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# Direct foreign investments at the time of crisis

Direct foreign investments (FDI)[i], despite that they did not gain as much attention during the crisis as other economic categories, such as portfolio investment flows, budget deficits or public debts, were still seriously affected by the crisis. This concerns their value as well as quality.

The number of times the word “crisis” appears in the cyclical reports concerning FDI, the so called World Investment Reports, issued by the United Nations Conference on Trade and Development (UNCTAD), shows how difficult the situation really is. While in 2008 this word appeared 46 times, in 2009 it was 319! In 2010 the crisis was mentioned 120 and in 2011 “only” 119. This year’s report discusses the issue of the deep changes which, to some degree, were the aftermath of the crisis. The first one is the increasing number and importance of public Multinational Corporations (MNC), resulting from the takeover of national companies, which were on the verge of bankruptcy because of the crisis, by the governments of different countries (650 of such entities run 8.5 thousand branches; even though they constitute less than 1% of the world’s MNC, they are responsible for 11% of all FDI flows and create 20% of the 100 largest MNC and specialize not only in agriculture and industry, but also services). The second change is the spread of new hybrid FDIs, the so called non-capital forms of production, joining trade with direct investments (licenses, franchises, contracted production, BPO), which are gaining popularity in Poland.

As far as value is concerned, the influence of the crisis on FDI is evident. After the record year 2007, with global flows reaching 1.8 trillion dollars, began a progressive decline, deepening year by year. In 2008 it amounted to 20% in relation to 2007, while in developed economies it reached 33%. In 2009 an even further decrease in FDI occurred – by 40%. It was mainly caused by a lower number of mergers, takeovers (by 2/3) and, to a lower degree, of Greenfield projects (by 23%). The process of rebuilding was noticeable as early as in 2010, but the return to the record level of 2007 is expected around 2013.

After 2007, a decrease in all types of FDI was visible. The interest in market seeking investments dropped, especially those directed at developed countries. The investments seeking resources and increased effectiveness, characterized by high inconstancy, also went down. Paradoxically, however, the latter may be fostered by the crisis, which requires restructuring and seeks effective solutions. Multinational corporations (MNC), being the driving force for FDI, became less eager to make new investments. This was mainly the result of reduced financial capabilities, lack of means, which can be attributed both to worse credit conditions and lower profits. Moreover, the general decrease in cross-border investments reflects the high risk and perspectives of zero / low profit, still lingering in the global economy. In many countries privatization projects came to a halt (Sweden, Kuwait, France, and Mexico). The production of consumer goods was affected most severely, including car production and the financial sector. Disinvestment took place, which means the withdrawal of capital and repatriation of profits instead of their reinvestment. In many cases restructuring turned out to be necessary, which included reducing personnel numbers, improving balance or even closing several factories.

In Poland, it seems that the crisis speeded up the countries movement on the Investment Development Path (IDP), reflecting its subsequent stages, where a country transforms from a receiver of foreign capital to its giver. The reason for that was, on the one hand, the decrease in FDI flow, on the other, the growing appetite for internationalization among Polish companies. According to research by

Grant Thornton International, two thirds of companies (23% in other analyzed countries) plan to take over another company in the coming years, with half of them taking foreign markets into consideration. Such decisions would mainly be motivated by the willingness to reach new output markets (60%), gain access to new technologies and attractive brands (53%) and getting a chance to extend the scale of the activity performed. Another good sign for the development of Polish investments is the additional support stimulating foreign expansion offered both by national (The MG Strategy and PAIiIZ Initiative) and private institutions (The Citygroup Emerging Market Champions Program). Also, conversations with those Polish companies which invested in Germany (conducted within the "Poles in Germany" project) seem rather optimistic, as the majority of them expect an improvement of the situation and further development abroad.

When it comes to Germany, the changes in relation to direct investment resulting from the crisis are much less beneficial. The fall in FDI was especially drastic. Disinvestments mainly took the form of capital withdrawal within long-term corporate loans, which constituted 75% of the drop. The so called equity flows remained on the same, relatively high level, decreasing by about 27%. According to the survey by the Chamber of Industry and Commerce (IHK), Experiences and Perspectives of German Companies in Business Abroad 2009, the crisis impedes the realization of investment plans. Companies fear protectionism, but they withdraw from foreign activity only if all else fails, first trying to use their surplus from previous years. More often their activities are restricted in scope or made more efficient – by establishing cooperation and focusing more on synergy effects through proper crisis management methods. Especially high investment activity was registered in energy production with new projects aimed at reaching new markets and increasing competitiveness, undertaken by the RWE AG and E.on AG, among others.

The value changes visible around the world, as well as quality transformations within FDI, are accompanied by certain political processes. On the one hand, these are the steps taken irrespectively of direct investments themselves, but simply as a reaction to the macroeconomic problems of a country in crisis (bailouts, new banking regulations, budget consolidation), on the other, actions of a protectionist nature become more and more common. Even though the general policy towards FDI is still more liberalist than protectionist, this advantage is decreasing systematically – from the relation of 98% vs. 2% in 200, to 69% vs. 32% in 2010.

Despite the rise in FDI in 2010, their level is still lower by about 15% from the average before the crisis. This constitutes a contrast with the global industrial output and trade, which quickly returned to their pre-crisis state. Even though the UNCTAD outlines new scenarios very carefully, the estimates for the future development of FDI around the world are still positive. First of all, it seems that this type of flows should be facilitated by cheap assets (bargain prices, undervalued assets) creating conditions for takeovers. Unfortunately, such activity has side effects in the form of greater consolidation (too big to fail) and the risk of monopolization. Secondly, large financial resources in the developing and less developed countries point to the fact, that the free financial means necessary to stimulate the FDI market are actually available. The recent purchases of shares from Citigroup (USA) by the Abu Dhabi Investment Authority and from Merrill Lynch (USA) by KIC (Korea) and the Kuwait Investment Authority can serve as evidence. Moreover, since direct investments also include the influx of technologies and new methods of production and management, the urgent need for restructuring in many countries and industries suggests, that there is potential for this type of flow. Also the expansion of new activities – environment friendly production, low emissivity technologies or the development of renewable energy sources provide a basis for optimism, suggesting the need for the transfer of knowledge and capital between countries in the form of FDI. After all, from a strictly business point of view, such investments constitute a part of an internationalization strategy, determining a full-scale development of a company. Nowadays, the majority of entrepreneurs are obliged to “go global”.

Taking into consideration the current stage of the FDI development in Poland, further actions intensifying the influx of foreign investors should be recommended. It is also important to remember about the promotion of the investments related to advanced business services, which are especially beneficial to the economy and are gaining popularity at the moment. The available data suggests that Poland has a real chance to become a truly attractive market in the region for this type of service. It's main advantages are the well educated and disciplined workforce, which is still inexpensive for West European standards, as well as improving science and research facilities. It is also important to mention the creation of clusters or other rudiments of specializations visible in certain economic spheres or agglomerations (Warszawa, Poznań and Łódź are centers of finance and accounting, Trójmiasto and Kraków – IT, while Wrocław – B+R). The foreign expansion of Polish companies should be supported by proper institutions, especially in the case of small and medium companies, which might encounter problems entering foreign markets because of their size. In order to facilitate the internationalization of Polish companies and encourage the influx of foreign capital, it is necessary to preserve a "balanced FDI policy". There is no greater harm to the economy than uncertainty, frequent changes, lack of strategy or placing short-term profits before long-term, more stable and economically beneficial gains.

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[i] FDI are one of the basic categories in international economic relations and an item in the balance of payments for each country. They include the takeovers of existing entities (fusions and M&A takeovers) or starting business activity abroad from scratch (*Greenfield*). An entity owning at least 10% of shares of votes in the so called foreign company is considered to be a foreign investor. This allows such entity to exert lasting influence on the development of this particular company.