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TENDENCIES OF FOREIGN DIRECT INVESTMENT

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Abstract

The paper attempts to provide an analysis of tendencies of foreign direct investment (FDI) activity in developed economies and in Lithuania in 2009-2011. The financial and credit crisis that began in the second half of 2007 has not affected the overall volume of FDI inflows. World FDI flows fell moderately in 2008 following a five-year period of uninterrupted growth. FDI flows to and from developed countries fell sharply in 2008, after reaching a historic peak in 2007. Inflows down by 29 % from the previous year, and these declines occurred in all major host countries except the United States. Since mid-2008, divestments have exceeded gross FDI flows in a number of countries.

After three years of consecutive decline, FDI flows to developed economies, mainly in European countries, grew robustly in 2011, and the rise in FDI was driven by cross-border mergers and acquisitions (M&As). Against a background of continued economic uncertainty, turmoil in financial markets and slow growth, countries worldwide continued to liberalize and promote foreign investment as a means to support economic growth and development.

Keywords: foreign direct investment, mergers and acquisitions, financial and economic crises, investment opportunities.

JEL Classification: G34.

1. Introduction

In 2007, global foreign direct investment (FDI) inflows grew to an estimated US$1.5 trillion, surpassing the previous record set in the year 2000. As in the late 1990s, that growth was spurred by cross-border mergers and acquisitions (M&As). M&As, including privatizations involving FDI, have become a driving force of FDI, accounting for a high share of annual world FDI flows. Although the importance of M&As has largely been confined to FDI among developed countries, they are becoming important in developing countries as well. Increased corporate profits and an abundance of cash boosted the value of the cross-border M&As that constitute a large portion of FDI flows, although the value of M&As in the latter half of 2007 declined.

In 2008, the value of cross-border M&As sales of developed country companies fell by 39 %, approximately to their 2006 level, and the number of such M&As deals fell by 13 % as the financial crisis and economic downturn made a dampening effect on cross-border M&As activity. The decrease in total cross-border M&As has had a significant impact on FDI flows, as they are strongly correlated with the value of cross-border M&As transactions. One outcome of the crisis is that a number of large privatization projects have had to be cancelled. During a sharpening financial crisis and economic downturn, global FDI inflows fell from a historic high of $1,979 billion in 2007 to $1,697 billion in 2008, a decline of 14 %. The slide continued into 2009.

Declines are drastic in 2009 in both FDI inflows and outflows, as the impact of the global financial and economic crisis on international trade and credit markets for investment begins to spread to the whole region. However, in the medium term, higher commodity prices could attract more natural-resource-related inward FDI. Prospects for FDI outflows will depend on world economic growth trends. As far as FDI inflows are concerned, they sharply fell in 2009, with expected slow recovery in 2010 and gaining momentum in 2011.

The **objective** of the paper is to analyze the major tendencies in respect of the foreign direct investment in developed countries and in Lithuania in 2009-2011 and predict the impact of the financial crisis and the economic downturn on FDI flows.

Research methodology: systemic and comparative analysis of scientific literature and statistical information.

There are the several issues (Laskienė and Pekarskienė, 2011; Medne, 2006; Miečinskienė and Jurevičienė, 2010; Saee, 2010; Žilinskė, 2010; Valakevicius, Vaznelyte, 2012) that analyzed FDI both in theoretical and practical level. Quite a number of academic empirical studies are designed for the analysis of FDI in the context of a particular country: Lithuania – Brock and Urbonavicius, 2008; Čiburienė, 2010; Laskienė, 2010; Tvaronavičienė and Grybaitė, 2007; Tvaronavičienė and Kalašinskaitė, 2006; Italy – De Lucia

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et al. (2010); Ferragina *et al*. (2010); Imbriani *et al*. (2010); Pazienza and Vecchione (2009); Turkey – Dumludag (2009); Estonia – Vissak (2009); China – Zeng *et al*. (2009); Baltic States – Šečkutė and Tvaronavičius (2007); and GCC countries – Faras and Ghali (2009). Statistics on Lithuania is the source of statistical data.

2. Activity of foreign direct investment

During 2003–2007, FDI flows followed an upward trend, fuelled by steady world economic growth, ongoing liberalization in investment regimes and the implementation of large-scale internationalization strategies by a growing number of transnational corporations (TNCs). This led to an unprecedented level of FDI flows in 2007, with inflows reaching a historic record of $1.9 trillion (UNCTAD, 2012).

The year 2008 marked the end of a growth cycle in international investment that started in 2004 and saw world FDI inflows reach a historic record of $1.9 trillion in 2007. Due to the impact of the ongoing worldwide financial and economic crisis, FDI flows are estimated to have declined by 15 % in 2008.

The setback in FDI has particularly affected cross-border M&As, the value of which was in sharp decline in 2008 and early 2009 as compared to the previous year's historic high. It has also taken the form of a rising wave of divestments and restructurings. International greenfield investments were less impacted in 2008, but are likely to be increasingly affected in 2009 as a large number of new investment projects are presently being cancelled or postponed.

Among industries, FDI flows to financial services, automotive industries, building materials, intermediate goods and some consumption goods have been the most significantly affected in 2008. But the consequences of the crisis are quickly expanding to FDI in other activities, ranging from the primary sector to non-financial services. Practically all sectors have been affected by a decrease in cross-border M&A in 2008, with the exception of oil, mining and agri-food businesses. Rather new tendency is that there are more investments in companies that practice and report Corporate Social Responsibility (Ubius, Alas, 2012)

Inward FDI (as the equivalent of cross-border M&A sales) of the nine new EU member countries that did not participate in the EMU fell by 9 % in 2008. This was a much smaller rate of decline than that of inflows into the EU-15 countries (UNCTAD, 2009). Inward FDI flows to the group in 2008 were unevenly distributed: the Czech Republic, Hungary, Romania and Slovakia saw an increase in inflows that was more than offset by the decrease in flows to the Bulgaria, Estonia, Latvia, Lithuania and Poland. Four countries together accounted for the lion's share (77 %) of the group's total inflows: Poland ($16.5 billion), Romania ($13.3 billion), the Czech Republic ($10.7 billion) and Bulgaria ($9.2 billion). Despite the fact that the automotive industry has been the key driver of strong FDI inflows to the new EU member countries, the decline in euro zone car sales since the last quarter of 2008 has disclosed revealed the region's vulnerability on account of its serious reliance on the industry.

Global FDI flows exceeded the pre-crisis average in 2011, reaching $1.5 trillion despite turmoil in the global economy. However, they still remained some 23 % below their 2007 peak. Global FDI inflows rose 16 % in 2011, surpassing the 2005–2007 pre-crisis level for the first time, despite the continuing effects of the global financial and economic crisis of 2008–2009 and the ongoing sovereign debt crises. This increase occurred against a background of higher profits of TNCs and relatively high economic growth in developing countries during the year.

According to UNCTAD (2012), after three years of consecutive decline, FDI flows to developed economies, mainly in European countries, grew robustly in 2011 (reaching an estimate US$753 billion, 18 % up from 2010), and the rise in FDI was driven by cross-border M&As which in most cases appear to be driven by corporate restructuring, stabilization and rationalization of their operations, improving their capital usage and reducing the costs.

Outflows from Europe were slightly up despite a 67 % fall in cross-border M&A deals carried out by European TNCs. In some countries, outflows were mostly driven by a revival of intra-company financing to affiliates located abroad. In contrast, outflows from the United Kingdom, traditionally one of the largest investor countries, continued to suffer in 2010, reaching a level last seen in 1993, as parent firms withdrew or were paid back loans from their affiliates in order to strengthen their balance sheets at home. Outflows from the United States rose significantly (by 31 %) in 2010, mainly due to higher equity investments abroad (cross-border M&A deals by United States firms more than doubled in 2010) and reinvested earnings. Japanese outward FDI dropped by 24 % as declining intra-company loans and reinvested earnings overwhelmed a near doubling of cross-border M&As.

However, these general trends were not shared equally by all developed countries. For example, FDI in Greece and Germany was down, but up in Italy and France. The differences also manifested themselves among different FDI components.

Cross-border M&As rose 53 % in 2011 to $526 billion, spurred by a rise in the number of megadeals (those with a value over $3 billion), to 62 in 2011, up from 44 in 2010. This reflects both the growing value of assets on stock markets and the increased financial capacity of buyers to carry out such operations. Greenfield investment projects, which had declined in value terms for two straight years, held steady in 2011 at $904 billion. Developing and transition economies continued to host more than two thirds of the total value of greenfield investments in 2011. Although the growth in global FDI flows in 2011 was driven in large part by cross-border M&As, the total project value of greenfield investments remains significantly higher than that of cross-border M&As, as has been the case since the financial crisis.

FDI flows rose in all three sectors of production (primary, manufacturing and services), according to FDI projects data (comprising cross-border M&As and greenfield investments). Services-sector FDI rebounded in 2011 after falling sharply in 2009 and 2010, to reach some $570 billion. Primary sector investment also reversed the negative trend of the previous two years, at $200 billion. The share of both sectors rose slightly at the expense of manufacturing. Overall, the top five industries contributing to the rise in FDI projects were extractive industries (mining, quarrying and petroleum), chemicals, utilities (electricity, gas and water), transportation and communications, and other services (largely driven by oil and gas field services).

3. Foreign direct investment: evidence from Lithuania

The cumulative FDI in Lithuania by investing countries in 2009-2011 is showed in table 1.

Table 1. Cumulative foreign direct investment in Lithuania by investing countries

	2009		2010		2011	
	LTL million	**per cent**	**LTL million**	**per cent**	**LTL million**	**per cent**
Total	***33 695.86***	***100.0***	***35 553.05***	***100.0***	***37 159.93***	***100.0***
Sweden	3 942.11	11.7	3 149.56	8.9	5 741.13	15.4
Poland	3 560.93	10.6	4 054.89	11.4	4 283.15	11.5
Germany	3 445.95	10.2	3 903.97	11.0	3 873.04	10.4
Netherlands	2 311.26	6.9	3 120.36	8.8	3 272.52	8.8
Russia	2 150.01	6.4	2 901.69	8.2	2 438.28	6.6
Norway	1 242.20	3.7	1 186.35	3.3	2 000.73	5.4
Finland	1 593.70	4.7	1 702.04	4.8	1 960.00	5.3
Denmark	3 356.61	10.0	3 690.83	10.3	1 782.21	4.8
Estonia	2 498.13	7.4	2 181.03	6.1	1 677.55	4.5
Canada			210.50	0.6	1 340.71	3.6
Cyprus			1 098.15	3.1	1 103.51	3.0
Latvia	1 421.26	4.2	1 364.47	3.8	1 074.04	2.9
Other	8 173.70	24.2	6 989.21	19.7	6 613.06	17.8

Source: Statistics Lithuania

In 2011, cumulative FDI in Lithuania amounted to LTL 37 159.93 million (EUR 10 762.26 million). Over 2011, they increased by LTL 1606.88 million (4.5 %). FDI per capita amounted to LTL 11 615 (EUR 3 364) (in 2010 – LTL 10 958; EUR 3 174). The increase in cumulative FDI was determined by the share capital inflow and reinvestment.

The largest investment was made by Swedish investors – by LTL 5 741.13 million (15.4 %), Polish – LTL 4 283.15 million (11.5 %), German – LTL 3 873.04 million (10.4 %), Dutch – LTL 3 272.52 million (8.8 %), Russian – LTL 2 438.28 million (6.6 %), and Norwegian – LTL 2 000.73 million (5.4 % of the total FDI). Cumulative FDI in Lithuania from EU27 countries amounted to LTL 27 957.4 million (75.2 % of the total FDI), from CIS countries – LTL 2 656.5 million (7.1 %).

In 2010, cumulative FDI in Lithuania amounted to LTL 35 553.05 million (EUR 10 296.88 million). Over the year, they increased by LTL 1 857.19 million (5.5 %). FDI per capita amounted to LTL 10 817 (EUR 3 133) on average (in 2009, LTL 10 122; EUR 2 932). The increase in cumulative FDI was determined by the FDI inflow from other capital, i. e. loans obtained from foreign direct investors.

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The largest investment was made by Polish investors – LTL 4 054.89 million (11.4 % of total FDI), German – LTL 3 903.97 million (11.0 %), Danish – LTL 3 690.83 million (10.3 %), Swedish – LTL 3 149.56 million (8.9 %), Dutch – LTL 3 120.36 million (8.8 %), Russian – LTL 2 901.69 million (8.2 %), and Estonian – LTL 2 181.03 million (6.1 %). FDI in Lithuania from EU27 countries amounted to LTL 27 329.7 million (77.9 % of total FDI), from CIS countries – LTL 3 094.6 million (8.8 %).

In 2009, cumulative FDI in Lithuania amounted to LTL 33 695.86 million (EUR 9 759 million). The largest investment was made by Swedish investors – LTL 3 942.11 million (11.7 % of total FDI), Polish – LTL 3 560.93 million (10.6 %), German – LTL 3 445.95 million (10.2 %), Danish – LTL 3 356.61 million (10.0 %), Estonian – LTL 2 498.13 million (7.4 %), Dutch – LTL 2 311.26 million (6.9 %), and Russian – LTL 2 150.01 million (6.4 %).

Statistics Lithuania informs that FDI as of 1 January 2009 made LTL 31.48 billion, i. e. by 11.3 % less than as of 1 January 2008 (LTL 35.50 billion). Per capita FDI made LTL 9.4 thousand (as of 1 January 2008 – LTL 10.5 thousand). The decrease in FDI was conditioned by a decrease in share prices and reinvestment, although FDI in the share capital and other capital increased. The largest investment was made by Swedish – LTL 5.30 billion (16.8 % of total FDI), German – LTL 3.17 billion (10.1 %), Danish – LTL 2.75 billion (8.7 %), Estonian – LTL 2.40 billion (7.6 %), Dutch – LTL 2.11 billion (6.7 %), and Latvian – LTL 1.95 billion (6.2 %) investors. Direct investment from EU27 countries made LTL 25.57 billion (81.2 % of total FDI), from CIS countries – LTL 1.85 billion (5.9 %).

The cumulative FDI in Lithuania by economic activity in 2009-2011 is showed in table 2.

Table 2. Cumulative foreign direct investment in Lithuania by economic activity

	2009		**2010**		**2011**	
	LTL million	**per cent**	**LTL million**	**per cent**	**LTL million**	**per cent**
Total	***33 695.86***	***100.0***	***35 553.05***	***100.0***	***37 159.93***	***100.0***
Agriculture, forestry and fishing	303.04	0.9	318.71	0.9	351.47	0.9
Mining and quarrying	71.74	0.2	164.02	0.5	188.22	0.5
Manufacturing	8 919.98	26.5	9 942.20	28.0	11 069.57	29.8
Electricity, gas, steam and air conditioning supply	2 652.90	7.9	3 077.51	8.6	2 837.11	7.6
Construction	1 033.76	3.1	1 070.95	3.0	1 059.07	2.9
Wholesale and retail trade; repair of motor vehicles and motorcycles	4 498.23	13.3	4 756.12	13.4	5 003.31	13.5
Transport and storage	676.08	2.0	778.92	2.2	864.02	2.3
Information and communication	4 324.67	12.8	3 799.14	10.7	3 449.48	9.3
Financial and insurance activities	4 926.67	14.6	4 410.63	12.4	5 263.17	14.2
Real estate activities	3 771.86	11.2	4 424.20	12.4	4 174.00	11.2
Other activities	1 838.51	5.5	2 123.07	6.0	2 121.51	5.7
Purchase and sale of real estate	678.42	2.0	687.58	1.9	779.00	2.1

Source: Statistics Lithuania

In 2011, the largest investment was made in manufacturing – 29.8 %, financial and insurance activities – 14.2 %, wholesale and retail trade; repair of motor vehicles and motorcycles – 13.5 %, real estate activities – 11.2 %, information and communication activities – 9.3 % of the total FDI. In manufacturing, the largest investment was made in the manufacturing of refined petroleum products and chemicals and chemical products – LTL 5 311.9, EUR 1 538.4, million (48 % of the total FDI in manufacturing), basic pharmaceutical products and pharmaceutical preparations – LTL 1 401.1, EUR 405.8, million (12.7 %), and food products, beverages and tobacco products – LTL 1 397.4, EUR 404.7, million (12.6 %).

In 2010, the largest investment was made in manufacturing – 28.0 %, wholesale and retail trade; repair of motor vehicles and motorcycles – 13.4 %, financial and insurance activities – 12.4 %, real estate activities – 12.4 %, and information and communication – 10.7 % of total FDI. In manufacturing, the largest investment was made in the production of refined petroleum products and chemicals and chemical products –

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LTL 5 399.4, EUR 1 563.8, million (53.7 % of total FDI in manufacturing), food products, beverages and tobacco products – LTL 1 410.4, EUR 408.5 million (14 %).

In 2009, the largest investment was made in manufacturing – 26.5 %, financial and insurance activities – 14.6 %, wholesale and retail trade; repair of motor vehicles and motorcycles – 13.3 %, information and communication – 12.8 %, and real estate activities – 11.2 % of total FDI.

In 1 January 2009, the largest investment was made in manufacturing – 23.3 %, real estate, renting and business activities – 16.3 %, financial intermediation – 15.6 %, transport, storage and communications – 14.4 %, wholesale and retail trade – 14.1 %, electricity, gas and water supply – 7.5 % of total FDI.

The decrease in direct investment from Denmark and Russia conditioned a decrease in FDI in manufacturing, electricity, gas and water supply and financial intermediation enterprises. Direct investment from Poland decreased after the share capital of the joint-stock company Mažeikių nafta was recalculated from the market to nominal price.

In 2008, the most considerable increase was observed for FDI in real estate, renting and business activities, agriculture, forestry, fishery, hotels and restaurants, construction enterprises. In manufacturing, the largest investment was made in the manufacture of petroleum and chemical products – LTL 2.69, EUR 0.78, billion (36.7 % of total investment in manufacturing), food products, beverages and tobacco – LTL 1.55, EUR 0.45, billion (21.2 %).

4. Conclusions

- Global FDI inflows rose in 2011 by 17 %, to US $1.5 trillion, surpassing their pre-crisis average, despite turmoil in the global economy. The rise of FDI was widespread, including all three major groups of economies − developed, developing and transition − though the reasons for this increase differed across the globe. During 2011, many countries continued to implement policy changes aimed at further liberalizing and facilitating FDI entry and operations, but also introduced new measures regulating FDI. As data from cross-border M&As and greenfield investment projects suggest, FDI flows are expected to slow down in the fourth quarter of 2011.
- FDI flows to developed countries also rose by 18 %, but the growth was largely due to cross-border M&As, not the much-needed investment in productive assets through greenfield investment projects. Moreover, part of the M&A deals appear to be driven by corporate restructurings and a focus on core activities, especially in Europe.
- Preliminary results of the UNCTAD World Investment Prospects Survey 2009–2011 (WIPS) confirm this: some four fifths of TNCs surveyed expressed the view that there were negative impacts of the financial crisis and the economic downturn on their international investment plans. Medium-term FDI prospects are more difficult to assess, due to the exceptional magnitude of the present crisis and to the fact that it could lead to major structural changes in the world economy. Nevertheless, some favourable factors for FDI growth are still at work, some of which are even a consequence of the crisis itself. Driving forces such as investment opportunities triggered by cheap asset prices and industry restructuring, large amounts of financial resources available in a number of emerging countries, quick expansion of new activities such as new energies and environment-related industries and a resilient trend in the internationalization of companies will presumably trigger, sooner or later, a new pickup in FDI flows.
- A resurgence in economic uncertainty and the possibility of lower growth rates in major emerging markets risks undercutting this favourable trend in 2012. UNCTAD predicts the growth rate of FDI will slow in 2012, with flows leveling off at about $1.6 trillion, the midpoint of a range. Leading indicators are suggestive of this trend, with the value of both cross-border M&As and greenfield investments retreating in the first five months of 2012. Weak levels of M&A announcements also suggest sluggish FDI flows in the later part of the year.
- Based on the current prospects of underlying factors, such as GDP growth and cash holdings by TNCs, UNCTAD estimates that FDI flows will rise moderately in 2012. However, the fragility of the world economy, with growth tempered by the debt crisis, the uncertainties surrounding the future of the euro and rising financial market turbulence, will have an impact on FDI flows in 2012. Both cross-border M&As and greenfield investments slipped in the last quarter of 2011. M&A announcements continue to be weak, suggesting that equity investment − part of FDI flows − will slow down in 2012, especially in developed countries. All these factors indicate that the risks and uncertainties for further FDI growth in 2012 remain in place.

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