEs, and support SMEs to "go global" in technology, brand, marketing and service.

支持有条件的地方建设中小企业中外合作区，吸引高端制造企业在园区落地，吸引境外企业在华设立研发机构，促进境外原创技术在中国孵化落地。深化“政银企”合作机制，鼓励开展多种形式的银企对接、跨境撮合等活动，为金融机构和中小企业提供沟通交流的平台，支持中小企业国际化发展。

We will support the construction of Sino-foreign cooperative zones for SMEs where conditions permit, attract high-end manufacturing enterprises to land in the zones, attract overseas enterprises to set up R&D institutions in China, and promote the incubation and landing of overseas original technologies in China. We will deepen the cooperation mechanism between government, banks and enterprises, encourage various forms of bank-enterprise docking and cross-border matchmaking activities, provide a platform for financial institutions and SMEs to communicate and exchange, and support SMEs' internationalization.

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Table III. (part two)

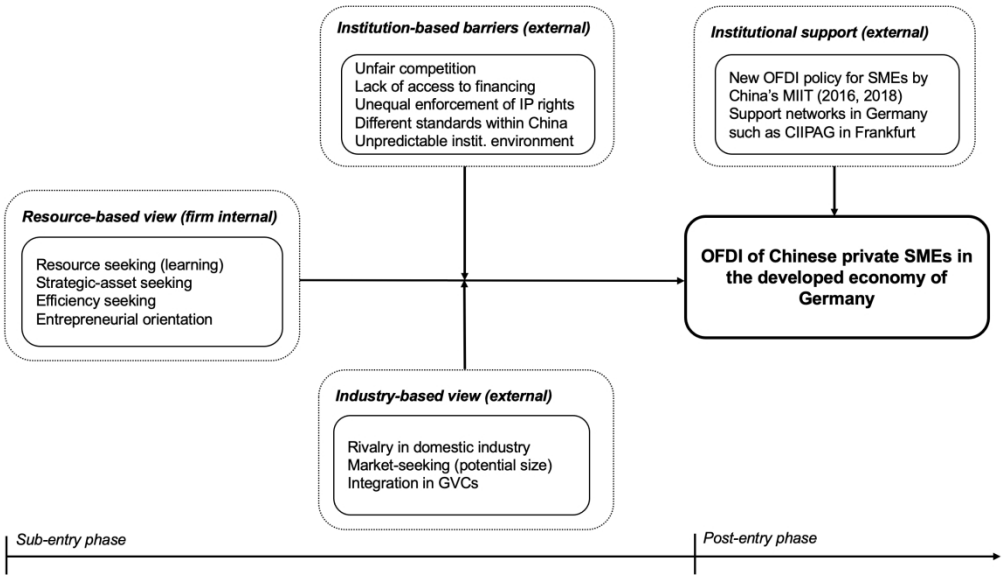

Figure 1.Conceptual framework: The motives for OFDI

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Figure 2.SME internationalization development plan (MIIT, 2016, Chapter 4, Article 6)