Financial Crisis an Opportunity or a Curse for Foreign Direct Investments

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Abstract
Since October 2008 financial news are deluged with reports for the closure of production plants and subsidiaries of large Multinational Enterprises (MNE's) due to the subprime-driven financial crisis and the attended economic recession. These news in combination with the projections of OECD, in its (December 2008) economic outlook, for lower Foreign Direct Investments (FDI's) inflows and UNCTAD's reports (January 2009) for the end of the growth cycle for international investments, create a question: Have we reached the end of FDI's and the downturn of MNE's?
On the other hand investors from developing countries like India, China, Abu Dhabi, carry on investments in EU and US in order to gain from the opportunities that recession creates. Is there a conflict in the above two cases or they are just the two tails of the same coin?
The article analyzes these latest developments in the flows of FDI's with the use of the most important incentives for engaging in FDI from the theoretical field in order to enlighten the future developments in these flows and to answer the question of the title is financial crisis an opportunity or a curse for FDI's.
Incentives focused on the reasoning for MNE's to proceed in FDI's in an economic environment that expands and technological developments created new needs and increase on demand. On the other hand recent empirical suggestions mostly paid attention on the positive impact that FDI's could have on host economies in such an expanding economic environment. Both failed to observe the economic deterioration that occurred and its impact on FDI's but provides us with practical tools to project the future developments.

Keywords: Financial Crisis, Economic Recession, FDI's, MNE's, future developments

JEL: F2, F23

Introduction

Comparisons to the Depression are inevitable in almost every discussion for the global economic crisis, an aspect that has a deep impact on market psychology, which stretches the downturn of the sluggish economic figures. This is also demonstrated to the OECD forecast (OECD Economic Outlook 2008, p. 12) that most countries will not reach the 2007 growth rate before the second half of 2010, implying that recession is likely to be the most severe since the early 1980s.

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OECD, in its estimation, diverts from the line to compare current financial crisis with Depression and focuses on the crises of 1980's (in USA and Western Europe) and 1990's (in Japan, South East Asia, Eastern Europe and Russia). These comparisons appear not to be secure as the current crisis has differences in nature and magnitude from all the previous cases for at least three reasons (UNCTAD 2009, p.12): (a) Its origin lays on developed countries and the rapidness of its diffusion is related to globalization. Crisis begun in the housing market of United States (De Larosiere 2009, p.7) and transferred rapidly to countries that, on the one hand are recipients of US direct and indirect investments and on the other hand have bought large amounts of US debt. (b) It reveals structural weaknesses and shortcomings in the financial sector regulations. The mode of self-regulation (G20's London Summit Declaration) in certain types of Financial Institutions and markets was disastrous, as nobody measured the risk of exposure. (c) It reflects a transfer of economic power from developed economies to emerging and cash-rich developing countries. Enterprises or State owned funds from not so developed countries that earned a lot of funds the last five years either from commodities prices (Dubai, Abu Dhabi, Kuwait) or from top selling consuming goods (China, India) seem now as probable investors for western enterprises that face the exodus of the market.

These differences in nature and magnitude create an unknown environment for FDI's, a case that requests for analysis in order to sketch its impact, positive or negative. Keeping in mind the types of Multinational Enterprises (MNE's) activity (Dunning 1996, p. 56-61) that are presented in the first part, an analysis of the effects of the crisis on FDI's will follow in the second part with concentration on negative impact. The next part will analyze the positive impact for FDI in this crisis and in the fourth part through an analytical synthesis of negative effects and positive impact will conclude in the future trends (short-term and medium-term) for FDI's. The last part summarizes the results and draws some future areas of analysis.

MNE's type of activity

Even though the main purpose in this work is to present the impact of the current financial crisis it would be mistake if it does not refer to the motives for foreign production that Dunning (1996, ch. 3) first provided and all the future researchers use and will be used for the exploitation of the negative effects and the opportunities that exist.

Dunning (1996, p. 56-61) identified four types of MNE activity:

I. Resource seekers are prompted to invest abroad to acquire particular and specific resources at a lower real cost than could be obtained in their home country. Their motivation is to make the investing enterprise more profitable and competitive in the markets it serves or intends to serve.

   As an abridgement of resource seekers in the 21st century can be assumed that two are the main motives either to gain from the exploitation of domestic KIT advantages (Vlysidis 2008, p.7) or to exploit public policies [privatization (Damijan, 2005, p. 271-295), market openness (Buckley et al, 2005, p. 3-31) etc] that provide access to resources. A more traditional case is that of Chinese outward FDI (Buckley et al, 2007, p. 499-518) that are predominantly natural resource seeking as a response to domestic economic imperatives.

II. Market seekers invest in a particular country or region to supply goods or services to markets in these or in adjacent countries. Market seeking investment may be undertaken to sustain or protect existing markets or to exploit or promote new products.

Summarizing the literature for market seekers it can be assumed that two are the most favorable motives either market expansion (mostly in cases of countries that now open their domestic markets to global competition) or presence in leading markets in order to gain recognition in the global competition, the other motives seem not to be of great importance.

III. Efficiency seekers intend to take advantage of different factor endowments, cultures, institutional arrangements, economic systems and policies, and market structures by concentrating production in a limited number of locations to supply multiple markets[2].

In this category two are the dominant motives either regional internalization or global internalization, the difference in these motives is the search for common markets or a globalized competitive advantage.

IV. Strategic assets seekers comprise those, which engage in FDI, usually by acquiring the assets of foreign corporations, to promote their long-term strategic objectives-especially that of sustaining or advancing their international competitiveness.

This category tries to capture the increasing volumes of global mergers and acquisitions that dominate the financial news whenever the take place.

These modes will be used to better explore the negative impact of the current financial crisis on FDI’s in the next part and the opportunities that creates for further increase on FDI in the third part.

The Negative Impact of the Financial Crisis on FDI’s

Foreign Direct Investments in 2007 (WIR 2008, ch. 1) following the strong macroeconomic growth, the liberalization in investment regimes and the internationalization strategies of MNE’s, reached a historic record of USD 1.8 trillion. In 2008 negative shadows started in FDI’s flows, guiding MNE’s to state on UNCTAD report (WIPS 2008, p. 12) that the current financial crisis would have a negative or very negative impact on their FDI plans. The shock became greater in the autumn of 2008 with the collapse of Lehman Brothers, AIG, Fortis, Dexia etc. and the turn to IMF for assistance from a large number of emerging economies such as Hungary, Latvia, Ukraine, Romania, Turkey etc.

Financial influenza spread through the globalization transmission mechanism of FDI’s and MNE’s, to developing and transition economies,

[2] Efficiency seekers are multidomestic companies in a global basis that try to create a global competitive advantage [as Porter described it in a national base (1998, ch.3)]

creating a global economic crisis that expanded from financial sector to real economy. Crisis is better depicted in Table 1 where on the one hand an impressive decline is presented in Developed Economies and West Asia in both FDI inflows and M&A's mainly due to decreased earnings of MNE's, a decline of syndicated bank loans, a decline in leveraged buyout transactions and a decline on oil prices (UNCTAD 2009, p. 6), on the other hand developing countries seem not to be so influenced but their growth rates are of lower volumes than previous years.

Table 1

FDI inflows and cross-border M&A's, by region and major economy, 2007-2008

(Billions of dollars)

	FDI inflows			Cross border M&A's		
Region/Economy	2007	2008	%	2007	2008	%
World	1.833,3	1.449,1	-21,0%	1.637,1	1.183,7	-27,7%
Developed Economies	1.247,6	840,1	-32,7%	1.454,1	981,8	-32,5%
Europe	848,5	562,3	-33,7%	825,0	548,7	-33,5%
United States	232,8	220,0	-5,5%	379,4	314,9	-17,0%
Japan	22,5	17,4	-22,6%	21,4	19,1	-10,8%
Developing Countries	499,7	517,7	3,6%	152,9	177,0	15,7%
Africa	53,0	61,9	16,8%	10,2	26,3	157,0%
Latin America & Carribean	126,3	142,3	12,7%	30,7	29,5	-3,8%
Asia & Oceania	320,5	313,5	-2,2%	112,0	121,3	-8,2%
West Asia	*71,5*	*56,3*	*-21,3%*	*30,3*	*31,5*	*4,0%*
South, East and South-East Asia	*247,8*	*256,1*	*3,3%*	*81,5*	*89,4*	*9,7%*
Transition Economies	85,9	91,3	6,2%	30,1	25,0	-17,0%

Source: UNCTAD 2009, p. 6

Why crisis is transmitted in such a shape? On the one hand is the capacity of MNE's to invest. Tighter credit conditions and lower corporate earnings have a negative effect in investment financing. Credit became scarce and expensive, imposing to Central Banks and Governments aggressive monetary & fiscal policies (Economist 29/4/2009) in order to decrease interest rates and provide financing, policies that were not seen since early 1970s. On the other hand, poor earnings in combination with the decline in stock markets have limited their ability to self-financing of FDI projects. Then there is the risk aversion of MNE's to proceed on investment plans as they keep in mind a worst-case scenario for the future of world economy, which refers to the phenomenon of "undershooting" where negative inflation is a sign of low consumer trust for future trends.

As a summary of the negative implications (UNCTAD 2009, p. 16) that crisis exercises to FDI's in the short and medium term, someone could refer the following:

- Availability of Financial Resources: Intensive credit squeeze from risk-averse banks together with the necessity to repatriate capital under domestic bailout policies (USA, EU, Japan, etc.) create constraints for short term decisions to invest abroad in contrast with medium term where the speed of recovery will be the judge in such decisions.

- Asset Prices: The decrease in stock-market value has a negative short-term effect on M&A activity mainly on leverage buyouts, but the increase in stock-market volumes and values in the 2nd quarter of 2009 may be a sign of a medium-term recovery in M&A driven FDI's.
- Market Growth: IMF suggests in its World Economic Outlook [(April 2009) p. xii] "Even with determined steps to return the financial sector to health and continued use of macroeconomic policy levers to support aggregate demand, global activity is projected to contract by 1.3 percent in 2009. This represents the deepest post–World War II recession by far. Moreover, the downturn is truly global: output per capita is projected to decline in countries representing three-quarters of the global economy. Growth is projected to reemerge in 2010, but at 1.9 percent it would be sluggish relative to past recoveries."
- Perception of Uncertainty: Negative or very low indices of market trust either in USA or EU force MNE's to restrain their investment plans and proceed in divestments and restructuring operations. An increase of confidence on market operation will be a prerequisite for an increase in FDI's.
- Public Policies: On the one hand fiscal policies (Bailout, nationalization of FI's) and expansive monetary policies (low interest rates) create a protectionist environment[3] that can restrict MNE's from investing abroad. On the other hand these policies [G20, Global plan for recovery and reform (02/04/2009)] have as main targets to: restore confidence, growth, and jobs; repair the financial system to restore lending; strengthen financial regulation to rebuild trust; fund and reform our international financial institutions to overcome this crisis and prevent future ones; promote global trade and investment and reject protectionism, to underpin prosperity; and build an inclusive, green, and sustainable recovery. All these will ensure stability and create a safe environment for FDI's in the medium-term.
- Sector-specific crisis and restructuring: Financial sector, automotive and construction industries are full of divestments, sales of assets and M&A's for restructuring. On medium-term main factor for economic renaissance will be the speed of sector restructuring with focus on financial sector[4].
- Location Patterns of FDI: MNE's that seek market shares in developed countries face a continuous decline in their sales. In medium-term MNE's that will have to focus on South (defines less developed countries and developing countries) and mostly to countries with small consumption percentages.
- New sources of FDI: SWF's were protagonists on the expansion of FDI's in the last years but now they face a capital squeeze due to low prices on commodities. In medium-term SWF's from transition economies or developing countries may increase in order to gain larger shares in cash-scarce developed economies.

Relating the types of MNE's activity with the above negative implications gives us that (i) resource-seekers suffer from low demand and collapse of prices on natural resources, seek for restructuring

[3] According to World Bank, 17 members of the group have taken a total of 47 trade-restricting steps since November 2008 (Economist 28/3/2009, p. 70).
[4] A very influential work on how G20 must stabilize the financial system is that edited by Barry Eichengreen and Richard Baldwin under the title "What G20 leader must do to stabilise our economy and fix the financial system", CEPR 2009.

M&A’s (Rio-Tinto) in order to avoid closure, (ii) market-seeking projects are affected due to declining demand (lower volumes of consumption) and negative growth rates, (iii) efficiency-seekers restructure their international activities to cut cost and boost overall efficiency, something that affects mainly their activities in non-cost-competitive facilities in developed economies and (iv) strategic asset-seekers face lack of capital for new mergers and acquisitions.

In conclusion future is cloudy for FDI’s as this type of investment is itself pro-cyclical. In recent years the increase of FDI’s was positively correlated with economic growth and created an illusion for permanent and sustainable high levels of growth. This likelihood is now over due to credit crunch and capital becomes scarcer and more expensive, so MNE’s will scale back their investments plans[5]. FDI’s are also closely connected with “recipient country’s local growth” as now economies deteriorate and the same happens with FDI’s. In the next part some encouraging facts will be presented that can have a positive effect on FDI trends.

Possible Positive Effects from the Financial Crisis

Current financial crisis creates business opportunities with possible positive effects on the future trends of FDI.

Initially, emerging economies BRIC’s (Brazil, Russia, India and China) are still attractive for market-seeking FDI, as their domestic markets are not developed with opportunities for a consumption expansion. According to IMF estimations (World Economic Outlook Update January 2009, p. 6), projected economic growth rate of BRIC’s in 2008 is as follows: 5,8% for Brazil, 6,2% for Russia, 7,3% for India and 9% for China. These estimations in relation with the continuing deterioration of economic activity in developed countries create a positive environment for FDI’s in BRIC’s.

M&A’s deteriorate due to lack of credit but opportunities to buy assets at “bargain prices” rise and enhance large-scale industry consolidation. This opportunity refers to companies from cash-rich developing countries, which can acquire undervalued assets that may boost investments and consolidations in certain industries such as energy, automotive and financial sector.

Third, MNE’s are still committed to increase their level of internationalization in the medium-term, a finding that constitutes a significant indicator for a future upturn in FDI flows. The main factors for this commitment (WIPS 2008-2010, p.16) over the next three years are:

- Internationalization is rooted in the company culture and most learnt to “think Global”.
- MNE’s will continue to extend their presence in foreign markets in order to take advantage of newly arising opportunities.

[5] “We are seeing more and more projects, particularly complex infrastructure projects, being delayed because of problems in putting the financing in place, causing confidence to deteriorate further globally” said MIGA Chief Operating Officer James Bond.

- A likely durable rise in energy and transportation costs will affect the way they organize their cross-border activities.
- No major protectionist backlash against FDI has taken place.

New sources of FDI appeared from emerging economies, countries well-endowed with natural resources, through Sovereign Wealth Funds. Governments created these funds to invest in foreign assets and their volume is nine times larger than of private equity funds. SWF’s investments create positive effects but also raise criticism (WIR 2008, p.23) that they pose a threat to national security, they may roll back the improvements in privatized companies or they might not respect human rights and environmental standards and that their asset portfolio’s and investment decisions are not transparent.

New industry segments that comprise technological innovation, market growth, organizational changes, or a combination of all three factors may lead to a rapid rise in FDI flows. Such industries are:

- Life sciences: people nowadays spent a lot on health expenses.
- Agro-food industries: turn to a more organic food and bio agriculture.
- Transport equipment: people seek for hybrid motors, and more environmentally friendly transportation means.
- Business services: many companies search for outsourcing in certain management sectors that are cost creating.
- Personal services: people look for more tailored made services for themselves.
- Equipment and machines: robotics.
- Information & Communication technologies: in the century of information there will always be a need for better and quicker information and communication.
- Energy, Chemistry and environmental conservation: Recycling, new modes of energy, nano-technology are the industries of the future for a planet that is dieing from day to day.

Measures introduced to prevent further deterioration of the global economy might have a multiplication result on the above positive effects of the crisis. Bailout plans and rescue packages increase credit opportunities for MNE’s. Several countries announced large public investment programmes, mainly aimed at infrastructure, which create a stabilized environment for the entrepreneurship in local market. Finally, counties that adopted fiscal or monetary stimulus measures may have a positive impact on FDI flows.

Taking into account the four types of MNE’s activity and the above mentioned positive effects of the financial crisis a dynamic analysis for the relation between these is formed.

Resource-seekers will switch on alternative resources for energy and biological products as people turn their backs to polluting products and genetically altered food. Market-seeking projects will focus on new underdeveloped markets where pioneers seek for increasing profits in the future, as markets will expand. Efficiency-seekers turn to outsourcing in order to minimize cost. Finally, strategic assets-seekers will invest in R&D with the intention of creating new profitable assets.

Financial crisis raises opportunities for FDI's in a mode where MNE's seek for new assets or environmentally friendly products that are demanded from the consumers. In the next part an analytical synthesis will be presented for the future trends of FDI's.

Analytical Synthesis

In both negative and positive cases, even on the case of financial crisis per se, the critical factor for analysis is time. Time distinguishes two periods short-term and medium-term. Long-term is not encountered as it refers to upturn part of the economic cycle where factors of the current crisis will be changed.

Short-term

Current fiscal year (2009) and the following year are critical for FDI's as the projections of IMF [World Economic Outlook (April 2009) p. xii] show negative growth rates following the pace of growth rates.

In the biennium of 2009-2010 critical factors for the analysis will be the success in the 5 main scopes of G20's London's meeting, which are:

- Success of expanding fiscal and monetary policies (no undershooting) in rebuilding the trust of consumers on markets.
- Resisting protectionism and promoting global trade and investments.
- Ensuring a fair and sustainable recovery for all
- Strengthening international financial institutions
- Strengthening financial supervision and regulations

Low consumer confidence for markets along with negative inflations (undershooting) will retard recovery as in late 1990's in Japan. In that case deterioration of consuming will affect negatively FDI's and mainly market seeking and resource seeking, as the expectations for increasing earnings will be low.

Government presence in key financial institutions indicates policies of economic nationalism together with approaches like those of president Sarkozy for national champions that create protectionism against globalization.

Sustainable recovery is important, as a new recession will create a depression environment. Critical point is a simultaneous recovery to all countries. Countries that will not follow, they will need more financing through public debt that creates imbalances in world trade and finance.

Global financial institutions are the last source of funds for countries with huge public debt and a late response will introduce new turmoil.

Banks and other financial institutions need new regulations and supervision in order to create a safer credit environment.

In the short-term crisis lifts barriers to FDI's due to the complexity and the quantity of counter measures. Financial crisis appears to be a curse for FDI's in short-term, as they deteriorate.

Medium-Term

In the medium-term the success of G20's scopes does not guarantee the recovery of FDI's. Analysis in third part highlighted that global economy needs a different growth strategy and rescheduling of policies that were based on cost cutting and increased corporate debt.

New growth strategy needs both different scopes and means. Its scopes need to be in line with the industries and segments that are in sequence with new consuming habits of the 21st century. Existing consuming habits and cost cutting production lines that were financed with increased corporate debt turned not to be successful as consumers' tastes changed. Consumers seek on the one hand for more environmentally-friendly products and on the other hand they demand products of advanced technology that will make easier their day-to-day life, such an environment is a real opportunity for technology cutting-edge market-seekers that can deliver such products. On the other hand efficiency-seekers need to reexamine their cost cutting strategies in an enhancing nationalistic environment of government interventions that target the local labor markets, which deliver votes in elections. Resource seeking MNE's need to reestablish their production lines in a more environmentally friendly path that could keep them in line with the international treaties (treaty of Kyoto) for the protection of earth. Finally, strategic asset-seekers need to develop new lines of financing through SWF's or private equity funds and not to be based on stock markets and banks.

A green sustainable growth strategy becomes the real opportunity for further FDI's on sectors, products or locations that can gratify the needs of the 21st century people.

Overall Results

MNE's during 2009-2010 face a negative environment for further investments in most sectors due to: (a) increased public debts, (b) extreme corporate debts, (c) sluggish credit lines, (d) zero interest rates in combination with negative inflation rates, (e) negative consuming environment, and (f) negative psychology for the future. In this environment most of them try to reorganize their production lines and their debt in order to secure their existence. Only FDI's that have secured financing from SWF's or private equity funds could succeed growth rates and also investments in new less developed markets that still have great consuming opportunities.

In the medium-term FDI's in new trends and rules of consuming market will boost. Such an opportunity will be better accomplished by companies in the technology cutting edge that have secured their financing lines. FDI's, as known, will not have opportunities as they would refer to past market trends and collapsing financing strategies that provide limited funds.

Conclusions

This article enlightens the impact of current financial crisis on FDI's and delineates the future trends for investment opportunities or investment traps in this area.

Albeit that global economy is still in the downturn part of their cycles someone can depict the negative effects on FDI's due to the direct lines that globalization has created and boost them. In contrast positive opportunities are difficult to be portrayed as the unstable economic environment, despite the increased government intervention, generates a pessimistic approach for the future.

Current financial crisis will be a curse for MNE’s that can’t change and follow the new tendencies of the markets. World economy is in a curve as demand-driven growth looks as if it was an old pair of shoes and will be replaced by a shinny qualitative-environmentally friendly-back to the basics growth pattern. FDI’s that target to follow this pattern will have opportunities and be in the start line when world economy will face the upturn of its new cycle.

Future research should depict the new pattern and the trends of the sectoral markets in order to provide useful information on how to survive to MNE’s in the new era that rises.

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