GLOBAL TRENDS IN FDI

CHAPTER I

Global foreign direct investment (FDI) flows began to bottom out in the latter half of 2009. This was followed by a modest recovery in the first half of 2010, sparking some cautious optimism for FDI prospects in the short term. In the longer term, the recovery in FDI flows is set to gather momentum. Global inflows are expected to pick up to over $1.2 trillion in 2010, rise further to $1.3–1.5 trillion in 2011, and head towards $1.6–2 trillion in 2012. These FDI prospects are, however, fraught with risks and uncertainties, including the fragility of the global economic recovery.

Some major changes in global FDI trends will most likely gain momentum in the short and medium term:

- Developing and transition economies absorbed half of global FDI flows in 2009 and their relative weight as both FDI destinations and sources is expected to increase further, as they are leading the FDI recovery.
- Services and the primary sector continue to capture an increasing share of FDI.
- FDI stock and assets continued to increase despite the toll taken by the crisis on TNCs' sales and value added.

A. Global trends in FDI flows: from a steep decline to a slow recovery

1. Overall and geographical trends

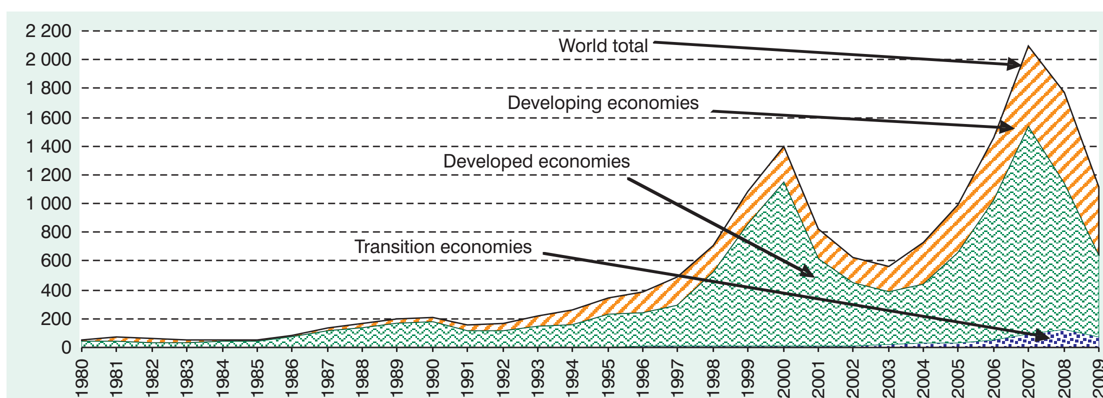
Global FDI flows began to bottom out in the latter half of 2009. This was followed by a modest recovery in the first half of 2010, sparking some cautious optimism for FDI prospects in the short term. In the longer term, from 2011 to 2012, the recovery in FDI flows is set to gather momentum. Global inflows are expected to pick up to over $1.2 trillion in 2010, rise further to $1.3–1.5 trillion in 2011, and head towards $1.6–2 trillion in 2012. These FDI prospects are, however, fraught with risks and uncertainties arising from the fragility of the global economic recovery.

The current recovery is taking place in the wake of a drastic decline in FDI flows worldwide in 2009. After a 16 per cent decline in 2008, global FDI inflows fell a further 37 per cent to $1,114 billion (fig. I.1), while outflows fell some 43 per cent to $1,101 billion.[1] FDI flows contracted in almost all major economies, except for a few FDI recipients such as Denmark, Germany and Luxembourg, and investment sources such as Mexico, Norway and Sweden (annex table 1).

Unless private investment regains its leading economic role, the sustainability of the global recovery remains questionable. FDI flows bounced back slightly in the second quarter of 2009, but remained low for the rest of the year. According to UNCTAD's Global FDI Quarterly Index,[2] however, foreign investment showed renewed dynamism in the first quarter of 2010 (fig. I.2). Cross-border mergers and acquisitions (M&As) – still low at $250 billion in 2009 – rose by 36 per cent in the first five months of 2010 compared to the same period in the previous year.[3] This suggests that annual FDI flows are likely to recover in 2010, thanks to higher economic growth in the main home and host countries, improved corporate profitability, and higher stock valuations (section C).

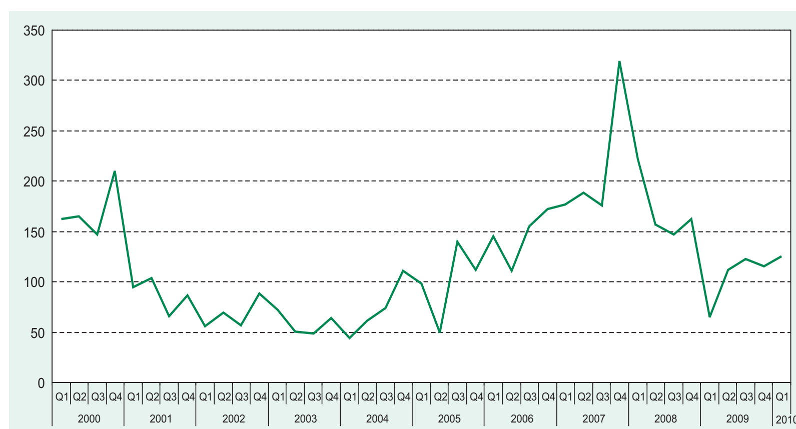
As foreign investment continued to flow, albeit at a much reduced pace, FDI inward stock rose by 15 per cent in 2009, reaching $18 trillion (annex table 2). This rise, however, also reflects the improved performance of global stock markets at the end of 2009, as FDI stock is usually valued at market price, as opposed to book value. In contrast, devastated stock markets and currency depreciations vis-à-vis the United States dollar had resulted in a 14 per cent decline in FDI

Figure I.1. FDI inflows, globally and by groups of economies, 1980–2009
(Billions of dollars)



Source: UNCTAD, based on annex table 1 and the FDI/TNC database (http://www.unctad.org/fdistatistics).

Figure I.2. Global FDI Quarterly Index, 2000 Q1–2010 Q1
(Base 100: quarterly average of 2005)



Source: UNCTAD.

stocks in 2008. These depreciations also further reduced FDI stock when measured in United States dollars.[4]

a. FDI inflows

Global FDI witnessed a modest, but uneven, recovery in the first half of 2010. Developing and transition economies now absorb half of FDI.

FDI inflows plummeted in 2009 in all three major groupings – developed, developing and transition economies. This global decline reflects the weak economic performance in many parts of the world, as well as the reduced financial capabilities of TNCs.

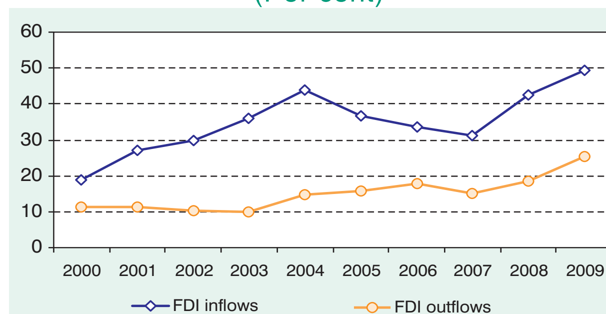
Following their 2008 decline, FDI flows to ***developed countries*** further contracted by 44 per cent in 2009. Falling profits resulted in lower reinvested earnings and intra-company loans, weighing on FDI flows to developed countries. At the same time, a drop in leveraged buyout transactions continued to dampen cross-border M&As.

Developing and transition economies, which proved relatively immune to the global turmoil in 2008, were not spared in 2009 but did better than developed countries. After six years of uninterrupted growth, FDI flows to developing countries declined by 24 per cent in 2009 (see chapter II for regional analyses).

The recovery of FDI inflows in 2010 – if modest in global terms – is expected to be stronger in developing countries than in developed ones. As a result, the shift in foreign investment inflows towards developing and transition economies is expected to accelerate. This shift was already apparent during 2007–2009 (fig. I.3), due to these economies' growth and reform, as well as their increased openness to FDI and international production (*WIR91*). As a result, developing and transition economies now account for nearly half of global FDI inflows (fig. I.3). While part of this relative increase may be temporary, most of it reflects a longer-term shift in TNC activity.

Global rankings of the largest FDI recipients confirm the emergence of developing and transition economies: three developing and transition economies ranked among the six largest foreign investment recipients in the world in 2009, and China was the second

Figure I.3. Shares of developing and transition economies in global FDI inflows and outflows, 2000–2009
(Per cent)



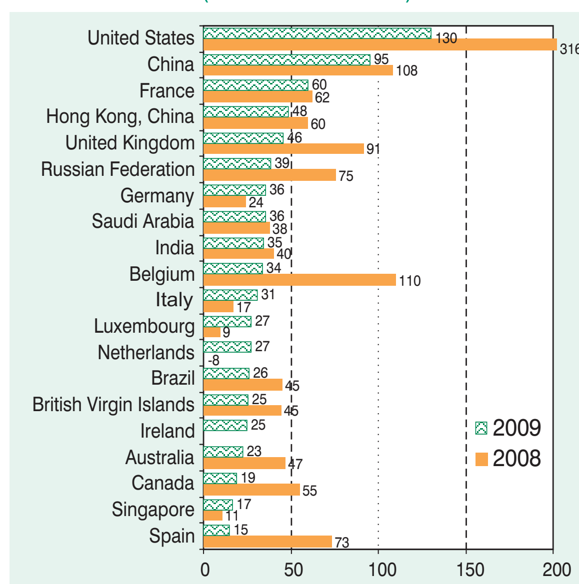
Source: UNCTAD, based on data from the FDI/TNC database (http://www.unctad.org/fdistatistics).

most popular destination (fig. I.4). While the United States maintained its position as the largest host country in 2009, a number of European countries saw their rankings slide.

Developing and transition economies attracted more greenfield investments than developed countries in 2008–2009 (table I.1). Although the majority of cross-border M&A deals still take place in developed regions, the relative share of such transactions in developing and transition economies has been on the rise.

UNCTAD's *World Investment Prospects Survey 2010–2012* (WIPS) also confirms that interest in developed countries as foreign investment destinations compared to other regions has declined over the past few years and is likely to continue to do so in the near future (section C).

Figure I.4. Global FDI inflows, top 20 host economies, 2008–2009[a]
(Billions of dollars)



Source: UNCTAD, based on annex table 1 and the FDI/TNC database (http://www.unctad.org/fdistatistics).

[a] Ranked on the basis of the magnitude of 2009 FDI inflows.

Table I.1. Number of cross-border M&As and greenfield investment cases, by host region/economy, 2007–2010[a]
(Per cent)

Host region/economy	Net Cross-border M&A sales[b]				Greenfield investments			
	2007	2008	2009	2010[a]	2007	2008	2009	2010[a]
World	100	100	100	100	100	100	100	100
Developed economies	74	72	69	66	52	46	46	49
European Union	39	38	32	32	39	34	30	31
France	3	3	2	3	5	4	3	3
Germany	6	5	4	4	4	4	3	3
United Kingdom	10	10	7	9	6	5	8	7
United States	18	17	17	16	7	6	9	10
Japan	2	2	2	2	1	1	1	1
Developing economies	22	23	23	25	42	47	48	45
Africa	2	2	1	2	3	5	5	5
South Africa	1	1	1	-	-	1	1	1
Latin America and the Caribbean	6	6	5	8	7	7	9	8
Brazil	2	2	1	2	1	2	2	2
Mexico	1	1	1	1	2	2	2	2
Asia	14	16	16	16	32	35	34	32
West Asia	2	2	2	2	5	7	7	7
South, East and South-East Asia	13	14	15	14	27	28	27	26
China	3	4	3	3	10	9	8	8
Hong Kong, China	2	1	2	2	1	1	2	1
India	2	2	2	2	6	6	5	6
South-East Europe and the CIS	4	5	8	9	6	7	6	6
Russian Federation	2	3	4	6	3	4	3	3
Memorandum								
Total number of cases	7 018	6 425	4 239	1 802	12 210	16 147	13 727	4 104

Source: UNCTAD cross-border M&A database and information from the the Financial Times Ltd, fDi Markets (www.fDimarkets.com).

[a] 2010 data cover January to May for M&As and January to April for greenfield investments.

[b] Net sales by the region/economy of the immediate acquired company.

Besides the relative shift between developed and developing economies, FDI inflows in 2009 also accentuated existing trends in other country groupings, reflecting non-economic considerations. FDI inflows to tax haven economies,[5] for example, declined in 2009 with the implementation of higher standards of transparency (box I.1).

b. FDI outflows

Global FDI outflows are slowly recovering in 2010. Developing and transition economies now account for a quarter.

Global FDI outflows in 2009 declined by 43 per cent to $1,101 billion mirroring the trend in inflows. The global economic and financial crisis continued to weigh on FDI outflows from developed countries for the second year in a row. In addition, it started to affect outflows from developing and transition economies. This contraction reflected falling profits, mounting financial pressures on parent firms, and rechannelled dividends and loans from foreign affiliates to TNC headquarters.

Early 2010 data point to a modest recovery, though. Global FDI outflows rose by about 20 per cent in the first quarter of 2010 compared to the same period in 2009.[6] A half of countries (26 out of 51) – including major investors such as Germany, Sweden and the United States – recorded an increase in FDI outflows in the first quarter of 2010, largely reflecting stronger economic growth, improving profits for TNCs, and a more predictable business climate. However, the perception of increased risk of sovereign debt default in mid-2010 in certain European countries, and its possible transmission to the eurozone, could easily disrupt this upward trend.

While the decline of FDI outflows from ***developed countries*** was widespread in 2009 (with only a few exceptions such as Denmark, Ireland, Norway and Sweden), the region remained the largest source of FDI, with outflows largely exceeding inflows. FDI outflows from the United States fell strongly in their equity capital component (by $127 billion) due to some large divestments of foreign affiliates in European Union (EU) countries.[7] Outflows from the United Kingdom declined by 89 per cent in 2009. In the eurozone, FDI outflows fell to $325 billion – lower than their 2005 level. Japanese TNCs also scaled back their foreign invest-

Box I.1. FDI in tax haven economies

Since the beginning of 2008, reducing international tax evasion, implementing high standards of transparency and promoting information exchange have been high on the international policy agenda (OECD, 2010).[a] The conclusion of a higher number of double taxation treaties in 2009, for instance, reflected a desire to reduce FDI flows to tax haven economies (chapter III). As a result of such efforts, investment to these economies contracted to $30 billion in 2009, a 42 per cent decline.[b] At the same time, investment from tax havens to major host countries, the bulk of which consists of FDI round-tripping to its original source countries and FDI in transit that is redirected to other countries, has declined too.[c] FDI flows into the United States from the British Virgin Islands, for example, sank from $16.5 billion in 2008 to a negative value of $0.5 billion in 2009. The 81 per cent decline in cross-border M&A sales in these economies was more pronounced than the global decline of 65 per cent (see http://www.unctad.org/wir for detailed data on FDI and cross-border M&As).

Source: UNCTAD.

[a] For example, tax transparency was a key feature of the deliberations at the G20 summits in Washington, London and Pittsburgh in 2008 and 2009.

[b] However, FDI flows are underestimated, as some of those countries do not report FDI data. For example, data on FDI inflows to the British Virgin Islands are collected from home countries that report investments there.

[c] Round-tripping refers to investments to foreign destinations that are channelled back to their original economy countries. The purpose is usually to obtain more favourable tax treatment.

ment, after a buying spree in 2008 (*WIR09*); the declining trend is expected to continue in 2010, fuelled by the tax abatement given to Japanese TNCs that repatriate funds from their foreign affiliates.[8]

Outflows from ***developing countries*** amounted to $229 billion in 2009, a fall of 23 per cent over the previous year, marking the end of a five-year upward trend. Yet this contraction was less severe than in developed countries. As a result, developing and transition economies further strengthened their global position as emerging sources of FDI in 2009, increasing their share to 25 per cent compared to 19 per cent in 2008 (fig. I.3).

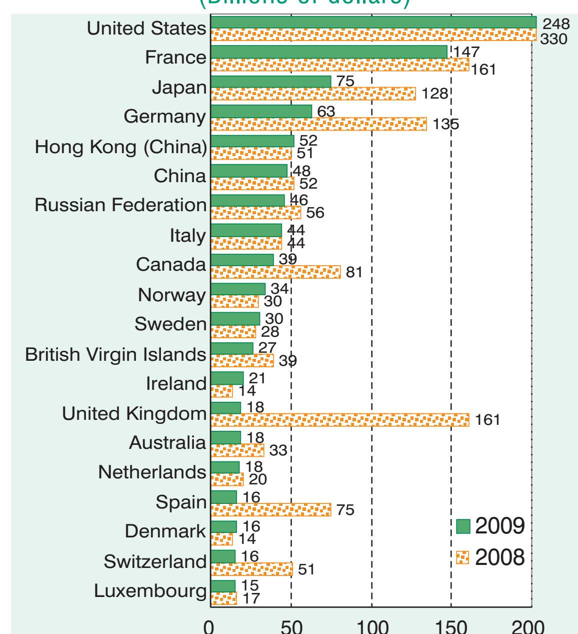
This confirms a trend that predates the recent crisis. Developing and transition economies' economic growth, the rise of their TNCs and growing competitive pressure at home have supported an expansion in their foreign investment. Added to the uneven regional impact of the recent global crisis on outward foreign investment, this has pushed the share of developing and transition economies in global FDI outflows to a record high. Other than the British Virgin Islands, which is one of the tax haven economies, three of the economies (China, Hong Kong (China) and the Russian Federation) are among the top 20 investors in the world (fig. I.5). TNCs from two of these economies, namely China and the Russian Federation, plus India and Brazil – also referred to collectively as BRIC – have become dynamic investors (box I.2). Outflows from developing and transition economies, however, remain well below their share of FDI inflows (fig. I.3).

2. FDI by components

All components of FDI are recovering, but slowly.

Equity investments, other capital flows (mainly intra-company loans) and reinvested earnings all declined in 2009. A continued depressed level in equity investments

Figure I.5. Global FDI outflows, top 20 home economies, 2008–2009[a]
(Billions of dollars)



Source: UNCTAD, based on annex table 1 and the FDI/TNC database (http://www.unctad.org/fdistatistics).

[a] Ranked on the basis of the magnitude of 2009 FDI inflows.

(reflected in weak cross-border M&As) and a low level of reinvested earnings (due to foreign affiliates' depressed profits) were the main factors keeping FDI flows low until the end of 2009. Fluctuations in intra-company loans slowed this downward trend somewhat, and reinvested earnings also started to rise in the mid-2009 (fig. I.6).

FDI is showing signs of recovery in 2010, sustained by a resumption of equity investment as well as increases in intra-company loans and reinvested earnings. Corporate profits have started to recover, following the sharp drop observed in the last quarter of 2008. Reported earnings of the Standard and Poor's 500 companies in the United States totalled more than $100 billion during the last three quarters of 2009, as compared to a historic loss of $200 billion reported for the last quarter of 2008. The earnings of 767 Japanese companies surveyed by the Nikkei for the year ending March 2010 were

12 trillion yen ($133 billion) higher than the previous year, but they still remained 40 per cent lower than at their 2008 peak. A similar trend can be observed in emerging economies. For example, the operating profits of companies of the Republic of Korea listed on the local stock exchange saw double-digit growth in the first quarter of 2010, compared to the same period in the previous year. General improvements in

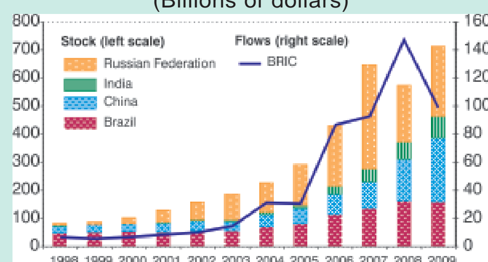
Box I.2. Outward FDI from the BRIC countries

Rapid economic growth at home, high commodity prices, and FDI liberalization in host countries have been feeding a boom in outward investment from BRIC, which reached a peak of $147 billion in 2008 – almost 9 per cent of world outflows, compared to less than 1 per cent ten years ago (box figure I.2.1). Although their FDI outflows fell in 2009 due to the global financial and economic crisis, the four countries' TNCs were again active outward investors over the first five months of 2010.[a]

As in the case of developed countries, outward FDI from BRIC has been boosted by rising volumes of cross-border M&As. Between 2000 and 2009, Indian firms finalized 812 deals abroad, Chinese firms finalized 450, Brazilian firms finalized 190, and Russian firms finalized 436. Some of these deals were valued at more than $1 billion (visit http://www.unctad.org/wir for the full list of mega deals). TNCs from BRIC share a number of common features:

Box figure I.2.1. Outward FDI flows and stocks from BRIC

(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

- They have developed various ownership-specific advantages that allow them to be competitive in foreign markets as well as in their own markets. In organizing their expansion abroad, Brazilian, Chinese, Indian and Russian TNCs alike have sought to establish portfolios of locational assets as increasingly important sources of their international competitiveness.
- Initially, firms from BRIC expanded mainly into their own region, often into countries with which they had close cultural links. A growing number of TNCs have ventured further afield, however, in search of new markets and resources. India's FDI stock in emerging markets, for example, used to be concentrated in Asia, which accounted for 75 per cent of the total in the mid-1990s. By 2008, India's FDI flows to outside of Asia had increased to 61 per cent.
- A large number of TNCs from BRIC are motivated by strategic considerations rather than by short-term profitability, reflecting the role of state-owned enterprises in the outward FDI of the group. The majority of Chinese TNCs, for example, are state-owned, and some Brazilian, Indian and Russian TNCs are also state-controlled (Petrobras, ONGC Videsh and Gazprom, for instance).
- Many of the TNCs headquartered in BRIC have become truly global players, as they possess – among other things – global brand names, management skills and competitive business models. Some of them, ranked by foreign assets, are: CITIC (China), COSCO (China), Lukoil (Russian Federation), Gazprom (Russian Federation), Vale S.A. (Brazil), Tata (India) and ONGC Videsh (India).

Supportive government policies have backed the rise of BRIC's outward FDI. The adoption, in the early years of the new millennium, of China's "go global" policy successfully encouraged domestic enterprises to invest globally. Brazil, India and the Russian Federation also want to create global players through incentives (e.g. creating national champions in the Russian Federation and in Brazil, and further liberalization of foreign exchange regimes in India).

Source: UNCTAD.

[a] "Growing nations draw deal activity", *Financial Times*, 17 May 2010.

Figure I.6. FDI inflows, by component, 2005–2009, with quarterly data for 2008–2010 Q1
(Billions of dollars)

Source: UNCTAD, FDI/TNC database (http://www.unctad.org/fdistatistics) and own estimates.

Note: The countries/territories included in the quarterly data are: Argentina, Australia, Belgium, Bulgaria, Chile, Denmark, Estonia, France, Germany, Hong Kong (China), Hungary, Iceland, Ireland, Israel, Japan, Kazakhstan, Latvia, Lithuania, Mexico, the Netherlands, New Zealand, Norway, Panama, the Philippines, Poland, Portugal, the Republic of Moldova, the Russian Federation, Slovakia, Sweden, Switzerland, Taiwan Province of China, the United Kingdom, the United States and the Bolivarian Republic of Venezuela.

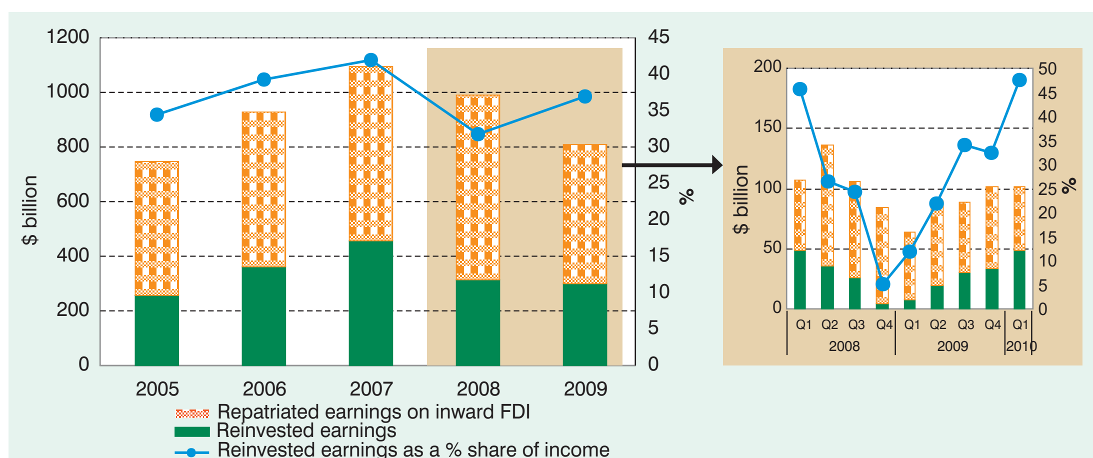
corporate profitability are also observed in income on FDI (fig. I.7), which reflects the performance of foreign affiliates. Reinvested earnings are on the rise, and their share in total income on FDI has also been increasing, due to lower repatriation of profits to parent firms.

3. FDI by modes of entry

M&As have experienced a faster recovery, while greenfield investments have been more resilient during the crisis.

The collapse of financial markets has curtailed TNCs' financing of M&As. Banks and financial institutions have often been unable or unwilling to finance

Figure I.7. FDI income, 2005–2009, with quarterly data for 2008–2010 Q1
(Billions of dollars and as per cent)



Source: UNCTAD.

Note: Based on the 132 countries that account for roughly 90 per cent of total FDI inflows for the period 2000–2009.

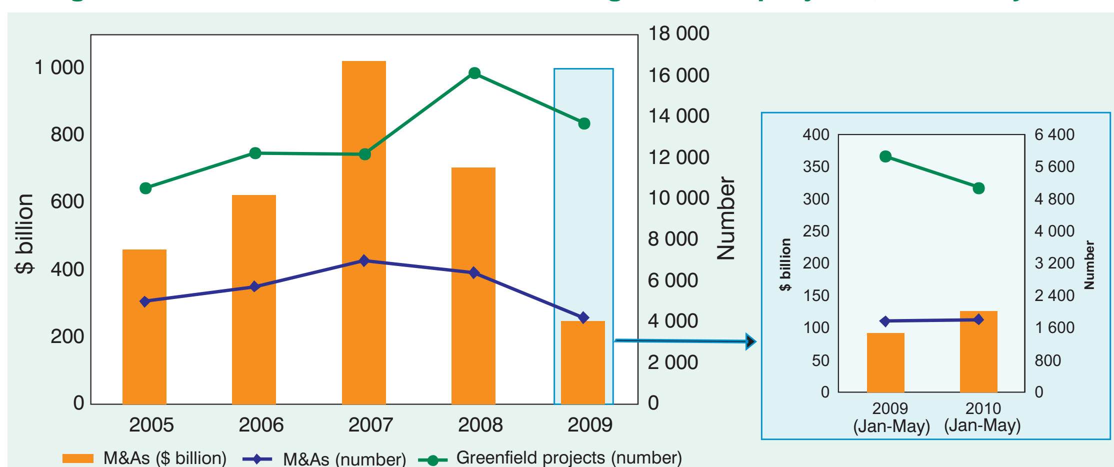
acquisitions. Moreover, the collapse of stock markets has reduced – and in some cases eliminated entirely – the ability of TNCs to raise equity capital. Internal resources have also been squeezed. Greenfield investments, which enable TNCs to expand the operations of their foreign affiliates more gradually, could be less costly, and are perceived as less risky, judging by the failure rate of M&A deals (*WIR00*). They also provide TNCs with greater operational flexibility in adjusting the level of activity at the initial stage of establishment, which enhances their ability to respond promptly to crises.

A preference for M&As over greenfield investments as the dominant mode of FDI has been observed over the past two decades or so, particularly in developed countries. This preference lies in part on asymmetric information regarding the value of M&As and greenfield projects. Financial markets usually provide efficient mechanisms to set the value of M&A targets, while there is no such mechanism to assess the value of greenfield investments. During financial crises, financial markets become unreliable, eliminating the M&As' information advantage. In the initial stages of the recent crisis, however, investors were able to benefit from the collapse of the stock market to acquire lower-priced targets than before. For example, several sovereign wealth funds (SWFs) acquired stakes in United States financial companies.[9]

Recent developments are consistent with these observations. Most of the drop in FDI in 2008 and 2009 was due to a substantial decrease in M&A deals rather than greenfield operations. The number of cross-border M&A transactions declined by 34 per cent (65 per cent in terms of value), compared with a 15 per cent decline in greenfield projects (fig. I.8).

This may not signal a long-term reversal of the preference for M&As as the dominant mode of FDI, however. As economies recover from crises, capital becomes more abundant and stock markets return to normal, tilting the scale back in favour of M&As. The rise of developing countries as FDI destinations is also likely to weigh on the choice between greenfield projects and M&As, as developing-country firms become more attractive targets for acquisitions. The data available for the beginning of 2010 indeed indicate a more dynamic growth in M&As than in greenfield investments (fig. I.8). The average value of cross-border M&As was only $70 million in the first five months of 2010, though, or only half of the record average in 2000.

Figure I.8. Cross-border M&A sales and greenfield projects, 2005–May 2010



Source: UNCTAD, cross-border M&A database for M&As; and information from the *Financial Times* and from fDi Markets (http://www.fDimarkets.com) for greenfield projects. For complete data, see http://www.unctad.org/wir.

4. FDI by sector and industry

Services and the primary sector continue to capture an increasing share of FDI. The decline in FDI affected not only industries sensitive to economic cycles, but also industries that were initially resilient to the crisis.

FDI inflows and outflows slumped in all three sectors (primary, manufacturing and services) in 2009.[10] The global economic and financial crisis continued to dampen FDI flows not only in industries sensitive to business cycles – such as chemicals and the automobile industry – but also in those that were relatively resilient in 2008, such as pharmaceuticals and food and beverage products. In 2009, only a handful of industries generated higher investments via cross-border M&As than in the previous year; these included electrical and electronic equipment, electricity services and construction. Telecommunication services also continued to expand, protected by resilient demand and a slightly lower internationalization than in other industries (e.g. in the United States, FDI in the information industry, which includes telecommunications, rose by 41 per cent in 2009 compared to 2008 (United States, Bureau of Economic Analysis, 2010)).

In 2009, the value of cross-border M&As in the *primary sector* declined by 47 per cent after the peak of 2008. Energy investment worldwide plunged, in the face of a tougher financing environment, weakening final demand and low cash flows. The economic recession caused the global use of energy to fall in 2009 for the first time since 1981, although it is expected to resume its long-term upward trend shortly (International Energy Agency (IEA), 2009). In the oil and gas industries, most companies cut back capital spending not only by drilling fewer wells but also by delaying and even cancelling exploration projects. The Gulf of Mexico oil spill in mid-2010, the largest of its kind in United States history, may threaten the recovery of the industry as countries reassess the use of their coastal resources – host to many recent oil discoveries. Nevertheless, mining activities remained relatively high (table I.2) and are expected to recover quickly.[11] FDI in agriculture also declined in absolute terms in 2009, based on the value of cross-border M&As in the sector; the number of transactions, however, increased (from 59 to 63 (table I.2)).

The global slowdown and tumbling consumer confidence took a toll on many *manufacturing* industries. The value of cross-border M&As in this sector collapsed by 77 per cent in 2009. Worst hit were manufacturing goods such as non-metallic mineral products,

Table I.2. Cross-border M&As sales, by sector/industry, 2007–2009

Sector/industry	Value ($ billion)			Number of cases		
	2007	2008	2009	2007	2008	2009
Total	1 023	707	250	7 018	6 425	4 239
Primary	74	90	48	485	486	433
Agriculture, hunting, forestry and fishing	2	3	1	64	59	63
Mining, quarrying and petroleum	72	87	47	421	427	370
Manufacturing	337	326	76	1 993	1 976	1 153
Food, beverages and tobacco	50	132	10	213	220	109
Chemicals and chemical products	117	74	33	325	316	225
Non-metallic mineral products	38	29	0	130	91	22
Metals and metal products	70	14	-3	218	199	95
Machinery and equipment	20	15	2	228	265	134
Electrical and electronic equipment	24	14	18	266	309	203
Motor vehicles and other transport equipment	3	12	9	86	95	74
Services	612	290	126	4 539	3 962	2 653
Electricity, gas and water	103	49	62	135	159	130
Construction	13	2	10	149	114	96
Trade	41	17	4	588	590	324
Transport, storage and communications	66	34	16	436	343	211
Finance	249	74	10	712	563	458
Business services	102	101	17	1 972	1 681	1 109

Source: UNCTAD, cross-border M&A database (www.unctad.org/fdistatistics).

Note: Cross-border M&A sales in a host economy are sales of companies in the host economies to foreign TNCs excluding sales of foreign affiliates in a host economy. The data cover only those deals that involved an acquisition of an equity stake of more than 10 per cent.

as well as the metals and metallic products industries, as many producers were hit by low margins and falling demand. Acquisitions in the automotive industry, which was severely affected by the crisis from the start, due to the tightening of consumer loans and the decline in household purchasing power, suffered another significant decline. A sharp decrease in cross-border M&As was also recorded in chemical products. Although the largest cross-border deal recorded in 2009 was in the pharmaceutical industry (the $47 billion acquisition of Genentech (United States) by Roche (Switzerland)) (see http://www.unctad.org/wir for the full list of mega deals in 2009), both greenfield investments and M&As in the pharmaceutical industry fell, with some divestments leading to a further decline in FDI in this industry.[12] In food processing (the food, beverage and tobacco industries), trends vary according to the mode of investment: cross-border M&As fell, but the number of greenfield investments was higher than in the two previous years (table I.3).

In the *services sector*, the value of cross-border M&As declined by 57 per cent in 2009, even though firms in this sector are less sensitive to short-term business cycles. Business services were among the industries where investment expenditures were hard hit by the crisis, with a decrease in the value of cross-border M&A activity by 83 per cent and a reduction of greenfield investment cases by 20 per cent. Financial services also suffered an 87 per cent decline in cross-border M&As, with large divestments further weighing on FDI activities in the industry;[13] greenfield investments in financial services declined to 1,267 in 2009 compared to 1,616 in 2008. In contrast, the value of cross-border M&As in distribution services of electricity, gas and water increased by 26 per cent in 2009, as four out of the top ten cross-border deals took place in electricity distribution services.[14]

Table I.3. Number of greenfield FDI projects in selected industries, 2007–2009

Sector/industry	2007	2008	2009
Total sectors	12 210	16 147	13 727
Minerals	31	66	48
Coal, oil and natural gas	290	561	465
Alternative/renewable energy	293	416	330
Food, beverages and tobacco	668	916	956
Chemicals and chemical products	662	739	704
Pharmaceuticals	198	247	236
Non-metallic minerals	241	322	163
Metals	458	600	337
Machinery and equipment	672	981	855
Electrical and electronic equipment	791	942	806
Motor vehicles and other transport equipment	861	1 090	840
Hotels and tourism	297	553	370
Transport, storage and communications	1 024	1 269	1 133
Communications	448	594	544
Financial services	1 161	1 616	1 267
Business activities	2 922	3 647	2 927

Source: UNCTAD, based on information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com).

The impact of the crisis across sectors has resulted in a shift in their relative weight in FDI. Manufacturing has declined at the global level, relative to the primary and services sectors (fig. I.9). The share of manufacturing in total cross-border M&As was lower in developed countries – where it stood at 30 per cent of their value in 2009 – than in developing and transition economies, where it accounted for 32 per cent of the transaction value. The shares of the primary sector and services in total cross-border M&As by value, on the other hand, were higher in developed countries than in developing and transition economies (fig. I.9).

5. FDI by special funds

Private equity funds are shunning large foreign investments in favour of smaller ones. Their FDI is recovering slightly especially in North America and Asia with the revival of the leveraged buyout market.

Entities other than TNCs[15] are also engaged in FDI; these include individuals, governments, and regional or international organizations, as well as special funds. While FDI by the former three entities is difficult to measure, FDI by special funds can be estimated by examining

the data on cross-border M&A deals, which account for most of their investments. In 2009, special funds' combined FDI reached about $129 billion ($106 billion for private equity funds and $23 billion for sovereign wealth funds) (table I.4 and fig. I.10), accounting for over one tenth of global FDI flows, up from less than 7 per cent in 2000 but down from 22 per cent in the peak year of 2007.

a. Private equity funds

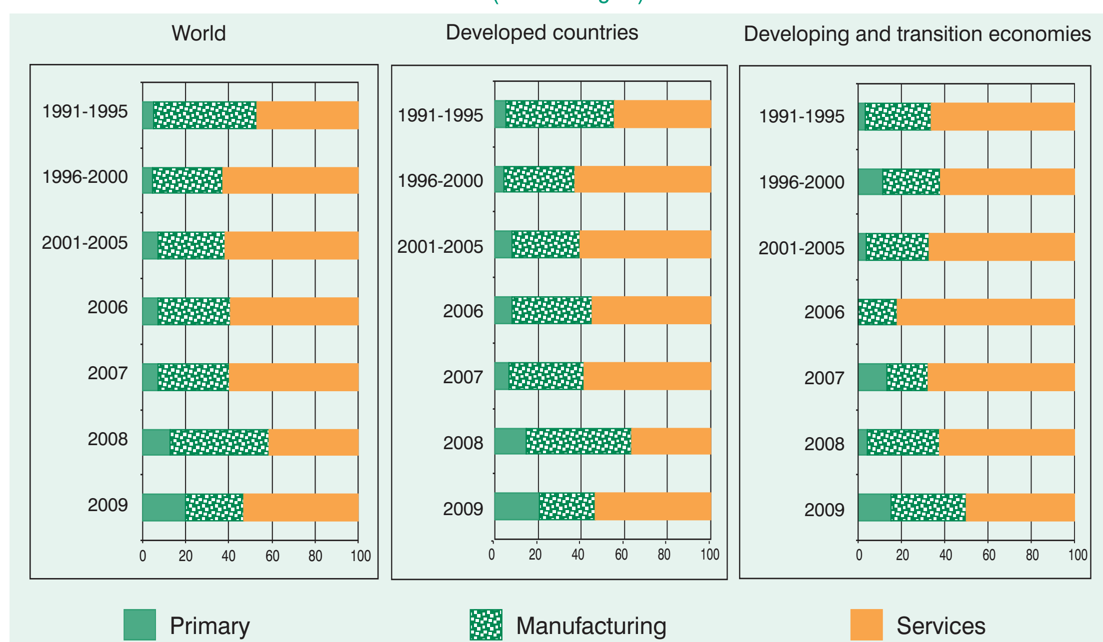
FDI by private equity funds and other collective investment funds dropped considerably in 2009. The value of their cross-border M&As plummeted much more than that of other investors. It registered a 65 per cent decline in 2009 (table I.4), following a 34 per cent contraction in 2008.

The slump in investments from private equity funds was mainly due to a sharp fall in large-scale investments. Deals valued at more than $1 billion fell by an estimated 75 per cent. In contrast, investments in small and medium-sized enterprises (SMEs) increased. The number of cross-border M&As by private equity funds rose by 12 per cent to 1,987 in 2009, reflecting a steady involvement by private equity firms in the M&A market and smaller deals.

Investors' growing risk aversion, which translated into a strong decline in fundraising, also contributed to reduced investment activity by private equity and other collective investment funds. In 2009, private equity funds raised $220 billion, 65 per cent less than in 2008 and the lowest amount since 2003 (Private Equity Intelligence, 2009).

Other factors behind the decline in FDI by private equity funds include the lack of promising new investment projects in a climate of uncertain economic prospects, as well as increasing financial pressures from existing investments. The collapse of the leveraged buyout market also contributed to the decline. Financing for highly leveraged buyout transactions dried up as credit conditions deteriorated, and banks stopped granting new loans. Risk premiums for such loans skyrocketed (European Private Equity

Figure I.9. Sectoral distribution of cross-border M&As, by industry of seller, 1990–2009
(Percentages)



Source: UNCTAD, cross-border M&A database (http://www.unctad.org/fdistatistics).

and Venture Capital Association, 2009). In addition, the performance of the companies that have been through a leveraged buyout deteriorated in 2008 and 2009, making new transactions much less attractive.[16]

The downward trend continued in the first five months of 2010. Both the value and the number of cross-border M&As decreased, by 2 per cent and 36 per cent respectively, compared to the same period in 2009. Whereas their cross-border M&As in continental Europe were still low, private equity firms increased their investments in North America and in developing countries in Asia.

A recovery in private equity funds' FDI will depend on several factors. A revival of the leveraged buyout market can only be expected when financial markets have largely recovered from the crisis and when banks have further reduced the risk profiles of their balance sheets. In addition, regulators and supervisory bodies will influence private equity funds' investments. The policy framework for the leveraged buyout market is currently changing. In April 2009, the European Commission proposed a directive on Alternative Investment Fund Managers (AIFMs), which intends to provide a regulatory and supervisory framework for the activities of alternative investment fund managers in the EU, in order to contribute to financial stability.[17] New rules proposed by the EU in May 2010 further tighten operations in the EU by hedge funds (including private equity funds) located outside the region.

The highly leveraged mega deals of the 2003–2007 boom years will probably not be seen in the near future. Meanwhile, private equity funds keep concentrating on SMEs: the average value of FDI projects decreased to about $50 million in 2009–2010, down from about $200 million in 2007–2008.

Table I.4. Cross-border M&As by private equity firms, 1996–May 2010[a]
(Number of deals and value)

Year	Number of deals: Number	Number of deals: Share in total (%)	Value: $ billion	Value: Share in total (%)
1996	932	16	42	16
1997	919	14	54	15
1998	1 082	14	79	11
1999	1 283	14	89	10
2000	1 338	13	92	7
2001	1 246	15	88	12
2002	1 244	19	85	18
2003	1 486	22	108	27
2004	1 622	22	157	28
2005	1 725	19	205	22
2006	1 688	18	267	24
2007	1 906	18	456	27
2008	1 776	18	303	24
2009	1 987	24	106	19
2010[a]	696	22	38	16

Source: UNCTAD, cross-border M&A database.

[a] For 2010, January–May only.

Note: Value is on a gross basis, which is different from other M&A tables based on a net value. Includes M&As by hedge funds. Private equity firms and hedge funds refer to acquirers as "investors not elsewhere classified". This classification is based on the Thomson Finance database on M&As.

b. Sovereign wealth funds

FDI by sovereign wealth funds was resilient during the crisis with a shift away from finance into other sectors.

Funds set up by or on behalf of sovereign states have emerged as active sources of FDI in recent years. Similar to private equity funds but with much lower levels of FDI, these sovereign wealth funds were, however, seriously affected by the financial market crisis and the global economic downturn in 2008 and 2009. Firstly, SWFs' assets lost considerable value, particularly in the first half of 2009. SWFs with a high share of equity and alternative assets in their portfolios were more seriously affected than funds that concentrated on fixed-income and money market products.[18] However, as SWFs are generally long-term investors and have less need for liquidity, most of these losses were book losses that were not realized. In addition, the improving world equity markets during the latter half of 2009 resulted in a partial recovery of their asset portfolios.

As a result, the market value of SWFs' total assets declined slightly in 2009, falling from an estimated $4.0 trillion at the end of 2008 to an estimated $3.8 trillion at the end of 2009 (Sovereign Wealth Fund Institute, 2009a).[19] Most analysts have adopted a more pessimistic view of SWFs' growth prospects than in the past two years.[20]

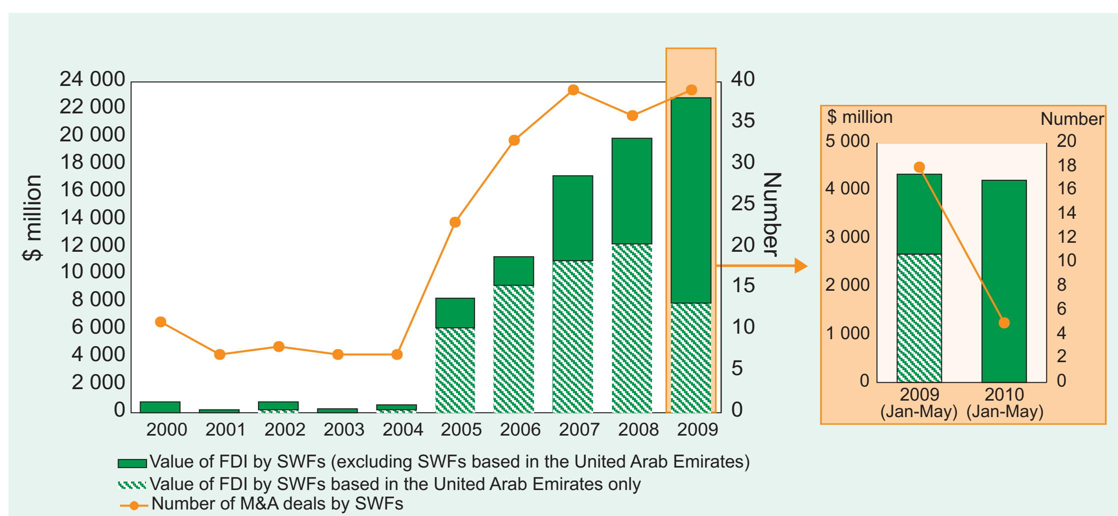
At the same time, funding of commodity-based SWFs was hit hard by the declining prices of oil and other commodities. The funding of non-commodity-based SWFs suffered due to their countries' declining trade surpluses, which resulted from falling demand from developed countries.

And yet the value of FDI directed by SWFs from their funds, which is indicated by cross-border M&A data, increased in 2009, despite the reduced levels of total funds, in contrast to private equity funds' outflows. SWFs invested $22.9 billion in FDI in 2009 – 15 per cent more than in 2008 (fig. I.10). However, investment behaviour during and after the crisis differed among SWFs. Several funds temporarily stopped FDI activities; others, such as the Korea Investment Corporation, are considering allocating more funds for buy-out groups (such as private equity funds). In the first five months of 2010, however, SWFs' FDI fell somewhat compared to the same period in the previous year, with no major M&A transaction recorded by funds based in the United Arab Emirates, which were the largest investors until 2009 (fig. I.10).

Besides reducing their FDI, many SWFs have revised their investment strategy. The financial sector used to dominate SWFs' FDI, accounting for 36 per cent of their cross-border acquisitions in 2007–2008. In 2009–2010, however, cross-border M&As in the financial sector amounted to only $0.2 billion, down by 98 per cent from 2007–2008. A minority of SWFs even divested their banking holdings,[21] sometimes realizing heavy losses.[22] Many SWFs reoriented their FDI towards the primary sector and industries less vulnerable to financial developments (fig. I.11).[23] SWFs also increased their cross-border M&As in the manufacturing sector.[24]

SWFs changed their regional focus in 2009 and 2010, too. Before the start of the financial market crisis, their FDI had con-

Figure I.10. FDI by sovereign wealth funds,[a] 2000–May 2010[b]



Source: UNCTAD cross-border M&A database (http://www.unctad.org/fdistatistics).

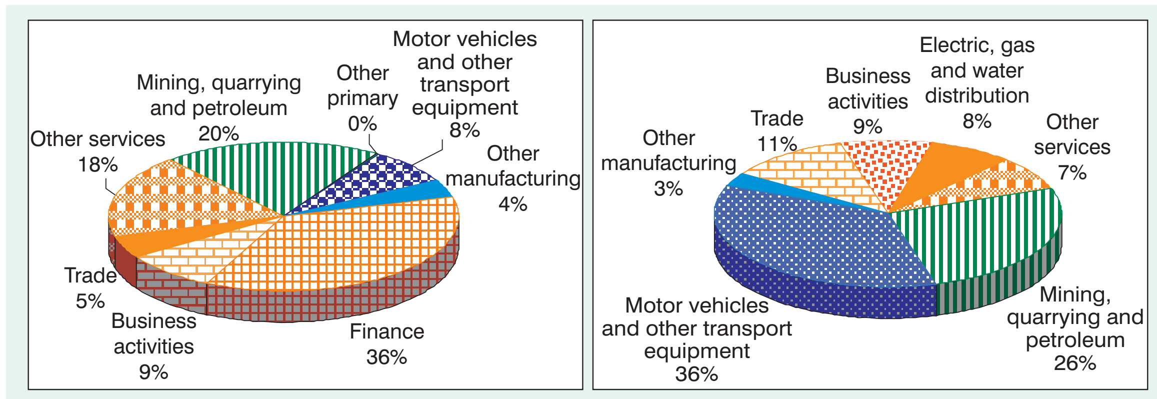
[a] Cross-border M&As only; greenfield investments by SWFs are assumed to be extremely limited. Data show gross cross-border M&A purchases of companies by SWFs, i.e. without subtracting cross-border sales of companies owned by SWFs.

[b] For 2010, January–May only.

centrated on developed countries in North America and the EU. In 2009 and the first five months of 2010, SWFs increased their FDI in Asia,[25] which had been much less affected by the financial market crisis and the economic downturn.

SWFs' investment prospects are also influenced by other considerations. Their growing foreign investment activities have raised concerns that they could be a possible threat to national security and to the market-based economies of host developed countries. Some recipient countries have tightened their investment regimes, or otherwise regulated FDI (chapter III).[26] SWFs have responded by making efforts to improve transparency, by adopting a set of rules known as the Santiago Principles. A study of the 10 largest SWFs carried out by RiskMetrics found that they fully complied with a total of 60 per cent of these Principles (RiskMetrics, 2009). This could help reduce concerns in host countries about the implications of their investments.

Figure I.11. FDI[a] by sovereign wealth funds, by main target sectors, 2007–2008 and 2009–May 2010[b]



Source: UNCTAD, cross-border M&A database (http://www.unctad.org/fdistatistics).
[a] Cross-border M&As only. Greenfield investments by SWFs are assumed to be extremely limited.
[b] For 2010, January to May only.

B. International production: the growing role of developing and transition economies

FDI stock and assets continued to increase despite the toll taken by the crisis on TNCs' sales and value-added. The share of developing-country TNCs in global production is growing.

The economic and financial crisis has significantly affected TNCs' operations abroad.[27] Foreign affiliates' sales and value-added declined by 4–6 per cent in 2008 and 2009 (table I.5). Since this contraction was slower than the decline of world economic activity, however, the share of foreign affiliates' value-added (gross product) reached a new historic high of 11 per cent of world gross domestic product (GDP). Besides greenfield investments, any expansion of the foreign operations of TNCs in 2009 can largely be attributed to the organic growth of existing foreign affiliates.

Foreign employment remained practically unchanged in 2009 (+1.1 per cent) (table

Table I.5. Selected indicators of FDI and international production, 1990–2009

Item	Value at current prices (Billions of dollars)				Annual growth rate (Per cent)				
	1990	2005	2008	2009	1991–1995	1996–2000	2001–2005	2008	2009
FDI inflows	208	986	1 771	1 114	22.5	40.0	5.2	-15.7	-37.1
FDI outflows	241	893	1 929	1 101	16.8	36.1	9.2	-14.9	-42.9
FDI inward stock	2 082	11 525	15 491	17 743	9.3	18.7	13.3	-13.9	14.5
FDI outward stock	2 087	12 417	16 207	18 982	11.9	18.4	14.6	-16.1	17.1
Income on inward FDI	74	791	1 113	941	35.1	13.4	31.9	-7.3	-15.5
Income on outward FDI	120	902	1 182	1 008	20.2	10.3	31.3	-7.7	-14.8
Cross-border M&As a	99	462	707	250	49.1	64.0	0.6	-30.9	-64.7
Sales of foreign affiliates	6 026	21 721	31 069[b]	29 298[c]	8.8	8.2	18.1	-4.5[b]	-5.7[c]
Gross product of foreign affiliates	1 477	4 327	6 163[d]	5 812[e]	6.8	7.0	13.9	-4.3[d]	-5.7[e]
Total assets of foreign affiliates	5 938	49 252	71 694[f]	77 057[f]	13.7	19.0	20.9	-4.9[f]	7.5[f]
Exports of foreign affiliates	1 498	4 319	6 663[g]	5 186[g]	8.6	3.6	14.8	15.4[g]	-22.2[g]
Employment by foreign affiliates (thousands)	24 476	57 799	78 957[h]	79 825[i]	5.5	9.8	6.7	-3.7[h]	1.1[i]
Memorandum									
GDP (in current prices)	22 121	45 273	60 766	55 005[j]	5.9	1.3	10.0	10.3	- 9.5[j]
Gross fixed capital formation	5 099	9 833	13 822	12 404[j]	5.4	1.1	11.0	11.5	-10.3
Royalties and licence fee receipts	29	129	177	..	14.6	8.1	14.6	8.6	..
Exports of goods and services	4 414	12 954	19 986	15 716[j]	7.9	3.7	14.8	15.4	-21.4

Source: UNCTAD, based on its FDI/TNC database (www.unctad.org/fdi statistics); UNCTAD, GlobStat; and IMF, International Financial Statistics, June 2010.

[a] Data are available only from 1987 onwards.
[b] Data for 2007 and 2008 are based on the following regression result of sales against inward FDI stock (in millions of dollars) for the period 1980–2006: sales=1 471.6211+1.9343* inward FDI stock.
[c] Data for 2009 based on the observed year-over change of the sales of 3,659 TNCs' foreign operations between 2008 and 2009.
[d] Data for 2007 and 2008 are based on the following regression result of gross product against inward FDI stock (in millions of dollars) for the period 1982–2006: gross product=566.7633+0.3658* inward FDI stock.
[e] Decline in gross product of foreign affiliates assumed to be the same as the decline in sales.
[f] Data for 2007 and 2008 are based on the following regression result of assets against inward FDI stock (in millions of dollars) for the period 1980–2006: assets= -3 387.7138+4.9069* inward FDI stock.
[g] Data for 1995–1997 are based on the following regression result of exports of foreign affiliates against inward FDI stock (in millions of dollars) for the period 1982–1994: exports=139.1489+0.6413*FDI inward stock. For 1998–2009, the share of exports of foreign affiliates in world export in 1998 (33.3%) was applied to obtain the values.
[h] Based on the following regression result of employment (in thousands) against inward FDI stock (in millions of dollars) for the period 1980–2006: employment=17 642.5861+4.0071* inward FDI stock.
[i] Data for 2009 based on the observed year-over change of the estimated employment of 3,659 TNCs' foreign operations between 2008 and 2009.
[j] Based on data from IMF, World Economic Outlook, April 2010.

Note: Not included in this table are the value of worldwide sales by foreign affiliates associated with their parent firms through non-equity relationships and of the value of sales of the parent firms themselves. Worldwide sales, gross product, total assets, exports, and employment of foreign affiliates are estimated by extrapolating the worldwide data of foreign affiliates of TNCs from Austria, Canada, the Czech Republic, Finland, France, Germany, Italy, Japan, Luxembourg, Portugal, Sweden and the United States for sales; those from the Czech Republic, Portugal, Sweden and the United States for gross product; those from Austria, Germany, Japan and the United States for assets; those from Austria, the Czech Republic, Japan, Portugal, Sweden and the United States for exports; and those from Austria, Germany, Japan, Switzerland and the United States for employment, on the basis of the shares of those countries in worldwide outward FDI stock.

I.5). This relative resilience might be explained by the fact that foreign sales started to pick up again in the latter half of 2009. In addition, many TNCs are thought to have slowed their downsizing programmes as economic activity rebounded – especially in developing Asia. In spite of the setback in 2008 and 2009, an estimated 80 million workers were employed in TNCs' foreign affiliates in 2009, accounting for about 4 per cent of the global workforce.

Dynamics vary across countries and sectors, but employment in foreign affiliates has been shifting from developed to developing countries over the past few years (chapter II); the majority of foreign affiliates' employment is now located in developing economies.[28] The largest number of foreign-affiliate employees is now in China (with 16 million workers in 2008, accounting for some 20 per cent of the world's total employees in foreign affiliates). Employment in foreign affiliates in the United States, on the other hand, shrank by half a million between 2001 and 2008.

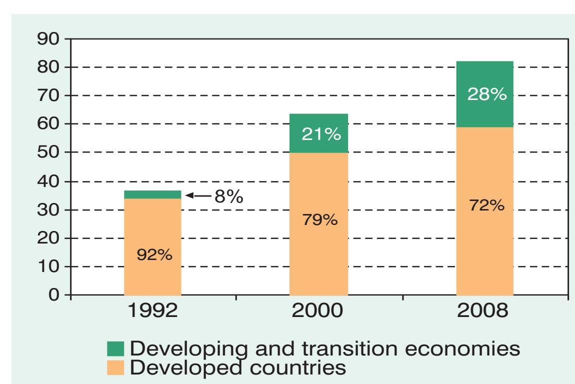
In addition, the share of foreign affiliates' employment in manufacturing has declined in favour of services. In developed countries, employment in foreign affiliates in the manufacturing sector dropped sharply between 1999 and 2007, while in services it gained importance as a result of structural changes in the economies (OECD, 2010).

Foreign affiliates' assets grew at a rate of 7.5 per cent in 2009. The increase is largely attributable to the 15 per cent rise in inward FDI stock due to a significant rebound on the global stock markets (section A).

The regional shift in international production is also reflected in the TNC landscape. Although the composition of the world's top 100 TNCs confirms that the triad countries remain dominant, their share has been slowly decreasing over the years. Developing and transition-economy TNCs now occupy seven positions among the top 100. And while more than 90 per cent of all TNCs were headquartered in developed countries in the early 1990s, parent TNCs from developing and transition economies accounted for more than a quarter of the 82,000 TNCs (28 per cent) worldwide in 2008 (fig. I.12), a share that was still two percentage points higher than that in 2006, the year before the crisis. As a result, TNCs headquartered in developing and transition economies now account for nearly one tenth of the foreign sales and foreign assets of the top 5,000 TNCs in the world, compared to only 1–2 per cent in 1995 (table I.6) (see http://www.unctad.org/wir for the list of the 100 biggest TNCs).

Other sources point to an even larger presence of firms from developing and transition economies among the top global TNCs. The *Financial Times*, for instance, includes 124 companies from developing and transition economies in the top 500 largest firms in the world, and 18 in the top 100.[29] *Fortune* ranks 85 companies from developing and transition economies in the top 500 largest global corporations, and 15 in the top 100.[30]

Figure I.12. Number of TNCs from developed countries and from developing and transition economies, 1992, 2000 and 2008
(In thousands)



Source: UNCTAD.
Note: Figures in the bar show a distribution share.

Over the past 20 years, TNCs from both developed and developing countries have expanded their activities abroad at a faster

Table I.6. Foreign activities of the top 5,000 TNCs,[a] by home region/country, 1995 and 2008
(Per cent)

Home region	Foreign assets 1995	Foreign assets 2008	Foreign sales 1995	Foreign sales 2008
Developed countries	98.9	92.0	98.7	90.9
EU	27.9	40.4	37.7	40.9
United States	55.5	29.5	28.0	29.1
Japan	8.8	13.3	27.8	13.9
Developing and transition economies	1.1	8.0	1.3	9.1
of which: Asia	1.0	6.6	1.1	7.6
Total	100.0	100.0	100.0	100.0

Source: UNCTAD, based on Thomson One Banker.
[a] For 1995, data cover some 2,084 TNCs.

Table I.7. Recent evolution in the internationalization level of the 100 largest non-financial TNCs worldwide and from developing and transition economies, 2007 and 2008
(Billions of dollars, thousands of employees and percentage)

Variable	100 largest TNCs worldwide 2007	2008	% Change	100 largest TNCs from developing and transition economies 2007	2008	% Change
Assets						
Foreign	6 116	6 172	0.9	808	907	12.3
Total	10 702	10 760	0.9	2 311	2 680	16.0
Foreign as % of total	57	57	0.2	35	34	-1.1
Sales						
Foreign	4 936	5 173	4.8	805	997	23.9
Total	8 078	8 354	3.4	1 699	2 240	31.8
Foreign as % of total	61	62	0.8	47	45	-2.9
Employment						
Foreign	8 440	8 905	5.5	2 648	2 652	0.2
Total	14 870	15 408	3.6	6 366	6 779	6.5
Foreign as % of total	57	58	1.0	42	39	-2.5

Source: UNCTAD/Erasmus University database on the top 100 TNCs.
[a] In percentage points.

rate than at home. This has been sustained by new countries and industries opening up to FDI, greater economic cooperation, privatizations, improvements in transport and telecommunications infrastructure, and the growing availability of financial resources for FDI, especially for cross-border M&As.

The internationalization of the largest TNCs worldwide, as measured by the transnationality index, actually grew during the crisis, rising by 1.0 percentage points to 63, as compared to 2007. The transnationality index of the top 100 non-financial TNCs from developing and transition economies, however, dropped in 2008. This is due to the fact that in spite of the rapid growth of their foreign activities, they experienced even faster growth in their home countries (table I.7). Among both groups, this index varies by region: TNCs based in the EU, Africa, and South Asia are among the most transnationalized (table I.8).

Table I.8. The transnationality index of the 100 largest TNCs worldwide and the 100 TNCs from developing and transition economies, by home region, 2008
(TNI values and number of entries)

100 largest TNCs worldwide: Home region	Average TNI[a]	Number of entries	100 largest TNCs from developing and transition economies: Home region	Average TNI[a]	Number of entries
Total	63.4	100	Total	48.9	100
EU	67.6	58	Africa	58.8	9
France	66.6	15	Latin America and the Caribbean	42.5	9
Germany	56.9	13	West Asia	50.6	7
United Kingdom	75.5	15	East Asia	51.1	47
Japan	50.0	9	South Asia	57.9	5
United States	58.1	18	South-East Asia	47.5	15
Developing and transition economies	50.7	7	South-East Europe and the CIS	27.2	8

Source: UNCTAD.
[a] TNI, the transnationlity Index, is calculated as the average of the following three ratios: foreign assets to total assets, foreign sales to total sales and foreign employment to total employment.

C. FDI prospects: a cautious optimism

Prospects for global FDI: cautious optimism in the short-term and regaining momentum in the medium-term.

The gradual improvement of macroeconomic conditions, recovering corporate profits and stock market valuations, and policies generally promoting openness to FDI are expected to be sustained over the next few years. These favourable trends will continue to boost business confidence. TNCs, investment promotion agencies (IPAs) and FDI experts surveyed by UNCTAD's latest *World Investment Prospects Survey* confirmed that global FDI flows were therefore likely to increase during 2010–2012 (UNCTAD, forthcoming a).[31]

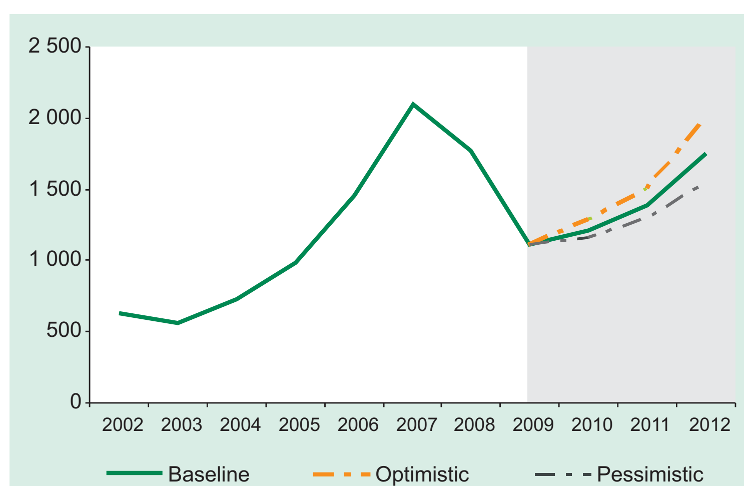
The FDI recovery over the next few years is expected to confirm global trends that pre-date the crisis:

- The relative share of manufacturing will most likely continue to decline, as services and the primary sector offer more attractive FDI opportunities;
- Developing and transition economies are expected to absorb and generate increasing shares of global FDI. Asia is viewed as the most attractive region for FDI, while a relatively weaker investment recovery is expected in Europe and Africa. France, Germany, the United Kingdom and the United States will remain the main sources of FDI, but newcomers such as China, India and the Russian Federation will increasingly figure among the top home bases for FDI.

1. FDI flows in 2010 and beyond: global prospects

UNCTAD's estimates suggest that FDI flows will slowly recover to about $1.1–1.3 trillion (with the baseline scenario of over $1.2 trillion) in 2010, before gaining momentum to reach $1.3–1.5 trillion ($1.4 trillion on the baseline) in 2011 (fig. I.13). Only in 2012 would foreign investment regain its 2008 level, with flows estimated within a range of $1.6–2 trillion ($1.8 trillion on the baseline) (fig. I.13).

Figure I.13. Global FDI flows, 2002–2009, and projections for 2010–2012
(Billions of dollars)



Source: UNCTAD.
Note: The estimates for 2010, 2011 and 2012 are based on the results of the *World Investment Prospects Survey* (UNCTAD, forthcoming a), taking into account data for the first quarter of 2010 for FDI flows and the first five months of 2010 for cross-border M&As for the 2010 estimates, as well as the risks and uncertainties elaborated upon in the text. In addition to the baseline scenario, two less likely scenarios are included, as upper and lower ranges, in the figure.

These projections are supported by encouraging macroeconomic, corporate and policy outlooks. At the same time, TNCs are expressing renewed optimism about the global FDI environment, in particular

from 2011 onwards. These factors all point towards an increase in FDI over the next few years, although substantial risks and uncertainties remain.

a. Key factors influencing future FDI flows

Leading macroeconomic, corporate and policy factors point to a recovery of FDI inflows from 2010 onwards.

Macroeconomic factors. Recent forecasts suggest that the global economy has exited recession and returned to growth, although the path to recovery is still uncertain and fragile. The world economy as a whole is expected to grow by 3 per cent in 2010, after a 2 per cent contraction in 2009. Longer-term prospects are considered better, although the speed and scale of recovery will vary among regions and countries (table I.9). More buoyant economic growth is expected to facilitate the availability of investment capital and the growth of overseas markets, which augur well for FDI prospects.

Table I.9. Real growth rates of GDP and gross fixed capital formation (GFCF), 2009–2011
(Per cent)

Variable	Region	2009	2010	2011
GDP growth rate	World	-2.0	3.0	3.2
	Developed economies	-3.4	1.9	2.1
	Developing economies	2.2	5.8	5.8
	Transition economies	-3.7	1.1	3.0
GFCF growth rate	World	4.3	6.9	7.0
	Advanced economies[a]	-12.0	0.9	5.4
	Emerging and developing economies[a]	3.3	8.3	8.4

Source: UNCTAD based on United Nations, 2010 for GDP and IMF, 2010 for GFCF.

[a] IMF's classfication on advanced, emerging and developing economies are not the same as the United Nations' classification of developed and developing economies; the two organizations use different country classifications.

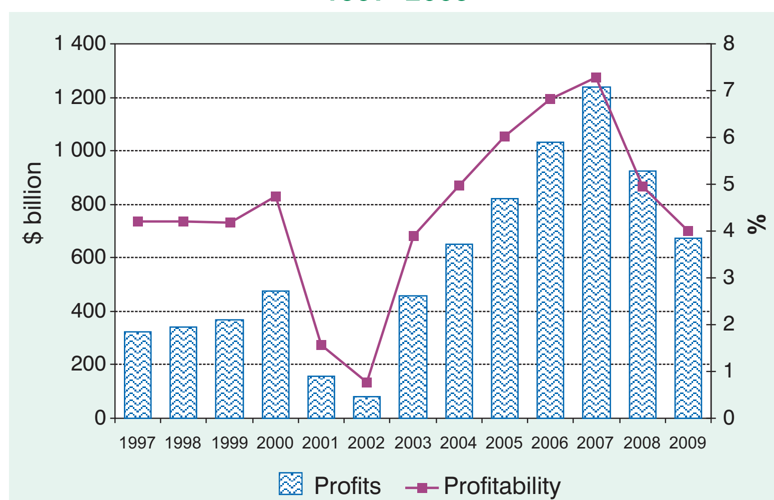
At the same time, domestic investment should recover rapidly in the coming two years (table I.9), suggesting stronger business demand and opportunities for FDI. Central banks are expected to maintain low interest rates until the end of 2010, which will moderate the cost of corporate financing for investment. Commodity price increases are likely to remain modest, helping to contain operating costs.

Firm-level factors. Annual TNC profits in 2009 were lower than in 2008 (fig. I.14). Yet the modest economic recovery in the second part of 2009, improved demand in a number of industries, and successful cost-cutting effort[32] have enhanced corporate profits slightly since mid-2009 (section A). As a result, the profits of the top 500 United States and top 600 European companies should increase by one third in 2010, while Japan's listed companies should see their bottom line improve by 70 per cent.[33]At the same time, TNCs' liquidity position (cash holdings) has improved,[34] due to recovering profits and reserves built up on the back of depressed investment spending.[35] Added to the improved stock market performance in 2009, this will increase the funds available for investments and could boost the value of cross-border M&A deals.

Policy factors. To stem the downward FDI trend and respond to competition for investment projects, most countries have further liberalized their investment regimes and are expected to continue doing so, which should encourage FDI; a resurgence of targeted state intervention, however, could deter investment in some cases (chapter III).

Besides investment policy, the expected phasing out of government rescue packages will also impact on foreign investment. On the one hand, some TNCs are still struggling with the effect of the economic crisis, and the end of government aid schemes could hamper their ability to invest abroad. On the other hand, the privatization of rescued companies should create investment opportunities, including for foreign TNCs. In this context, the risk of investment protectionism cannot be excluded, requiring continued vigilance[36] (chapter III).

Figure I.14. Profitability[a] and profit levels of TNCs, 1997–2009



Source: UNCTAD, based on data from Thomson One Banker.
[a] Profitability is calculated as the ratio of net income to total sales.
Note: The number of TNCs covered in this calculation is 2,498.

Risks and uncertainties. The scenario of FDI recovery presented above (fig. I.13) remains fraught with uncertainties. Firstly, the stability of the global financial system going forward is not yet assured. The health of the banking system has improved somewhat, thanks to government bailouts, the improved economic environment, balance-sheet restructurings, and the normalization of financial markets. Yet systemic weaknesses remain, and efforts to reform the international financial architecture to avoid further crises have not yet come to fruition. The shape of regulatory reforms in the financial sector, and their impact on credit and investment, therefore remain uncertain (chapter III). Until these reforms are concluded, confidence in global financial markets is unlikely to fully recover, resulting in limited access to credit, and continued stock exchange volatility. At the same time, ballooning fiscal deficits in some European countries are putting pressure on an already constrained credit market and have resulted in unsustainable levels of government debt. Risks of a sovereign debt crisis cannot be excluded, and the financial crisis that would ensue would severely derail global economic growth and FDI flows.

Secondly, substantial macroeconomic risks remain. Mounting fiscal deficits and public debt will require more stringent fiscal discipline and higher taxes in the medium term, especially in developed countries. Unless a robust economic recovery is under way, government austerity programmes could stall GDP growth. Alternatively, continued spending could fuel inflationary pressures and contribute to exchange rate instability. The recent sovereign debt crisis in some European countries has further contributed to the instability of the euro (UN-DESA, 2010). All these factors could affect FDI.

Lastly, risks of investment protectionism have not yet disappeared, even if no such trend has been observed so far. In addition, ongoing efforts to rebalance the rights and obligations of the State and investors, if not properly managed, could contribute to uncertainties for investors.

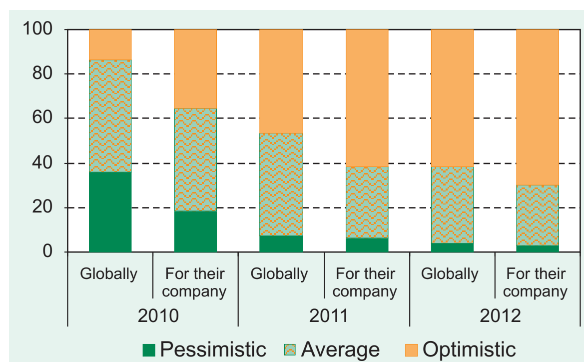
If they materialize, any of these risks would easily derail the fragile economic and financial recovery under way, resulting in depressed FDI levels.

b. TNCs' future plans

TNCs appear optimistic about investment prospects in line with their continuing international expansion plans.

Companies' perceptions of their business and investment environment are improving, according to UNCTAD's *WIPS* (UNCTAD, forthcoming a). While 47 per cent of *WIPS* respondents were pessimistic regarding their overall business environment in the 2009 survey, only 36 per cent were pessimistic in the 2010 survey. Optimism is even more pronounced when longer-term perspectives are considered (fig. I.15).

Figure I.15. Level of optimism/pessimism of TNCs regarding the investment environment, 2010–2012
(Percentage of responses by TNCs surveyed)

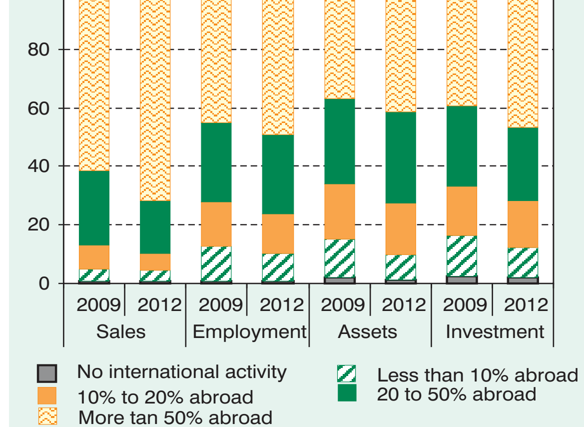


Source: UNCTAD, forthcoming a.

This cautious optimism seems to be shared by others. The large majority of IPAs surveyed in the *WIPS* are upbeat about the FDI outlook for the coming three years. As in the case of TNCs, IPA respondents were on average more positive for the medium term (2012) than for 2010.

This renewed optimism is translating into foreign investment intentions. The *WIPS* reveals that the foreign share in TNCs' assets, employment, investment and sales will keep growing in the coming years (fig. I.16). This is true in all industries, and for all business functions, including R&D. Accordingly,

Figure I.16. Internationalization prospects for TNCs, 2009 and 2012
(Percentage of responses by TNCs surveyed)

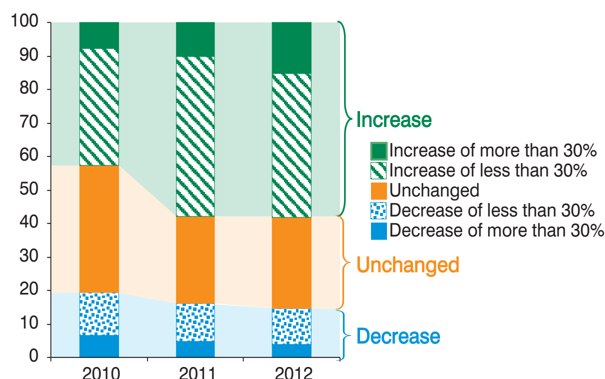


Source: UNCTAD, forthcoming a.

TNCs plan to ramp up their international investment programmes (fig. I.17).

2. Prospects for FDI by type

Figure I.17. Prospects for respondent companies' FDI expenditures as compared to those in 2009
(Percentage of responses by TNCs surveyed)



Source: UNCTAD, forthcoming a.

a. By mode of entry

Cross-border M&As are leading the FDI recovery.

Cross-border M&As are expected to pick up for various reasons: (a) the financial situation of TNCs is improving; (b) stock exchange valuations are much higher than in 2009; and (c) ongoing corporate and industrial restructuring is creating new acquisition opportunities, in particular for emerging-country TNCs. These conditions are more conducive to M&As than greenfield investments (*WIR00*). As has already been highlighted in section A.3, cross-border M&As tend to recover faster than greenfield investments when global economic conditions improve.

Large-scale restructuring is resulting in growing concentration. This is the case not only in the automotive industry, where the number of suppliers could drop substantially,[37] but also in industries such as agribusiness and retailing. In innovation industries such as pharmaceuticals and the biotech industry, M&As have been used to gain fast and ex-

clusive access to technology, a trend which could gain additional momentum.[38]

Cash-rich TNCs, including those from developing and transition economies, are likely to take advantage of lower asset prices to further their foreign expansion through M&As. Recent transactions have highlighted opportunities in the automotive [39] and chemicals[40] industries, in particular.

Greenfield investments should also pick up, moderately in 2010 and then faster in 2011 and 2012. Investment activities are expected to be concentrated in natural resources and services, where market prospects are more favourable.

b. By industry

Services and primary sector TNCs are more bullish about their medium-term investment prospects.

In the ***primary sector***, the gradual market and price upturn since the second half of 2009 has encouraged major companies that continue to enjoy sound financial positions to maintain ambitious investment programmes. The FDI prospects for up to 2012 are therefore rather promising, especially in petroleum upstream activities. Various petroleum companies, such as Total (France), are investing in new oil and gas fields, not only in the Middle East, but also in other regions, such as North America.[41]

Manufacturing industries such as agribusiness or pharmaceuticals that rely on non-cyclical or fast-growing markets have been resilient in spite of the crisis. Some of the industries most affected by the crisis, such as the automotive industry, are now recovering, and could once again revive their investment plans. However, other manufacturing activities sensitive to the crisis continue to be faced by falling demand or a weak recovery. Fast-growing markets (such as those for environment-friendly products, renewable energies, or consumer markets in emerging economies), will encourage TNCs to expand their capacity to meet the additional demand.

International investment in the ***services sector*** is expected to grow faster than in manufacturing, based on TNC responses to the *WIPS* (UNCTAD, forthcoming a). Medium-term prospects for services are generally superior to those for the manufacturing sector. In addition, many services TNCs, which some years ago were mainly focused on their home market, are now pursuing internationalization strategies involving ambitious investments abroad. Hutchison Whampoa (Hong Kong (China)) has, for instance, recently announced large new projects in infrastructure (Australian harbours) and energy (energy distribution in Canada).

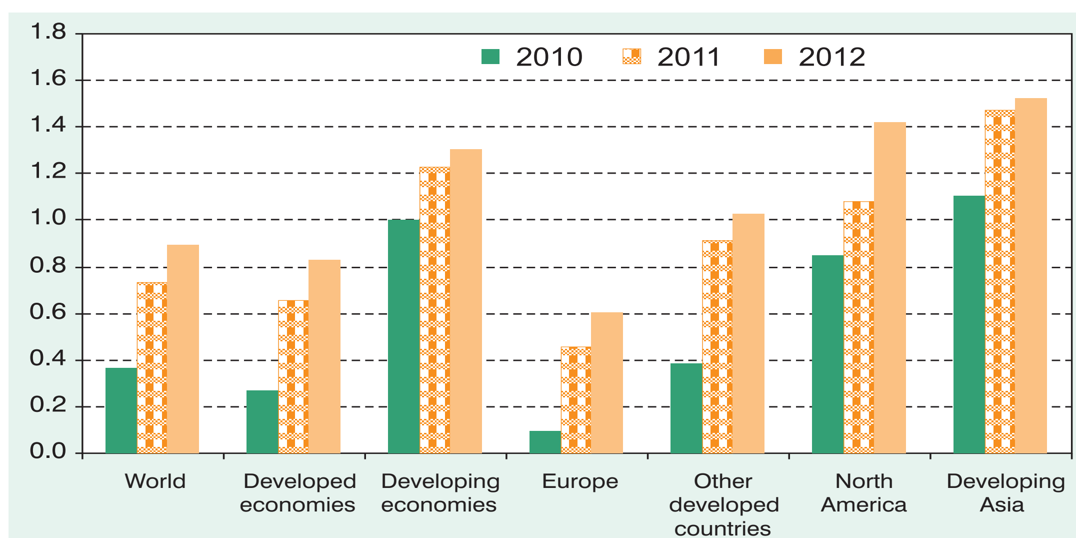
c. By home region

The role of developing and transition economies as sources of FDI will accelerate.

TNCs from developed countries are generally more pessimistic than those from developing countries in the short term. Although these differences tend to disappear over a longer time horizon, developing-country TNCs – especially in Asia – anticipate a stronger growth of their FDI expenditures from 2009 to 2012 than those from developed, especially European, countries (fig. I.18). This suggests that the share of developing and transition economies in global FDI outflows, while still small (fig. I.3), will keep rising over the coming years.

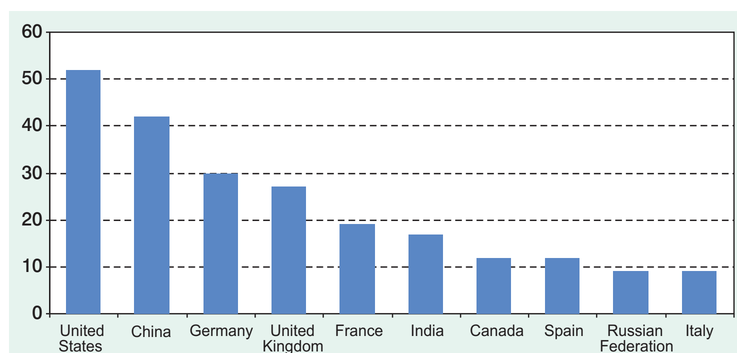
The growing role of developing economies as sources of FDI is confirmed by investment promotion agencies (IPAs) surveyed in the *WIPS* about the most promising investors in their respective countries. While developed economies still account for the majority of FDI sources mentioned by IPAs, developing and transition economies account for three out of the top ten (fig. I.19) and seven out of the top twenty.

Figure I.18. Prospects for respondent companies' FDI expenditures as compared to those in 2009, by home region
(Average of responses by TNCs surveyed)



Source: UNCTAD, forthcoming a.
Note: -4: very large decrease; +4: very large increase.

Figure I.19. The most promising investor home countries in 2010–2012, according to IPAs
(Number of times the country is mentioned as top investor by respondent IPAs)



Source: UNCTAD, forthcoming a.

On the other hand, TNCs' FDI plans are increasingly focusing on developing and transition economies, especially in South, East and South-East Asia, and, to a lesser extent, Latin America (fig. I.20). The ranking of future FDI destinations confirms the appetite of TNCs for investing in developing and transition economies, which are expected to attract an increasing share of global FDI inflows: four of the five top destinations – China, India, Brazil and the Russian Federation – are not developed economies (fig. I.21). FDI inflows to BRIC will be sustained by BRIC's large and fast-growing domestic markets, liberalized industries and vast natural resources, which have promoted a shift in global production in their favour, and positioned the countries well to weather the global downturn.

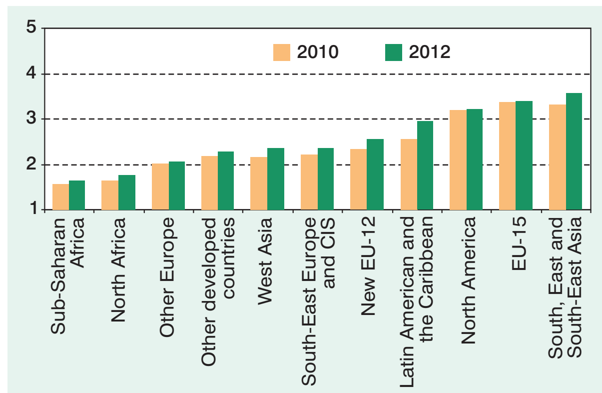
This finding indicates that investors expect these countries to continue to grow despite the economic crisis. Developing Asia con-

d. By host region

Developing and transition economies will be increasingly attractive as investment destinations.

According to the *WIPS*, the EU and North America remain among the top three host regions for FDI (fig. I.20), confirming their continued attraction as investment destinations. Investor interest in these two regions, however, remains largely unchanged over time.

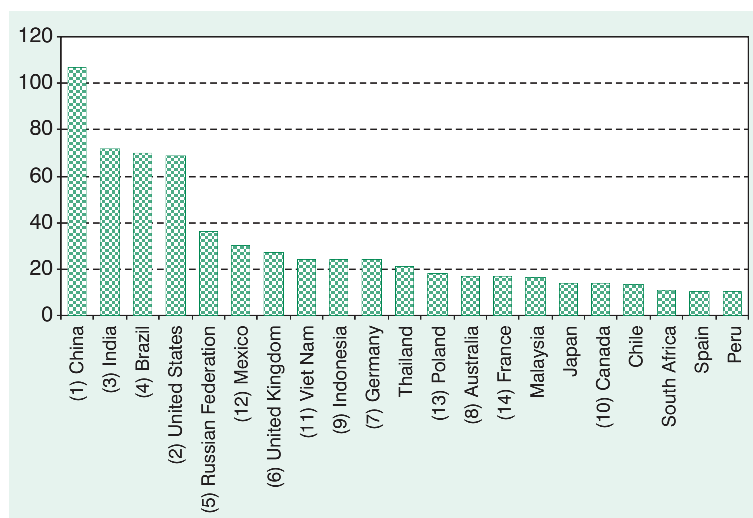
Figure I.20. Priority given to each host region by the respondent TNCs in their FDI plans, 2010 and 2012
(Average of responses by TNCs surveyed)



Source: UNCTAD, forthcoming a.
Note: 1: No priority; 5: Top priority.

tinues to become increasingly attractive relative to other regions, with six Asian countries among the top 15 – as against five in last year's survey. In contrast, the attractiveness of developed countries seems to have declined slightly (fig. I.21).

Figure I.21. Top host economies for FDI in 2010–2012
(Number of times the country is mentioned as top FDI priority by respondent TNCs)



Source: UNCTAD, forthcoming a.
Note: Rankings in the survey conducted in 2009 are given in parentheses before the name of selected countries.

Africa as a whole still trails at the bottom of future investment destinations, however. In addition, FDI inflows to tax haven economies are expected to decline further due to the higher standards of transparency and required information exchange on tax evasion. Improvements in the application of national treatment to domestic as well as foreign investment are also reducing incentives for round-tripping.

Investment intentions suggest that most FDI to developing and transition economies will keep focusing on a small number of emerging markets, while least developed countries (LDCs) will remain marginal.

TNCs' growing interest in developing and transition economies is not related only to cheaper labour costs. Large and/or fast-growing local markets, and in some cases, growing pools of skilled manpower, are also proving increasingly attractive. Consequently, FDI to developing and transition economies is not, and will not be, only directed at the most labour-intensive, low value-added components of the value chain, but, increasingly, at more innovative and technology-intensive activities.

* * *

After two years of decline, global FDI flows are expected to pick up in 2010. The economic recovery, the return of profits to levels similar to those before the crisis, and the continued interest of TNCs in internationalization of their production activities will lead companies to restore more ambitious international investment programmes. In a base-case scenario that assumes a world economic growth of 3 per cent in both 2010 and 2011–2012, FDI flows could recover to $1.3 trillion in 2011 and $1.5 trillion

in 2012, up from $1 trillion in 2009 and an estimated $1.2 trillion in 2010. Cross-border M&As should be the major driver of this investment recovery, whereas the contribution of greenfield projects is expected to be more limited.

Another major disruption of the global financial system and a possible crisis in the eurozone, however, could easily derail this expected recovery. These risks cannot yet be ruled out, and economic and investment prospects therefore remain fragile.

Regardless of the pace of investment recovery, developing and transition economies – especially in developing Asia – are bound to benefit the most, while their contribution to global outward FDI is expected to expand. Chapter II provides a more detailed analysis of regional trends.

Endnotes

1 Due to differences in data collection methodology among countries and between inflows and outflows, as well as the different timing of recording FDI transactions between host and home countries, there are some differences between FDI inflow and FDI outflow data.

2 The Global FDI Quarterly Index is based on quarterly data on FDI inflows for more than 60 economies which together account for roughly 90 per cent of global FDI flows. The index has been calculated from the year 2000 onwards, and is calibrated such that the average of quarterly flows in 2005 equals 100.

3 The data on cross-border M&As that are used for this report are based on the *Thomson Finance Database on M&As*. They are not fully comparable with official FDI flow data.

4 For example, in 2008, FDI stock in the United Kingdom denominated in United States dollars declined by $282 billion, while in the domestic currency there was an increase of £52 billion.

5 The countries and territories that fall into this group include: Andorra, Anguilla, Antigua and Barbuda, Aruba, Bahrain, Barbados, Belize, the British Virgin Islands, the Cook Islands, Dominica, Gibraltar, Grenada, the Isle of Man, Liberia, Liechtenstein, the Maldives, the Marshall Islands, Monaco, Montserrat, Nauru, the Netherlands Antilles, Niue, Panama, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Samoa, the Seychelles, Tonga, the Turks and Caicos Islands, the United States Virgin Islands and Vanuatu.

6 According to data for 79 countries for which such data were available.

7 For example, FDI outflows from the United States to Sweden were negative at $10 billion. (A negative value means that companies from the United States divested more than they invested in Sweden in 2009.)

8 Since April 2009, 95 per cent of the dividends received by Japanese firms from their foreign affiliates have been tax-exempted. In the year ending March 2010, Japanese TNCs received a record amount of dividends reaching more than 3 trillion yen ($33 billion), 20 per cent larger than in the previous year. *See:* Nikkei, 19 May 2010.

9 For example, Temasek Holdings (Singapore) acquired an 11 per cent stake in Merrill Lynch in 2008 for $4.4 billion.

10 The discussion here mainly uses data on cross-border M&As and greenfield investments, since FDI data broken down by sector/industry for 2009 and the first part of 2010 will only become available in 2011, or later, for most countries.

11 There are many cases of recent cross-border acquisitions in the mining sector; one example is the purchase by CNOOC (China) for $3.1 billion of a 50 per cent stake in Bridas (Argentina) in 2010.

12 For example, in 2009, two Canadian firms, QLT Inc. and MDS, sold their affiliates in the United States to Tolmar Holding Inc. (United States) and INC Research (United States) for $230 million and $50 million respectively.

13 For example, Sumitomo Mitsui (Japan) took over Citigroup Japan's brokerage businesses, Nikko Cordial Securities, for $6 billion.

14 They include, among others, the acquisition of British Energy Group plc by EDF (France) for $17 billion, and the purchase of the remaining 25 per cent of Endesa (Spain) by Enel (Italy) for $13 billion. See http://www.unctad.org/wir for the full list of mega deals.

15 For a definition of TNCs, see the report's methodological note (http://www.unctad.org/wir).

16 At the end of 2008, 45 per cent of firms out of a sample of companies surveyed by Standard and Poor's were more than 10 per cent behind forecasts on earnings before interest, taxes, depreciation and amortization (EBITDA) (Standard and Poor's, 2009).

[17] According to the proposed directive of article 25(3), the Commission shall adopt implementing measures setting limits on the level of leverage that AIFMs can employ, taking into account the type of alternative investment fund, its investment strategy and the sources of leverage. The definitions of leverage and quantitative measures are not yet in place (European Central Bank, 2009). However, the proposed tightening of the rules could limit the extent of future leverage in private equity and other collective investment funds, and therefore dampen their growth.

[18] For example, the market value of the total assets of Temasek (Singapore), which follows an active investment strategy with a high share of equity investments, declined by 30 per cent, from $185 billion in March 2008 to $130 billion in March 2009 (Temasek, 2009). On the other hand, China Investment Corporation (CIC), known as a rather passive investor, was not seriously hit by the crisis due to its conservative portfolio composition. At the end of 2008, CIC held 87 per cent of its assets in cash and cash products. *See:* Wall Street Journal. CIC took conservative, not jazzy, tone. 11 August 2009.

[19] State Street (2009) estimated a similar decline in SWFs' assets from $3.5 trillion at the end of 2008 to $3.2 trillion in August 2009. Estimates of the total asset values of SWFs differ, due to the varying definitions of SWFs and to the limited disclosure and lack of transparency by many SWFs. There are no official data for this market. Various institutions use a variety of techniques for their estimates. Therefore, the figures must be used and interpreted with caution.

[20] In March 2009, International Financial Services London revised its 2008 estimate for the value of SWF assets by 2015 from $10 trillion to $8 trillion. The McKinsey Global Institute (2009) projected the total assets of SWFs by 2013 at only $4.3 trillion.

[21] For example, IPIC (United Arab Emirates) sold an 11 per cent stake of Barclays plc, worth $5.7 billion. Deutsche Bank (2009).

[22] For example, Singapore's Temasek sold its stake in the Bank of America in 2009 at an estimated loss of more than $3 billion (CNNMoney, 2009).

[23] The Qatar Investment Authority is reviewing its strategy to focus more on commodities, food, energy and water (Sovereign Wealth Fund Institute, 2010). The chairman of China Investment Corporation (CIC) stated in October 2009 that CIC's strategy is to focus on commodity-related and real estate assets, in reaction to expected price bubbles in equity markets and as a hedge against expected inflation. *See:* China Economic Review. CIC chief warns of price bubbles, keen on commodities. 29 October 2009.

[24] For example, IPIC acquired a 70 per cent stake, worth $1 billion, in the German steel company MAN Ferrostahl, and a 100 per cent stake in Nova Chemicals, Canada, for $0.5 billion.

[25] For example, GIC (Singapore) acquired ProLogis China Operations in China for $1.3 billion, and China Investment Corporation (China) acquired Noble Group Limited in Hong Kong (China), for $0.9 billion.

[26] Canada and Germany established a review mechanism for certain foreign investments (see *WIR09*).

[27] There was a decline in the number of foreign affiliates in some countries. For example, the number of foreign affiliates in Japan declined by 6.3 per cent to 2,763 in 2008 (Japan, METI, 2010a).

[28] Developing and transition economies are estimated to account for 53 per cent of total employees of all foreign affiliates in 2007.

[29] Based on their market values on 31 March 2010.

[30] Based on 2009 revenues.

[31] This survey provides an outlook on future trends in FDI as seen by the largest TNCs, IPAs and experts. The 2010–2012 survey, based on some 240 TNCs, 110 IPAs and 12 experts, and undertaken between January and April 2010, is the most recent in a series of similar surveys that have been carried out regularly by UNCTAD since 1995, as part of the background work for its annual *World Investment Report*.

[32] For example, Japanese companies listed in the stock markets could reduce costs by 14 per cent in the year ending March 2010, the largest decline rate since mid-1970 (Nikkei, 26 May 2010).

[33] Nikkei, 23 May 2010; and information from Thomson-Reuter.

[34] For example, 10 United States technology TNCs could increase their liquidity by 40 per cent in March 2010, compared to the same period of the previous year. *See:* Financial Times. Cash-rich technology groups avoid the M&A path. 26 April 2010.

[35] For example, United States firms are estimated to have reached a record high of $1.54 trillion in their financial reserves in December 2009, 21 per cent higher than one year earlier. *See:* Nikkei. 11 April 2010.

[36] UNCTAD (2010e).

[37] There were about 4,500 auto suppliers globally in 2008, compared to around 30,000 ten

years earlier. *Source*: KPMG, Global M&A: Outlook for Automotive. August 2010. Further concentration is expected.

[38] As illustrated by the acquisition of Stiefel Laboratories (United States) by GSK (United Kingdom) for $3.6 billion, the acquisition of the Arrow group (United Kingdom) by Watson Pharmaceuticals (United States) for $1.7 billion; and the acquisition of Ebewe Pharma (Austria) by Novartis (Switzerland) for $1.3 billion.

[39] One example is the recent sale of Swedish carmaker Volvo – acquired by Ford (United States) in 1999 – to Geely (China) in a deal valued at $1.8 billion**.**

[40] According to KPMG, increased M&A activity driven by companies in the Middle East and Asia could change the shape of the international chemicals industry. *Source:* KPMG (2009). Global M&A: Outlook for Chemicals. November.

[41] *Source*: Total. Press release. 11 February 2010.