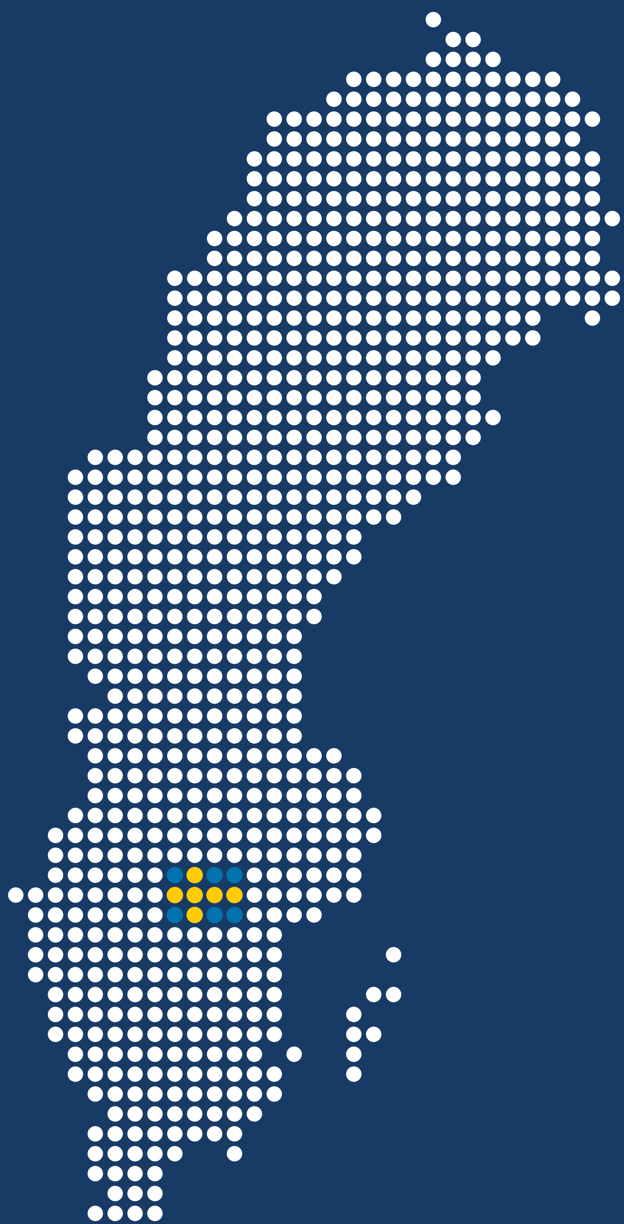
BUSINESS SWEDEN

FDI OVERVIEW 2019

DIRECT INVESTMENT IN THE GLOBAL AND SWEDISH ECONOMY



Graphic design/illustration: Business Sweden Marcom & Digitalisation
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”The fact that cross-border direct investment has stagnated over the last decade indicates that globalisation has entered a new phase.”

Lena Sellgren, Chief Economist, Business Sweden

SUMMARY

- Global flows of cross-border direct investment fell by 13 per cent in 2018, to USD 1,297 billion. In Europe, international direct investment was halved. The downturn was driven mainly by US companies' massive repatriation of accumulated profits abroad, but the fall was mitigated by a strong global market for company mergers and acquisitions.

- In 2018, the flow of foreign direct investment (FDI) into Sweden amounted to SEK 87 billion, which is a decrease of 17 per cent from the previous year and below the average for the period 2000–2018. European companies continue to dominate FDI into Sweden. The services sector accounts for 60 per cent of FDI stock. Overall, foreign direct investment stock in Sweden amounted to SEK 2,909 billion in 2017 (the latest available figure), which represents 64 per cent of GDP.

- Business Sweden's trend forecast suggests that global direct investment will be positively influenced by a continued robust – if yet dampened – development of the world economy, the internationalisation of the business community in emerging markets and the increased presence of small and medium sized companies in the international marketplace. The ongoing technology shift in manufacturing as well as countries' ambitions related to sustainable production will demand huge investments. Counterforces include rising protectionism, increased focus on near-market manufacturing as well as companies' successive reorientation towards services, which are often produced in the local market and do not necessarily require large capital investment.

- From a Swedish perspective, it is mainly the rapid internationalisation of Asia that will open new doors for investment: Swedish companies' outward investments in Asia and Asian companies' inward investments in Sweden. Asia was the recipient of 40 per cent of the global direct investment flows in 2018.

International direct investment (*foreign direct investment*, FDI, or *outward direct investment*, ODI) is defined as an investment where an investor, usually a company, directly or indirectly acquires at least 10 per cent of shares or votes in an operation located in a country other than the company's country of origin. The characteristics of cross-border direct investment – in contrast to portfolio investment – include long-term investment horizon and ownership control. Companies engage in cross-border direct investment mainly for making acquisitions, greenfield establishments or expansion investments.

Statistics on FDI in Sweden are collected by Statistics Sweden (SCB) by assignment from the Swedish Central Bank, and used in the compilation of the balance of payments and national accounts. As FDI statistics show financial transactions between the parent company and its foreign subsidiaries – which may include transactions related to company restructuring and intra-group loans – they should be interpreted with caution. The figures may also be revised at a later stage.

For a more detailed description of the FDI statistics, see Business Sweden's report *When companies invest* (2018).

For the purpose of simplifying the presentation, direct investment is alternately referred to as “investment” in this report.

All amounts are in current prices.

GLOBAL CROSS-BORDER DIRECT INVESTMENT

Behind the foreign investment decisions made by individual companies there are primarily three motives: to access new markets, lower costs, or obtain access to strategic resources. In many cases there are several motives behind an investment decision, but they vary in importance in different situations. In this context, strategic resources include, for example, talent and competencies, research and development (R&D), technology, brands and patents as well as, in some industries, raw materials such as oil, gas, minerals, and even "green" energy. For most companies, the overriding motive behind foreign investment decisions is the constant drive for increased revenue and improved profitability.

NEW CONDITIONS

The way each foreign investment project is designed is based on a combination of factors. Apart from the reasons mentioned above, it depends on the company's internal prerequisites and the nature of the business, its competitor situation, and the prevailing conditions in different markets.

Market driven, *horizontal* investment means that parts of the company's business in its home country are duplicated in one or more foreign markets.

Today's advanced technology, communications and transport also make it possible to break up the production of goods into their constituent parts and localise it geographically to countries and regions that offer good conditions for pricing, quality and availability.

These primarily cost-driven vertical investments split the production process into different stages in the value chain and exploit synergies for profit as well as differences in costs (wages, interest etc) between countries. In recent years, the pace of locating manufacturing to low cost countries has slowed, and in certain cases the whole process has been reversed. This so-called re-shoring is the result of increased automation, digitalisation, and the demand from companies' customers for innovation capacity and rapid adaptability in production as well as in deliveries.

ANOTHER WEAK INVESTMENT YEAR

Recently published statistics from the UN body UNCTAD show that global direct investment flows fell by 13 per cent in 2018 in comparison with the previous year – to USD 1,297 billion from USD 1,497 billion, see Diagram 1 on the opposite page. FDI in Europe more than halved to USD 172 billion.

The reason for the downturn is mainly that US companies repatriated large amounts of accumulated profits from abroad in the first half of 2018, to a great extent as a result of the US tax reform that was enacted in 2017. The reform contains a substantial reduction of the corporate tax rate, as well as a tax break for corporate profits accumulated abroad and which are brought back to the US in the next couple of years.

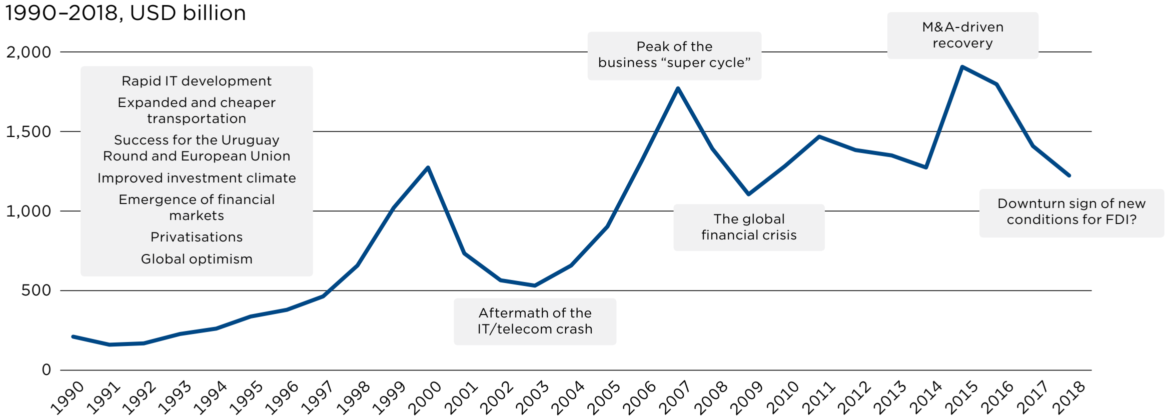
The effect of US companies' repatriation of profits is clearly visible in the FDI statistics for countries like Switzerland and Ireland (inflows of USD -87 billion and USD -66 billion respectively), where the corporate tax for foreign affiliates is advantageous. Correspondingly, these home-bound profits have an impact on US outward direct investment. In 2018, it amounted to USD -64 billion, which can be compared with the 2017 figure of USD +277 billion. More than half of the US outward direct investment stock of USD 6,500 billion is allocated to Europe.

In North America, inbound FDI decreased somewhat in 2018, by 4 per cent to USD 291 billion. By contrast, FDI inflows to Asia increased by 4 per cent to USD 512 billion. In the smaller investment regions, the development of FDI went in different directions: while FDI in South America decreased by 6 per cent to USD 147 billion, FDI in Africa instead increased by 11 per cent to USD 46 billion.

Chart 1

GLOBAL FOREIGN DIRECT INVESTMENT FALLS FOR THIRD YEAR IN A ROW

Annual inflow of foreign direct investment (globally)
1990–2018, USD billion

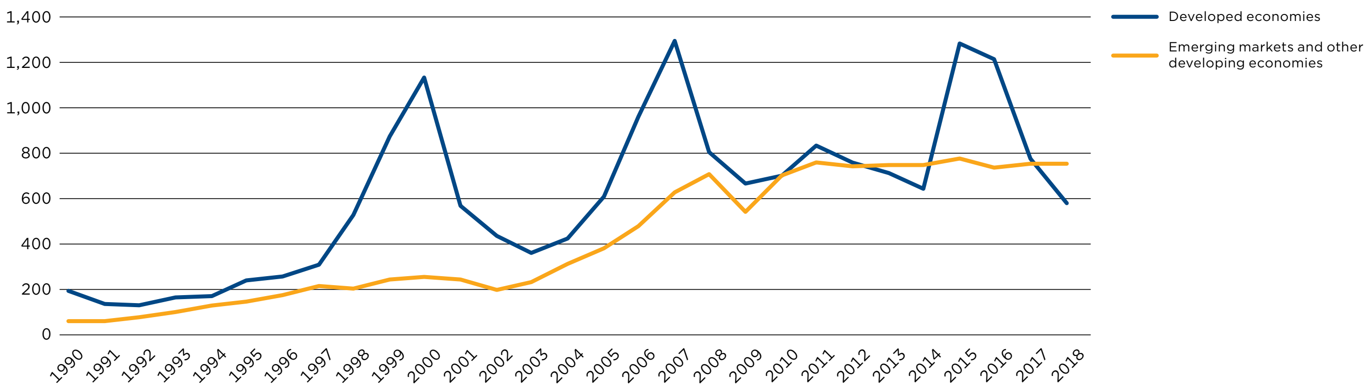


NB: M&A = Mergers and acquisitions
Sources: UNCTAD, Business Sweden (2019)

Chart 2

THE MAJORITY OF FDI IS DESTINED FOR EMERGING MARKETS

Annual inflow of foreign direct investment (globally)
1990–2018, USD billion



Sources: UNCTAD, Business Sweden (2019)

The picture of falling global direct investment is, however, not unambiguous. Some consultancy firms specialized in tracking FDI have recorded a leap in the number of companies' cross-border investment projects in 2018.

DOWNTURN EXPLAINED?

The global direct investment trend signals a stagnation that cannot be entirely explained by the business cycle. World economic growth has levelled out but is still relatively robust, and corporate mergers and acquisition activity remains high.

In the 1990s, global direct investment flows increased by an average of 21 per cent per year. Between 2000 and 2007 the increase was 8 per cent. From the onset of the global financial crisis until today the increase is only 1 per cent annually.

There may be several reasons behind the apparent stagnation. A possible explanation is that FDI transactions have become more elusive, due to the fact that financial arrangements related to – for example – company acquisitions have become more advanced. The internationalisation of capital markets has facilitated the use of local financing, which is not recorded in FDI statistics.

Another plausible explanation is related to the increased concentration of manufacturing companies' production and trade in industrial goods in the three regions North America, Europe and Asia. Companies' changing strategy of conducting more near-market manufacturing reduces the extent of off-shoring and geographical fragmentation of production.

A third explanation could be that companies' increased reorientation towards services is often executed in the local market and may decrease the necessity for large investments.

Diagram 2 above shows annual FDI inflows in developed countries and in emerging markets and other developing countries. While corporate FDI in developing countries has mainly been used for establishing a market presence and building new production capacity long-term, the investment peaks in the years 2000, 2007 and 2015 show that high mergers and acquisitions activity will have a marked impact in the FDI statistics for developed countries.

FOREIGN DIRECT INVESTMENT IN SWEDEN

Since the middle of the 1990s, Sweden has been a significant host country for foreign direct investment. A large number of domestic and international factors interacted to promote an interest in Sweden among foreign investors. Sweden's membership in the EU in 1995 as well as a period of considerable deregulation and privatisation of previously state-controlled businesses, gave foreign companies new incentives to exploit the potential for investments in Sweden.

IMPACT OF THE BUSINESS CYCLE

The structural prerequisites for international business have, in combination with Sweden's domestic attractiveness, contributed to the strong increase in the presence of foreign businesses. But the level of annual FDI inflows in Sweden also rises and falls in line with the economic cycle. The varying investment levels reflect the fact that companies tend to expand their activities and take on new markets in good times (when prices are also often higher), while their enthusiasm for foreign expansion cools when times are worse.

Diagram 3 below shows how the annual inflows of FDI in Sweden vary with the so-called GDP gap, which shows the difference between actual and potential GDP. When the curve is above the zero mark, Sweden's economy is in an expansionary phase, and vice-versa. However, FDI inflows fell in 2017 and 2018, contrary to what could be expected given the robust growth of the Swedish economy in the same period. FDI in Sweden amounted to SEK 87 billion in 2018, which is below the average for the period 2000–2018.

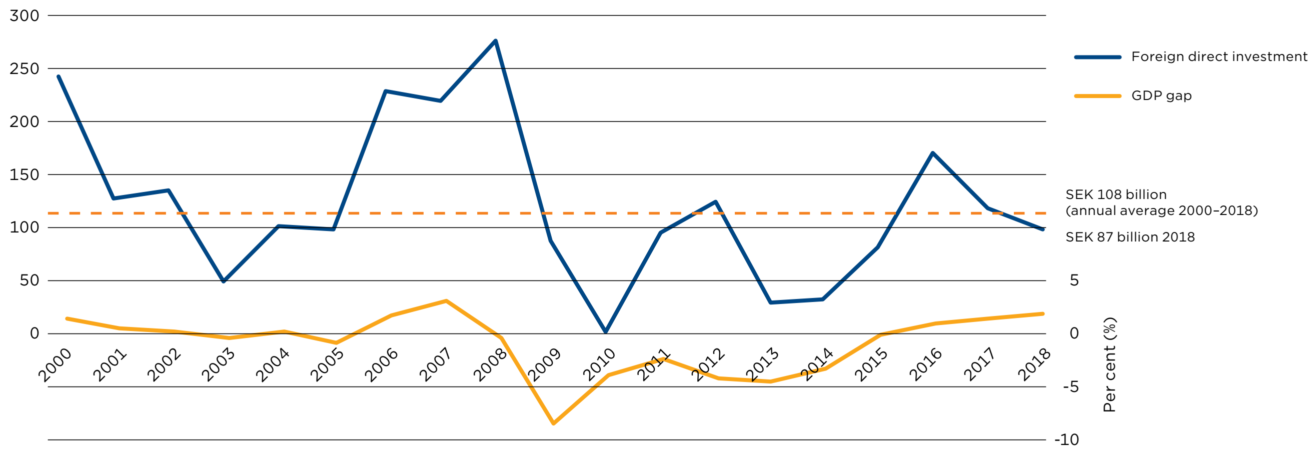
The fact that Sweden has one of the world's most internationalised economies contributes to boosting the inflows of FDI, since profits made by Swedish subsidiaries are regularly reinvested in their operations. These reinvestments are recorded as FDI inflows to Sweden.

Foreign companies in Sweden employ some 680,000 people, accounting for 39 per cent of all employees in manufacturing and 20 per cent of employees in the services sector. Many for-

Chart 3

SWEDEN IN LINE WITH GLOBAL DROP IN FDI

Annual inflows of foreign direct investment and GDP gap in Sweden 2000–2018, SEK billion and per cent



NB: The figure for foreign direct investment 2018 is preliminary and may be revised
Sources: Statistics Sweden, National Institute of Economic Research, Business Sweden (2019)

eign-owned Swedish subsidiaries are investment-heavy operations with a Swedish origin such as ABB, AstraZeneca, Volvo Cars and Scania.

EUROPEAN COMPANIES DOMINATE

As Diagram 4 below shows, it is mainly companies from the Nordic region and other major European countries that have a presence in Sweden. The importance of American companies has diminished over the past decade, whereas Asian companies – primarily Chinese and Indian – have increased their presence in Sweden considerably over the same time period, albeit from low levels. The acquisition by Hitachi, a Japanese conglomerate, of ABB Power Grids in 2018 signifies a substantial increase of Japanese business interests in Sweden.

It should be noted that holding companies in primarily Luxemburg and the Netherlands appear, on paper, to be major investors in Sweden, but that in most cases, the controlling parent company is located elsewhere, sometimes even in Sweden.

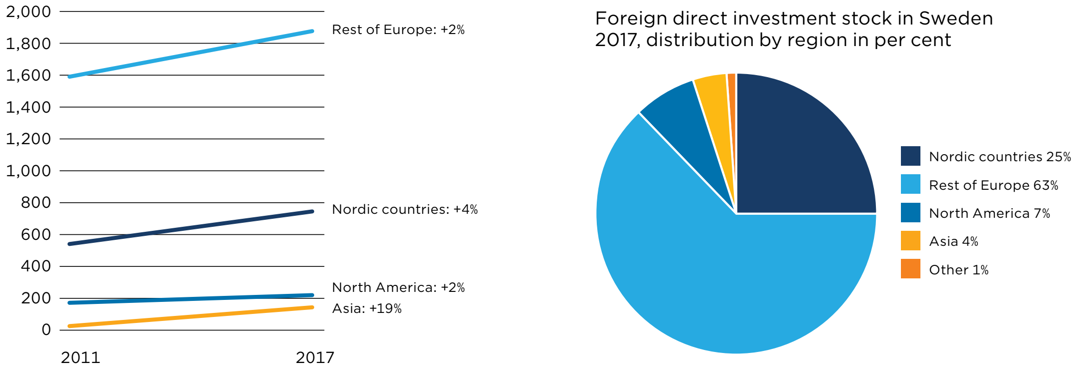
Of total FDI stock in Sweden, 60 per cent is allocated to the services sector and 40 per cent to manufacturing, see Diagram 5 below. In the services sector, it is mainly finance and insurance (SEK 465 billion), trading and retail (SEK 373 billion) and energy, water and recycling (SEK 206 billion) that attract foreign investors. FDI stock in manufacturing amounted to SEK 1,181 billion in 2017. This includes sectors such as chemicals and pharmaceuticals (SEK 442 billion), food (SEK 207 billion) and automotive (SEK 178 billion), see Diagrams 6 and 7 on next page.

Diagrams 8 and 9 at the bottom of next page show regional shares and the most important recipient countries for FDI in 2018. Sweden was the 24rd largest recipient in 2018, which signifies a marginal drop from 23[rd] place in 2017.

Chart 4

EUROPEAN COMPANIES LEAD THE WAY

Foreign direct investment stock in Sweden
2011–2017, SEK billion and average annual growth in per cent

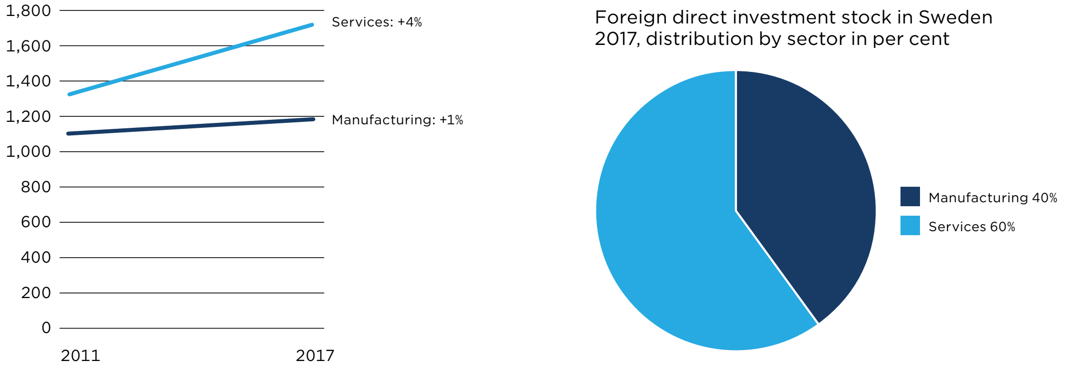


NB: Total foreign direct investment stock in Sweden increased from SEK 2,463 billion in 2011 to SEK 2,909 billion in 2017
Sources: Statistics Sweden, Business Sweden (2019)

Chart 5

SWEDEN'S SERVICES SECTOR ATTRACTS LION'S SHARE OF FDI

Foreign direct investment stock in Sweden
2011–2017, SEK billion and average annual growth in per cent

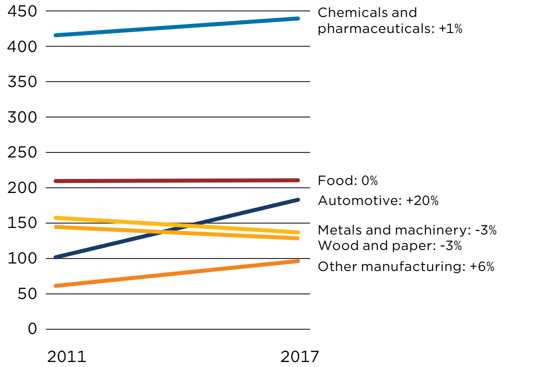


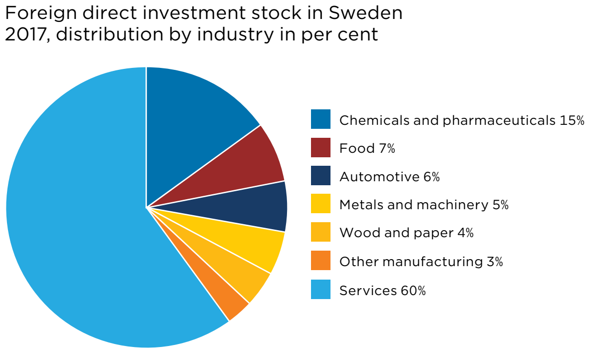
NB: The figures do not include FDI stock in agriculture and mining which amounted to SEK 14 billion in 2017
Sources: Statistics Sweden, Business Sweden (2019)

Chart 6

SWEDEN'S AUTOMOTIVE SECTOR ON THE RISE FOR FDI ...

Foreign direct investment stock in Sweden
2011–2017, SEK billion and average annual growth in per cent



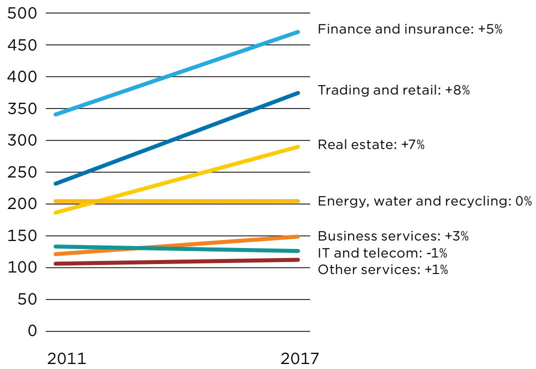


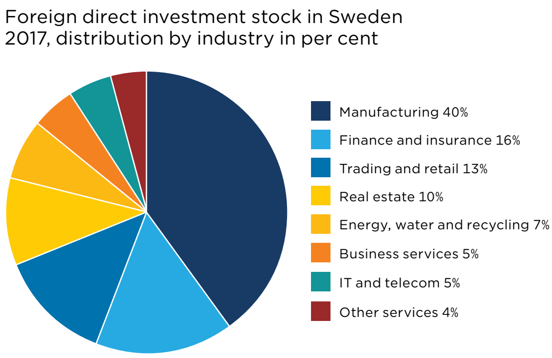
Sources: Statistics Sweden, Business Sweden (2019)

Chart 7

... AS ARE SEVERAL SERVICES INDUSTRIES

Foreign direct investment stock in Sweden
2011–2017, SEK billion and average annual growth in per cent



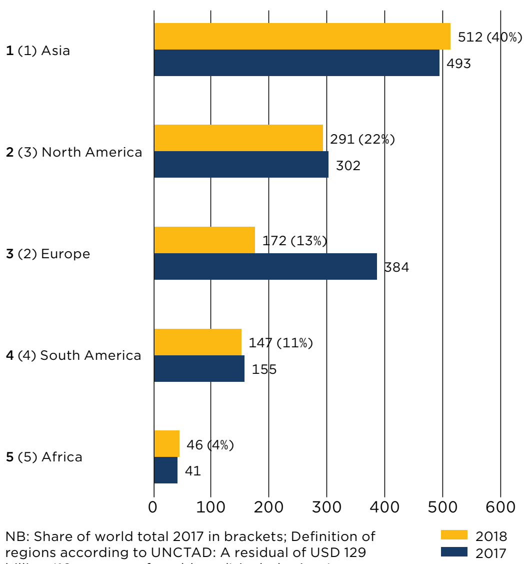


Sources: Statistics Sweden, Business Sweden (2019)

Chart 8

TOP 5 REGIONS

Inflow of foreign direct investment 2017 and 2018, USD billion and share of total in per cent

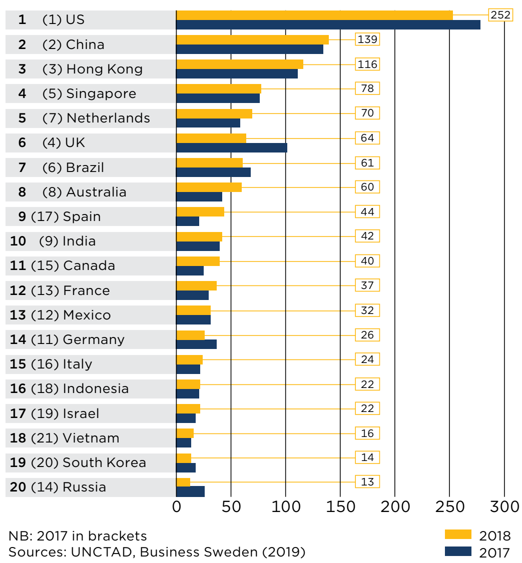


NB: Share of world total 2017 in brackets; Definition of regions according to UNCTAD: A residual of USD 129 billion (10 per cent of world total) includes i.e. Japan, Australia, Russia and parts of Central Asia
Sources: UNCTAD, Business Sweden (2019)

Chart 9

TOP 20 COUNTRIES

Inflow of foreign direct investment
2017 and 2018, USD billion



NB: 2017 in brackets
Sources: UNCTAD, Business Sweden (2019)

FOREIGN DIRECT INVESTMENT TO 2025

As Diagram 10 below illustrates, Sweden is today highly internationalised in terms of the size of the FDI inward stock in relation to GDP. The downward trend since 2009 reflects the fact that foreign assets have grown only slowly at the same time as the Swedish economy has been in a period of strong growth.

Business Sweden's forward glance towards 2025 identifies the following factors that will influence global direct investment.

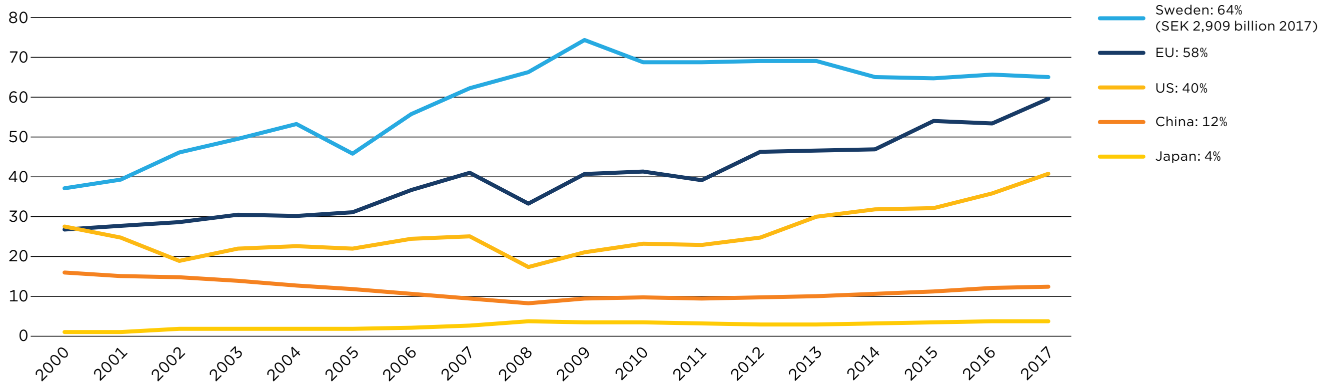
- Global economic growth has levelled out but will remain positive in the near and medium term, which provides a good basis for a robust development of cross-border direct investment. After many years of under-investment there is an accumulated need for investment particularly in Europe and many emerging markets, in sectors such as manufacturing, agriculture and infrastructure. The technology shift in manufacturing and countries' heightened ambitions related to the environment and sustainable production will require large investments. If the Trump administration's investment program for US infrastructure becomes a reality, it may also create opportunities for foreign investors.

- As Business Sweden states in its report *The Services Revolution – a global opportunity for Sweden and Swedish companies* (2018), manufacturing and international trade will become increasingly service-oriented. This means that future international expansions will rarely be about large capital investments in machinery and equipment. Meanwhile, the FDI figures can soar as a result of cross-border acquisitions of highly valued companies in the services sector.

- New conditions for the manufacturing industry will slow the pace of locating production in low wage countries, which has been a main driver behind the strong FDI increases in recent decades. Increased auto-

Chart 10

SWEDEN'S ECONOMY IS HIGHLY INTERNATIONALISED
Foreign direct investment stock as share of GDP
2000–2017, per cent



Sources: Statistics Sweden, Oxford Economics, UNCTAD, Business Sweden (2019) mation, digitalisation and the demand from customers for a high level of innovation and the ability to quickly adapt to change, make it less interesting for companies to handle intermediate goods with extensive delivery distances. Business Sweden highlights these new prerequisites in its new report *Altered playing-field for manufacturing* (2019).

- The internationalisation of the business community in emerging markets and other developing countries will continue at a rapid pace, which increases global direct investment. Diagram 11 below illustrates the foreign expansion of Chinese companies since 2000. China, in its capacity as the investing economy, was in 2nd place after Japan in a ranking of the most important countries for outward direct investment in 2018.

- The expansion of Chinese companies has prompted negative political reactions in primarily advanced economies, coupled with the lack of reciprocity in investment policies as well as the perception that Chinese companies compete under unfair conditions, supported economically by the Chinese government. Going forward, these reactions may be converted into concrete policies – the US administration's recent actions against Huawei, a Chinese telecom company, is an example of this – and create a counterweight to the ongoing globalisation of the business community. In April this year, the EU adopted a common framework for the monitoring of non-European acquisitions of European companies.

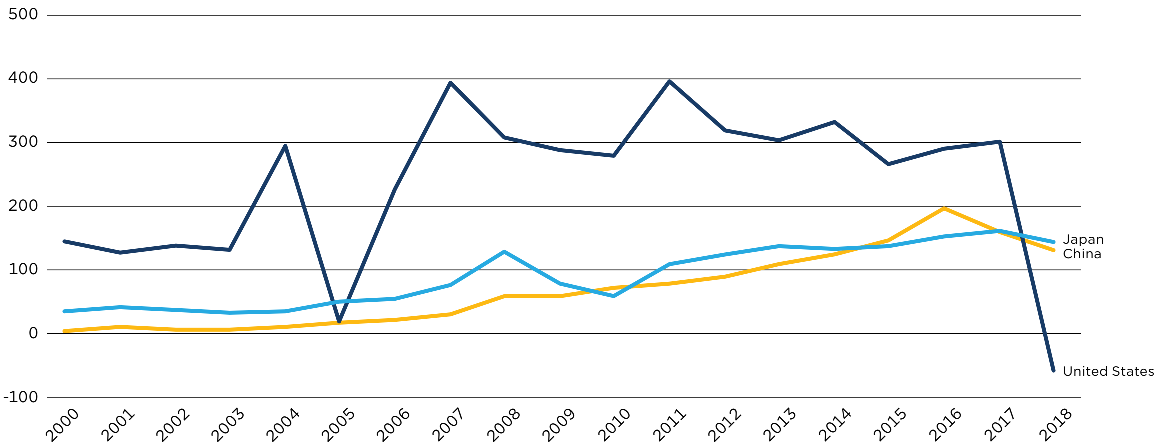
- The fact that small and medium sized companies will become internationalised faster and to a greater degree than at present will have a certain positive impact on figures relating to international direct investment. The trend towards *open innovation* – whereby large companies invite smaller companies to partake in their research and innovation environments – will be intensified.

- From a Swedish perspective, the rapid internationalisation of Asian industry gives rise to new opportunities to attract Asian companies looking to establish a presence in Europe. Also, the UK's impending exit from the EU (Brexit) may result in certain new opportunities for foreign direct investment in Sweden.

Chart 11

US INVESTMENTS FALL BELOW CHINA AND JAPAN

Annual outflow of direct investment from the United States, Japan and China
2000–2018, USD billion



NB: The substantial fall in US companies' outward investment in 2018 is due to the repatriation of accumulated profits in foreign markets, a result of the US tax reform in 2017
Sources: UNCTAD, Business Sweden (2019)

Sources:

National Institute of Economic Research
Statistics Sweden (SCB)
Swedish Agency for Growth Policy Analysis

fDi Markets
Mergermarket
Oxford Economics
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