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Chinese foreign acquisitions aimed for strategic asset-creation and innovation upgrading: The case of Geely and Volvo Cars

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ABSTRACT

The acquisition and integration of Western companies into Chinese business groups, the impact of host country region innovation dynamics, and the consequences for Chinese firms' innovation capabilities represent a void in the existing literature. This study applies an in-depth longitudinal case study of a cross-border M&A and links the strategic asset-augmentation literature and location theories to address the influence of target firm characteristics on the acquiring firm's innovation capabilities. Results show how the acquisition decision is influenced by post-acquisition accessibility to, and leverage of, firm-level capabilities, macro-level conditions, and the ability to draw advantages from host country regional innovation dynamics to leverage global innovation capabilities. The study extends the asset-augmentation literature to include the notion of strategic asset-creation as a motive for M&A and demonstrates the dynamics of strategic asset-creation in the automotive industry. This study makes three contributions. First, it provides a definition of strategic asset-creation in the automotive industry; Second, it provides a more comprehensive explanation of the importance of spatial dynamics in regional attractiveness in strategic asset-creation processes of emerging market MNCs (EMNCs); Third, it demonstrates how EMNCs harness, absorb, and create new strategic assets.

1. Introduction

Chinese industries' continued integration into the world economy is a relatively new contributor to regional economic development that has emerged during the last decade (e.g., Alon et al., 2012; Alvstam et al., 2009). Being among the most important trading partners for most developed economies, China has succeeded in attracting foreign direct investment (FDI) from many developed economies. This inward FDI has enabled China to attain technological capabilities primarily in manufacturing, and Chinese firms have increasingly become more skilled in terms of utilizing advanced manufacturing technology in industries such as the automotive industry (Alvstam et al., 2014).

The development path of China via inward FDI follows the mainstream theories on FDI (e.g., Blomström and Kokko, 2003; Borensztein et al., 1998; Enderwick, 2005). For many years, attracting foreign investment has been promoted as the standard recipe for economic growth and development (e.g., Ruane and Ugur, 2006; UNCTAD, 2001, 2002, 2013), which is particularly true for China. Western FDI in China is, unsurprisingly, well documented in the literature (e.g., Delios et al., 2009; Isobe et al., 2000; Zhou et al., 2002). However, as economic development has progressed in China, the realization that innovation capabilities are crucial in attaining higher echelons of competitiveness has grown among Chinese manufacturers (Liu and Woywode, 2012; Mathews, 2006, 2009). For Chinese manufacturers in knowledge-intensive industries producing products with high-technology content, foreign company acquisitions have become important vehicles for rapidly obtaining innovation capabilities. Considering developments in the Chinese economy and the increasingly important role Chinese outward investments plays in Western economies, there is an obvious need for more research on the global and regional integration of Chinese firms' innovation capability build-up (Alvstam et al., 2014). This paper investigates the interface between existing firm innovation capability, cross-border acquisitions as a rapid means of creating new core innovative capabilities, and the geography of Chinese automotive firms' internationalization. Specifically, this paper draws upon the experience from the Zhejiang Geely Holding Group (Geely) acquisition of Volvo Cars Corporation (Volvo) to explore how Geely is using Volvo's capabilities to create new automotive innovation capabilities that integrate the two companies not only at the regional level but also at the global level.

Locational issues are an important topic in International Business (IB) studies (e.g., Beugelsdijk et al., 2010; Schlunze et al., 2011; Beugelsdijk and Mudambi, 2013), but attempts to explain location decisions of FDI (e.g., Dunning, 1992; Rugman, 1981) have taken a rather

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static perspective and been limited to competitive advantages of host nations. Concurrently, the influence of geographic distance and factors in global trade patterns (e.g., Santos Silva and Tenreyro, 2003) on economic geography and international trade has been discussed since the 1990s (e.g., Fujita et al., 1999; UNCTAD, 2001). Furthermore, at the intersection of economic geography and international business, regional locational dimensions have been suggested as important factors (e.g., Beugelsdijk et al., 2010; Ström and Wahlqvist, 2010). More recently, the increased importance of innovation networks and complex relations that are often found at the regional level make analyses at the national level increasingly irrelevant (e.g., Beugelsdijk and Mudambi, 2013; Johanson and Vahlne, 2009).

Furthermore, within economic geography and innovation studies, the role of national and regional innovation systems has held a central position in theorizing and explaining the competitive advantage of nations, regions, and ultimately firms (Asheim and Gertler, 2006; Asheim et al., 2011; Dicken, 2015; Lundvall, 1992). Amighini and Franco (2013) observe an agglomeration pattern among the emerging market multinational corporations' (EMNCs) technology-driven innovation investments, which tend to be drawn to regions with a concentration of knowledge-intensive high-technology firms. These agglomeration effects have also been important for the regional development of company or knowledge clusters in both manufacturing and services industries (Ström and Wahlqvist, 2010). Thus, globalization has led to increased awareness of the locational factors among firms in establishment decisions, where global production chains are established along the most favorable economic locations based on either cost or knowledge. By offering special expertise and labor skills, favorable locational advantages tend to attract knowledge-intensive investments regardless of the physical distance between host and home countries.

Processes that still need to be studied include FDI location decisions, utilization of target firm capabilities, and the influence of geography and host region innovation dynamics. These processes are especially interesting when Chinese outward FDI is taken into consideration (Chaminade and Rabellotti, 2015). For instance, whereas innovation as a core dynamic capability among knowledge-intensive high-technology firms has been discussed in the literature for many years, it has often been treated from the narrow paradigm of resource-based view perspectives (e.g., Barney, 1991) mostly from Western multinational corporations' perspectives, which risk missing out important properties of *how* strategic innovation resources are supposed to be attained.

In addition, quantitative analyses dominate the research field on mergers and acquisitions' (M&As) role in developing research and development (R&D) and innovation capabilities (e.g., Bertrand and Zuniga, 2006; Blomström and Sjöholm, 1999; Buckley et al., 2002), making it difficult to reach inside the "black box" and to know *how* firms succeed in creating (dynamic) innovation capabilities. Hence, qualitative studies on how cross-border M&As benefit investing foreign firms, and especially Chinese multinational corporations (MNCs), are less frequent and represent an important research gap (e.g., Deng, 2009; Ström and Nakamura, 2014).

1.1. Purpose and research question of the study

The purpose of this study is to analyze qualitatively strategic asset-creation by an emerging market automotive firm. More specifically, we address how such asset-creation contribute to increased innovation capabilities, and how strategic asset-creation is augmented by the Chinese firms FDI location and utilization of a Western target firm's technological portfolio. Asset-creation and innovation capabilities are studied through an in-depth longitudinal case study, which shows the inherent complexity of asset-creation initiatives while highlighting the organizational imperatives used by the involved firms. In this study, the discussion is limited to the experiences from the Zhejiang Geely Holding Group (Geely) acquisition of Volvo Cars Corporation (Volvo). Our choice of case is highly relevant not only because it represents a Chinese strategic asset-seeking overseas investment, but also because this case involves a high-profile acquisition of an established Western automotive maker with a strong global brand and high level of R&D investments. What makes this specific case interesting is its uniqueness in presenting the creation of a new, jointly shared, strategic asset that leverages existing strengths from both Volvo and Geely Auto. Therefore, this paper aims to answer the question "*How are innovation capability leverages created in Chinese automotive firms from foreign acquisitions, and how are the spatial dimensions utilized by Chinese investors in this process?*"

In this paper, FDI is defined as cross-border M&A, not only because FDI is a recognized mode for development (e.g., Blomström and Kokko, 2003; Borensztein et al., 1998; Enderwick, 2005; UNCTAD, 2013) and cross-border M&As are appropriate for detailed analyses of FDI cases (e.g., Ström and Nakamura, 2014), but also because the majority of firm-level Chinese outward FDIs (OFDI) are cross-border acquisitions (e.g., Ren et al., 2012). Innovation capability is defined along the technological trajectory, where innovation capabilities refer to a firm's ability to enhance its technological innovativeness and create new business value propositions by acquiring, utilizing, and developing valuable technological resources and knowledge (Burgelman et al., 2004).

This paper is organized as follows. Next, the theoretical framework and methodology will be discussed, followed by the case description and analysis of the joint independent R&D company of Geely Auto and Volvo called China Euro Vehicle Technology (CEVT). After discussing the results and their implications for practice and theory, we wrap up with a brief concluding discussion.

2. Theoretical framework

The internationalization of Chinese firms has received due attention from scholars who have attempted to explain the underlying rationale for this expansion and the strategies used by different kinds of firms (e.g., Amighini et al., 2010; Child and Rodrigues, 2005; Morck et al., 2008; Wang et al., 2012). The Chinese manufacturing sector represents a concrete example of China's strength in production and industrial ownership integration, gained by expanding its regional production networks to include Western firms and production units. In earlier studies (e.g., Alon et al., 2012; Ström and Nakamura, 2014), Chinese firms that acquire foreign companies are characterized as being at an early internationalization stage. Typically, these M&As have occurred only after implementation of the Chinese "going out" policy in 2000 (Ström and Nakamura, 2014).

A mainstream approach to theorize about Chinese foreign investments arises mainly from resource-based perspectives (e.g., Barney, 1991). Dunning's (1992) and Rugman's (2010) theoretical frameworks are examples of attempts to explain FDI motives from resource ownership, resource access, and locational aspects. Deng (2004), Hong and Sun (2006), and Buckley et al. (2007) follow this line of argument by suggesting diversification and strategic asset-seeking, in addition to mainstream motives such as resource and market-seeking investments, as the main overseas investment motives of Chinese firms. Ström and Nakamura (2014) add to this discourse by arguing that the motive for foreign investments is not primarily to establish a presence in a foreign market but to strengthen Chinese firms' competitive position in their own growing home market, which is consistent with Mathews' (2006) findings. Other studies on Chinese OFDI to industrialized countries and regions have shown that Chinese investors are seeking strategic assets, among other aims, to enhance their innovative capabilities (e.g., Alon et al., 2012; Alvstam and Ivarsson, 2014). Acquired host country firms can, therefore, provide positive effects in terms of innovation capabilities for foreign investing firms (Fu and Zhang, 2011; UNCTAD, 2006; Wang et al., 2012).