Pondering FDI in Crisis: Investment Could Drop or It Just Might Rise

Karl P. Sauvant, Columbia University
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With US$1.8 trillion, world foreign direct investment (FDI) in 2007 reached an all-time high last year. All major regions benefited from increased flows. But that was then.

What is, and will be, the impact of the financial crisis and the diagnostic determinants: economic conditions, the regulatory framework and investment promotion?

If we are lucky, as far as the first of factors is concerned, global GDP will not shrink in 2009. A bit of shrinking in developed countries may be offset by expected growth in emerging markets.

Since economic growth is the single most important FDI determinant for attracting investment (developed countries received some 70 percent of FDI flows in 2007), this economic slowdown, further accentuated by the financial crisis, makes key markets less attractive to invest in — and hence depresses flows.

Even from the narrow perspective of FDI, the proposal of Jeffrey Sachs (Financial Times, October 27) and George Soros (Financial Times, October 29) on floating emerging market currencies if a global recession should be needed.

If Asian countries and especially China do as Sachs suggests, they may accelerate their outward FDI. Chinese outward FDI, for instance, was US$23 billion in 2007, was US$26 billion during the first half of 2008 alone, possibly reaching US$50-60 billion during this year.

By that potential FDI by Sovereign Wealth Funds (SWFs); so far, such sovereign FDI has barely taken off (and, in the financial world, was not very profitable).

Moreover, undervalued assets in developed countries and elsewhere beckon, helped possibly by the strong currencies of some home countries and the weak currencies of some host countries.

What this could mean is that important investors are sitting on the fence, waiting for the stock market to hit bottom, before investing.

If so, there is a chance that FDI outflows from emerging markets (which were US$300 billion in 2007) could possibly hold up, at least this year. This possibility depends on the openness of the regulatory framework for FDI, especially in developed countries.

Protectionism

While this is, grousso modo (roughly, most likely, assuredly), the mounting signs of a reevaluation of, if not distinct uneasiness about, at least certain forms of FDI.

This is reflected, among other things, in the increase of national policy changes, as well as more restrictive review processes, that make the investment environment less hospitable, especially for cross-border M&As.

A good part of such protectionist attitudes is directed against sovereign FDI by state-owned enterprises and SWFs. From emerging markets — precisely those entities that still are in a position to continue, if not increase, their outward FDI.

It is actually surprising how little FDI SWFs have undertaken so far, the skeptical attitude in developed countries partly explains this. Regulatory risk could escalate the negative economic factors. It is here where investment promotion agencies worldwide can be expected to make an extra effort to convince their governments to keep the investment climate welcoming.

(The author is executive director of Vale Columbia Center on Sustainable International Investment, research scholar and lecturer in law at Columbia Law School. The views are his own.)

Recession hits luxe-hungry low end buyers

As 2009 shapes up to be the most challenging year, for luxury times, marketers’ plans for targeting aspirational 16-year-olds are suddenly out.

After recession

US$23 billion in 2007, was US$26 billion during the first half of 2008 alone, possibly reaching US$50-60 billion during this year.

Fendi and Prada, those stores are empty. Women are shopping in their own closets. You feel shame in buying even if you can buy.

But core customers may not cut back their spending too much.

According to Randy Kabat, executive vice president of marketing and advertising for Prada USA, roughly 50 percent of the firm’s sales come from just 5 percent of its customers, although she is worried about the potential loss of some so-called “aspirational” middle-class consumers — 16-year-old girls spending a small fortune on the “it” handbag — during a recession.

Many marketers agreed that marketing and branding issues are very different in high-end luxury companies than for large mass-market consumer goods firms, which typically seek to identify scarce voids in the marketplace and then create new products in an effort to fill them.

Buying into a lifestyle

For luxury goods, they noted, the business plan places trust in the artistic vision of a designer — and hopes that will lure customers.

“One with high-end fashion, you’re buying into a lifestyle,” said Prada’s Kabat. “You’re buying into someone’s point of view, and that’s reflected in the products that are created.”

Mirucca Prada, the Milan designer who began creating the current incarnation of the company in the 1970s, is content to leave the business side of marketing new products to others so that she can focus on European runway shows, Kabat said.

That does not mean, however, that luxury firms do not want their products to reach a fairly broad audience.

Indeed, Kabat had words of praise for a trend she described as “Targetization,” in which the coast-to-coast mass retailer Target offers something of a higher

Design aesthetic to customers who are slightly more upscale than those of rival chains.

Still, she noted that the United States can develop its appreciation for good design much further.

In Europe, fashion and design are the fabric of the culture, but they are not a part of the fabric of our domestic culture.

Indeed, luxury marketers believe that their success in establishing an aura of desirability is what will ultimately get them through the financial crisis.

It may be counter-intuitive, but Abouchalach said that demand for a consumer product like Chieto cereal is finite, in a way that the need for a luxury item is not.

“When it’s a tough day and you’re on the way home and you have to buy that handbag... it’s just a different factor driving that purchase. A customer could always use another purse.”

But to boost the bottom line, fashion firms are likely to focus now on pampering their best and most loyal customers.

The success of individualized luxury goods — such as designer clothes or eyewear — is a development that could keep a customer repeatedly coming back for more.

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