Advances in Social Science, Education and Humanities Research, volume 286
3rd International Seminar on Education Innovation and Economic Management (SEIEM 2018)

Research on Outward Direct Investment in Emerging Economies

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***Abstract*—Outward direct investment from emerging economies has been increasing rapidly for the last decade. This paper analyzed the driven factors of outward direct investment from emerging economies, form both home country and host country perspective. This paper then elaborates the opportunities and risks in outward direct investment for emerging economies, and provides some policy implication. The economic growth, technology advancement, stable exchange rate, supporting policy, as well as rising cost and the regulation in home country motivate firms from emerging economies to participate in outward direct investment. The natural and strategic resources, the institutional quality, the macroeconomic scale, the labor cost of host countries attributes to decision making in outward direct investment. The multilateral cooperation, the financial support, the regional integration and international trade liberalization provide opportunity for direct investment. However, there are risks in outward direct investment, such as the macroeconomic uncertainties, the vulnerability to internal and external economic shocks, and policy and legal risks. The risk management platform for legal, financial and other advice from government, deepening multinational cooperation could help control risks and facilitate outward direct investment from emerging economies.**

Keywords—emerging economy; outward direct investment; driven factor; risk and opportunity

I. INTRODUCTION

Contrary to classical foreign direct investment theories, investment from developing countries to developed countries is growing fast, which amount has taken up half of the foreign direct investment globally. Foreign direct investment originated from emerging economies surged over the past decade. The characteristic, the mode of entry, the destination selection, the motivation, the driven factors, industry are different in outward direct investment from emerging market economies with developing countries. The emerging market economies were considered important source of economic growth in emerging economies. However, various factors of uncertainty and economic vulnerabilities in emerging economies lead to economic slowdown and risks in investment. This paper analyzes the driven factors from both home country and host country perspectives, the risk and opportunities in outward direct investment for emerging economies, and provides some policy implications. The rest of the paper is organized as follows: the second section would shed some light on the driven factors of outward direct investment from emerging economies; the third part would elaborate opportunities and risks for emerging economies to participate in outward direct investment; the fourth section would conclude and provide some policy implications.

II. DRIVEN FACTORS

A. Home country factors.

The rapid economic growth in emerging economies prepared them for international investment. Capital accumulation during macroeconomic development provides emerging economies with sufficient financial resource to invest abroad [1]. Dunning's OLI theory indicate that at certain stage of economic development, a country would have certain advantage in outward direct investment [2]. The emerging economies, such as BRICS countries have reached the level of macroeconomic development, and are well prepared for direct investment globally. From 2016, the flow of outward direct investment from emerging economies has catch up with developing countries, which counts for approximately half of the foreign direct investment. The surging amount of international trade participated by emerging economies provide the experience of international business, the knowledge of overseas business operation, the opportunities of investment with trade partners, the understanding of global market, and familiarity with rules and regulations of foreign countries. With significant difference from advanced economies, emerging economies are more likely to applicate outward direct investment as a method to avoid adverse domestic investment environment. Bypass home country regulation is one of the driven factors in outward direct investment from emerging market, such as tax planning of multinational enterprises. Business from private sector could seek overseas market to avoid unfair domestic market competition with state owned enterprises. The governance quality, consistency of regulatory rules, the transparency of policy, and the accessibility to financing could be factors driven firms to seek a more favorable operating environment in overseas market [3]. In some emerging economies and transitional economies, the governance quality are less than satisfactory, the consistency and transparency of regulation is absent, and financing difficulty is prevalent for private firms or small and medium sized firms [4]. Firms from Russia invested abroad to bypass

domestic regulation. Funds flowed into tax havens comprised of considerable share of outward direct investment of Brazil. Authorities of many emerging economies implement policies to support outward direct investment, as part of the countries' economic and internationalization strategy. In line with the "going out strategy" and the "one belt and one road initiative", a series of facilitation policies are implemented in China for promoting outward direct investment, including tax policy, financial support, regulation services. The steadiness and increasing value of currency of emerging economies is one of the driven factors for emerging economies to invest abroad. The appreciation of RMB attributes to the increase of outward direct investment from China. For industrial upgrading and transformation, corporations from emerging market would participate in merger and acquisition in developed countries to obtain advanced technology, for example, the merger and acquisition between Thinkpad and IBM, Geely Automobile with Volvo Cars. Huawei Technology has branches all over the world, with research centers in various developed countries. For marginal industrial transfer, with the disappearance of demographic dividend, China had transferred some low value added, labor intensive, polluted factories overseas, to lower costs and protect environment. Increasing cost of labor and other infrastructure facilities in domestic market has driven firms from emerging market to seek production overseas, especially in labor intensive manufacturing industry. Efficiency seeking outward direct investment from emerging market use outward direct investment as a channel to acquire strategic capital, such as advanced technology from host countries.

B. *Host country factors.*

Some research papers suggest that emerging economies are more inclined to invest in countries with poor institutional environment. The home country from emerging market tends to invest in countries with political bond, or similar institutional background [5]. The institutional factor plays more important role than other factors in outward direct investment from emerging countries, such as geographic distance, economic scale, resource and technology. However, taking other factors into consideration, such as natural resources, cultural similarity, trade connection, the negative relation between institution quality and direct investment inflow disappeared. Multinational corporations from Brazil, Mexico and Argentina are more likely to invest in Latin America. Obtaining natural resource is an important motivation in outward direct investment from emerging economies. Fast macroeconomic development lead to demand in large quantity of natural resources, of energy and raw material. However, the global downturn of commodity price contributes to the sluggish trend in foreign direct investment into countries with abundant natural resources [6]. Multinational firms from emerging economies invest aboard to obtain strategic resources, such as acquiring advanced technology from merger and acquisition with firms overseas to share copyright or patent. Multinational enterprises from information technology industry, from emerging market, such as China and India, have allocate branches and research institutions in developed countries to acquire advanced technology. Rapid macroeconomic development in emerging market demand large quantities of nature resources, while outward direct investment would be complementary to import. Tension in international trade inspired enterprises from emerging economies to invest in trade destinations, so as to bypass trade barriers and obtain higher market share in host countries. Trade barrier and recent protectionism in international trade in developed countries motivate firms from emerging economies to transfer their productions overseas. Chinese manufacture firms invested in Africa has developed large market share, such as Huajian Group in Ethiopian, which has taken up almost half of the local shoe manufacturing market. Lower labor cost in less developed countries has been attracting direct investment from firms of emerging economies. Industrial parks in some Southeastern Asian countries provide foreign investors with not only abundant low cost labor, but also benefits in rent and tax.

III. OPPORTUNITIES AND RISKS

A. *Opportunities.*

Multilateral Financial cooperation amongst emerging economies, international financial institution innovation, internationalization of financing and investment would help financial market reform and promote outward direct investment from emerging economies [7]. The establishment of new development bank, which was originally facilitate financing amongst BRICS countries, provides a platform for financing and other financial services across borders for emerging economies. Financial connections between emerging economies as well as with other countries would deepen the economic cooperation and facilitate direct investment. Interaction in international trade and other aspects of international business would boost foreign direct investment. Numerous free trade agreements had been signed between emerging economies with other developing or developed countries, or country groups. International trade prepares emerging economies for outward direct investment, while trade and direct investment could be complementary. Emerging market economies dominated Regional Comprehensive Economic Partnership would enhance economic cooperation amongst emerging economies, while the negotiation of developed countries dominated Trans-Pacific Partnership Agreement facing some difficulties. More favorable global macroeconomic environment would help facilitate outward direct investment from emerging economies. From IMF world economic outlook, the growth momentum of emerging economies from different regions is optimistic. Positive international financial market provides a channel of financing for overseas investment from emerging economies. Multiple bilateral investment treaties have been signed or updated. The political, social, economic cooperation amongst emerging market countries is deepening [5]. The cooperation in various forms has been established all over the world, regional and trans-regional, bilateral and multilateral, with emerging economies and advanced economies. Regional cooperative development, such as ASEAN, not only facilitates intra-regional foreign direct investment, but also enhances the region as integration to investment outside the region. ASEAN has played an important role in support Southeastern Asia in the global economic downturn, and succeeded in macroeconomic development, international trade development and increasing in investment, while other parts of the world are mostly facing

recession. Outward direct investment amongst countries of emerging market has been increasing for the last decade, which provides channels of financing and investment for emerging market economies, facilitates international economic interactions, and provides opportunities for diversification of industry, investment and international commerce.

B. Risks

Outward direct investment declined sharply over year 2016 and 2017, which was a universal phenomenon in different regions, country groups, industries and entry modes. Cross border mergers and acquisitions fell drastically, while green field investment also shown considerable shrink. The global value chain had been facing serious recession. As receipt countries, the inflow to developing countries shrank drastically. The manufacturing sector faces recession internationally. It would hinder outward direct investment from emerging economies, for manufacturing is an essential part in economic structure in these countries. Economic vulnerability of emerging economies, exposure to internal and external shocks and their ability to weather the shocks would influence their macroeconomic situation and their performance in outward direct investment [8]. Uncertainties in developed countries bring difficulty in international business and economic growth globally [9]. Economic cycle indicate that while developed countries are in recession, the demand of products from developing countries would decline, therefore the economic downturn would transmit from developed countries to developing countries. The rate of return on outward direct investment is low all over the world. The performance of multinational enterprises overseas is not as well as expected. On contrast to the surging number of mergers and acquisitions overseas by firms in emerging economies, the profit of parent corporations and overall macroeconomic effect in the home country underperformed. The financial risks during and after the merger and acquisition could be prominent. The integration process could bring legal, technological, human resource and other problems in operation in both firms as well. The geopolitical tensions in some regions make outward direct invest slowed down in the Caribbean, Africa and Middle East in the year of 2016 and 2017, while investment in emerging Asia is relatively stable. Multinational firms from emerging market could face political and policy risks while participate in outward direct investment. Developed countries have more strict laws and regulations regarding foreign investment since the financial crisis in 2008. Regulation in developed countries tend to hinder investment of multinational enterprises from emerging market economies in so-called strategic industries, such as information technology, electronics and other high tech industry. Huawei technology limited was blocked from mergers and acquisitions in the United States for several times. State owned enterprises could face more serious review while participate in outward direct investment, especially in strategic industry, such as natural resources and high technology industry. The tightening regulation of advanced economies has a negative impact on multinational firms from emerging market. Protectionism in international business in some developing countries brings elevated uncertainty for direct investment. Bilateral investment treaties provide some insurance against uncertainty in outward direct investment at the macro level. With the increase of international investment agreements, however, the number of international investment dispute is also increasing.

IV. CONCLUSIONS AND POLICY INDICATIONS

Outward direct investment from emerging economies has been increasing rapidly for the last decade. The economic growth, technology advancement, stable exchange rate, and supporting policy in home country promote firms from emerging economies to participate in outward direct investment. The rising cost and the regulation also motivate companies to seek overseas market. The nature resources and strategic resources of host countries attributes to location choice of outward direct investment from emerging economies. The institutional quality, the macroeconomic scale, the labor cost of host countries weights in decision making in outward direct investment. The multilateral cooperation amongst emerging economies facilitates outward direct investment. The financial support from international organizations, the regional integration and international trade liberalization also provide opportunity for direct investment [10]. However, there are risks in outward direct investment for corporations from emerging economies, such as the macroeconomic uncertainties in developed countries, the vulnerability of emerging economies in reaction to internal and external economic shocks, the geopolitical tensions in some regions and policy and legal risks. For emerging economies, the authorities could build a platform for risk management in outward direct investment, provides political, legal and financial advice for corporations invest abroad, help the corporations to establish a risk warning system in outward direct investment, and review the project more closely so as to improve cost efficiency and rate of return in the investments. At macro level, international investment treaties could be negotiated, the currency swap could be arranged, more international effort could be made to contain risks in overseas direct investment, and inject more vitality into global economy.

ACKNOWLEDGMENT

Y.Y thanks academic support from Hangzhou Institute of Service Engineering, Hangzhou Normal University.

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