THE IMPACT OF COVID-19 ON FOREIGN INVESTORS: EVIDENCE FROM THE SECOND ROUND OF A GLOBAL PULSE SURVEY

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KEY FINDINGS

Based on the latest results of a quarterly survey of multinational enterprise (MNE) affiliates in developing countries:

- The adverse effects of the COVID-19 pandemic became near-universal for MNE affiliates over the second quarter (April to June) of 2020, with over 90 percent experiencing some adverse effects. More than 80 percent of MNEs saw their net income decline, by an average of 37 percent, while two-thirds decreased investment and over half reduced employment in developing country affiliate operations.
- MNEs expect pandemic-induced shocks to ease over the third quarter (July to September) of 2020 as economies gradually reopen and companies adjust to new market conditions. Over half of respondents still expect adverse income effects, but the anticipated magnitude of effects is less severe. MNEs report an improved outlook for supply chain reliability, possibly signalling adaptation and resilience.
- MNEs also report an improved outlook for supply chain reliability, possibly signalling adaptation and resilience. Over half of MNEs (58 percent) have turned to digital technologies. Some are diversifying suppliers (37 percent) and production sites (18 percent). There are early signs that some firms are shifting production closer to consumers by nearshoring or reshoring (14 percent).
- Only about a third of MNEs affiliates have received COVID-19-related support from host governments, and some MNEs report receiving less support than domestic firms. This could be due to ineligibility based on ownership status, firm size, or other factors, or gaps in information and implementation.
- There are signs that FDI operational and entry rules (including screening and approvals) are becoming more restrictive, which could limit the scope for FDI to be able to contribute to a robust economic recovery in developing countries.

INTRODUCTION

The COVID-19 pandemic has had a profound impact on the global economy, triggering the deepest global recession of the past eight decades. Together, the crisis and public health response have caused both a severe supply shock in the form of reduced worker availability and supply chain disruptions, and a massive demand shock as consumption became restricted and confidence fell. The World Bank forecasts a 5.2 percent contraction in global GDP in 2020, including a 2.5 percent decline in emerging markets and developing economies (World Bank 2020).

Multinational enterprises (MNEs) have experienced successive and cascading effects from these demand and supply shocks, with significant implications for foreign direct investment (FDI). In the short term, there has been a large reduction in FDI activities, with the number of greenfield project announcements from January to May 2020 down 50 percent on the same period in 2019, and M&A transaction values also down 50 percent.[i] Global FDI flows, which peaked at USD 2 trillion in 2015, are expected to decline significantly further, to just USD 1 trillion in 2020 (UNCTAD 2020).

Depending on the course of the pandemic, the global economic recession could be protracted, further disrupting cross-border trade, investment, and global supply chains. At the same time, some governments have adopted or are considering policies that make rules for FDI entry more restrictive (UNCTAD 2020). As a result, the long-term future for FDI is uncertain as MNEs make changes in their business operations and possibly revisit production locations, supply chain sourcing, and investment allocations across regions.

FDI plays a key role in countries' economic development and is often the largest source of external finance for many developing countries — greater than remittances, private debt and portfolio equity, or official development assistance (Kusek, Saurav and Kuo 2020). FDI can boost developing countries' economic resilience and ease the economic fallout of the coronavirus crisis.

ABOUT THE SURVEY

The survey was administered using a short web-based survey sent to a wide sample of known MNE email addresses. The period of data collection was July 1 – August 26, 2020. The resulting sample comprises 78 MNE affiliates (companies with foreign owners) operating in 30 developing countries. The results of the pulse survey are not generalizable to all developing countries but are directionally indicative of the experience of MNEs operating in developing countries.

During the recovery from COVID-19, higher FDI inflows can ease capital constraints, contribute to output and employment growth, and increase aggregate productivity through positive productivity spillovers and technology transfers.

Given the importance of FDI to the crisis and recovery, the World Bank Group's global Investment Climate Unit is conducting quarterly 'pulse' surveys of foreign investors to gauge the effect of the pandemic on foreign investors. The results of the first round, for the first quarter of 2020, were published in April 2020 (Saurav, Kusek, and Kuo 2020). Survey data showed that more than 80 percent of MNEs had been adversely affected, with four in five experiencing reduced revenues and profits and three in four experiencing a decline in supply chain reliability. A vast majority of MNEs (85 percent) expected conditions to worsen in the second quarter of 2020.

A second round of the pulse survey, representing the second quarter of 2020, was administered in July-August 2020. In addition to the coverage of the actual effect of the pandemic on businesses in the past 3 months and the likely effect of the pandemic in the next 3 months, the second round of the survey also covers adjustments in business strategy and changes to the policy environment for entry and operations of MNEs.

[i] Based on World Bank analysis of fDi Markets (greenfield FDI) and Thompson Reuters (M&A) data.

A GROWING BODY OF EVIDENCE

Other organizations have also attempted to assess the effects of the pandemic on business decisions and investment by directly asking global corporate decision makers using business surveys. These have provided useful real-time insights, including:

- In an initial March survey, YPO's global survey of chief executives* found that 51 percent of global CEOs viewed the pandemic as a severe business risk. In their June update to the survey, 64 percent of COEs reported their business outlook had become more negative since March and 48 percent anticipated continuing negative effects on revenues over the coming year (Sigmond 2020). Further, 39 percent expected their total number of employees and total fixed investment to be down more than 10 percent in a year's time.

- PricewaterhouseCoopers (PWC) also updated their survey of global CFOs in June**, finding that 51 percent of CFOs expect a decline in revenues and/or profits of more than 10 percent as a result of the crisis (PWC 2020). Over 90 percent of respondents indicated that capital expenditure investments were the most likely to be deferred or cancelled as companies adjust to the crisis.

- In a series of surveys conducted by McKinsey between March and July***, the share of executives expecting a global economic contraction in the next six months has declined slightly but remains at 44 percent (McKinsey 2020). Likewise, the share of companies expecting profits to decrease has declined consistently since April (when it was above 60 percent) but remains at 37 percent.

The World Bank's quarterly global pulse survey contributes to this growing body of evidence by focusing on affiliates of MNEs operating in developing countries.

* A global survey of chief executives who are members of YPO, a community/organization of chief executives spanning about 130 countries. Results are based on the second round of the survey in May 2020 which included more than 2,700 respondents from 100 countries. More information: https://www.ypo.org/2020/06/business-outlook-improves-among-global-chief-executives-in-latest-ypo-survey/.

** A global biweekly survey of finance leaders. Results are based on the June 15th, 2020, round of the survey which included more than 980 respondents from 23 countries. More information: https://www.pwc.com/gx/en/issues/crisis-solutions/covid-19/global-cfo-pulse.html.

*** A global survey of business executives. Results are based on the July, 2020, round of the survey which included more than 2,110 respondents. More information: https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/the-coronavirus-effect-on-global-economic-sentiment.

EFFECTS OF COVID-19 ON FOREIGN INVESTORS IN THE PAST THREE MONTHS (APRIL-JUNE 2020)

The first global pulse survey indicated a severe effect of COVID-19 on MNEs, with 80 percent reporting reductions in revenues and profits in the first quarter of 2020. Eighty-five percent of respondents expected adverse effects on revenue and profit to continue through the second quarter of 2020.[ii]

These findings were further supported by public announcements: the majority of the world's 5,000 largest MNEs revised their earnings expectations between February and May 2020, with an average downward revision of 36 percent (UNCTAD 2020). Results from the second round of the global pulse survey confirm these findings.

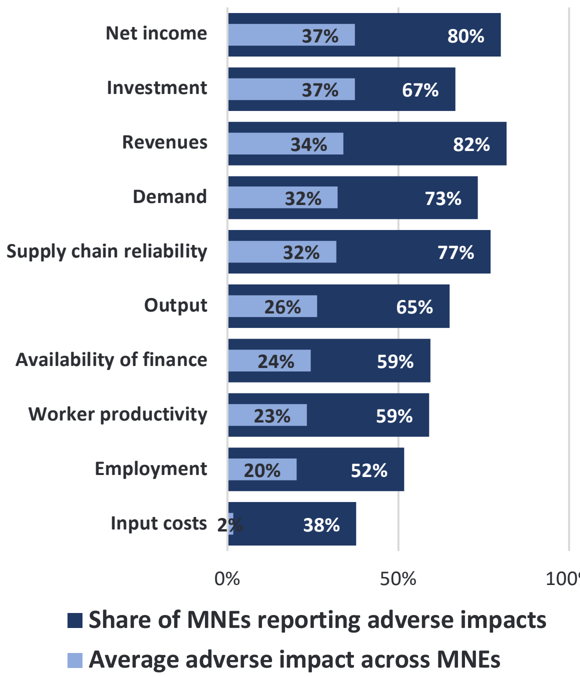
Data from the second round of the survey suggest that the adverse effects of the COVID-19 pandemic became near-universal for MNE affiliates over the second quarter of 2020, with 94 percent experiencing some adverse effects. The demand and supply shocks in the first half of 2020 have resulted in sizeable declines in income and revenues for over 80 percent of MNEs. The average declines in the second quarter of 2020 are 37 percent and 34 percent, respectively.

On the demand side, the crisis has reduced demand for three in four MNEs, with demand down by a third on average. On the supply side, three in four MNEs have experienced a decline in supply chain reliability, limiting access to raw and intermediate inputs essential to production. About 60 percent of MNEs report an average 23 percent decline in worker productivity. Firm production has adjusted accordingly, with two-thirds of MNEs reporting an average reduction of output by a quarter.

Consistent with the "wait and see" approach in the face of heightened business uncertainty, survey data suggest that MNEs are delaying or canceling planned investments. In the second quarter of 2020, two-thirds of MNEs have reduced investment in developing country operations, with an average decline of 37 percent. More than half of MNEs continue to be adversely affected through lower availability of finance and have reported reducing their employment by 20 percent on average.

Figure 1: The adverse effects of the COVID-19 pandemic are now near-universal for MNEs

Question: Over the last 3 months (April-June 2020), what has been your company's actual experience, as compared to what would have been expected without COVID-19?



Source: Computation based on the July-August 2020 Investor Confidence Pulse Survey.

[ii] Sample differences mean that these results are not directly comparable to expectations for the second quarter that MNEs reported in the first pulse survey. Full results from the first round of the pulse survey are available in the analytical report at https://openknowledge.worldbank.org/handle/10986/33774 and associated blog post at https://blogs.worldbank.org/psd/impact-coronavirus-foreign-investors-early-evidence-global-pulse-survey.

ANTICIPATED EFFECTS OF COVID-19 ON FOREIGN INVESTORS IN THE NEXT THREE MONTHS (JULY-SEPT 2020)

Looking ahead, the economic outlook remains uncertain and depends on how the pandemic, its economic effects, and policy responses evolve. The uncertainty weighs on businesses as they assess mechanisms to survive the immediate disruption, adapt to changed market conditions, and recover from the shocks of the pandemic.

Responses to the second global pulse survey indicate that MNEs expect both the intensity and prevalence of pandemic-induced shocks to ease in the third quarter of 2020. As economies gradually reopen and companies adjust to new market conditions, this outlook may reflect MNEs' confidence in their resilience and ability to adapt in the face of a sustained disruption.

While survey data show that over half of all MNEs still expected income and revenues to be adversely affected, this represents a marked improvement compared to results in the first and second quarters of 2020, when more than 80 percent of MNEs were adversely affected. The average expected impact on income and revenues is also less than half of the negative impact in the second quarter.

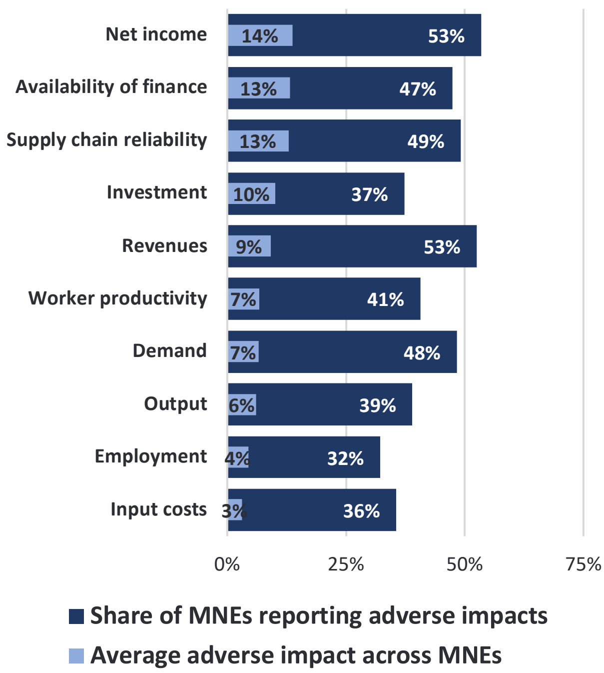
MNEs expect a modest recovery in demand with only about half projecting demand to be lower than normal in the third quarter (down from three in four in the second quarter). The anticipated magnitude of effect is also less severe, as compared to the effect in the first and second quarters of 2020.

Supply-side constraints are also expected to ease in the third quarter of 2020. A smaller share of firms reported concerns about supply chain reliability and worker productivity going forward, with expected impacts in these areas far milder on average when compared to impacts experienced in the first and second quarters.

The outlook for investment and production reflects the expected recovery in demand and easing of supply-side constraints. Less than 40 percent of firms expect to curtail investment or experience lower production in the third quarter (down from three in four in the second quarter).

Figure 2: MNEs expect the intensity and prevalence of pandemic-induced shocks to ease, signaling adaptation and resilience

Question: Over the next three months (July-Sept 2020), what is likely to be your company's experience, as compared to what would have been expected without COVID-19?



Source: Computation based on the July-August 2020 Investor Confidence Pulse Survey.

CHANGES TO BUSINESS STRATEGY IN RESPONSE TO COVID-19

Even before the pandemic struck, foreign investors faced significant business pressures, including changing patterns of industrialization, rising economic nationalism, and a growing emphasis on environmental sustainability (Kusek, Saurav, and Kuo 2020). The crisis has forced even more significant and rapid changes to business strategy, including finding ways to manage production disruptions and scale up digital solutions.

Over the long-term, MNEs may also consider structural changes to their supply chains to diversify risk and increase resilience. The second round of the global pulse survey investigates the strategies that firms have employed to counter the effects of COVID-19.

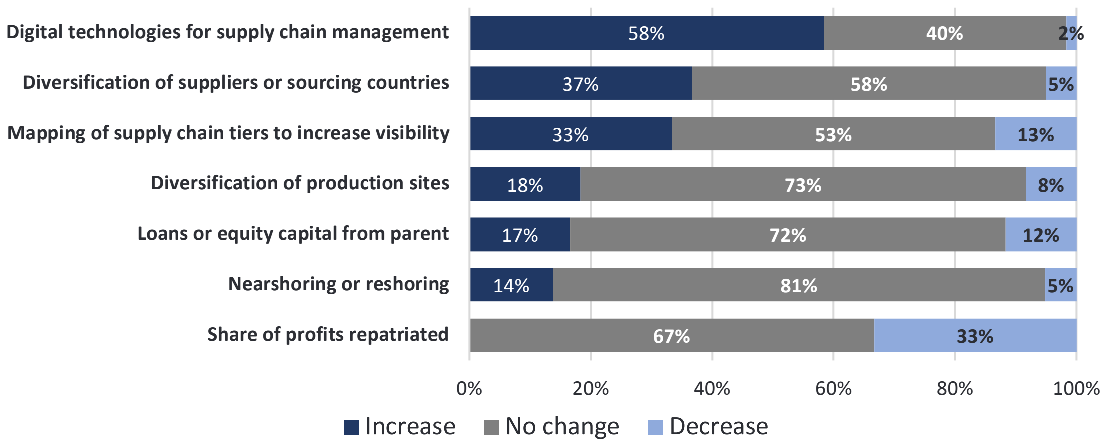
Survey data show that three in five MNEs report adopting digital technologies to improve their supply chain management. These technologies include data science applications, distributed ledgers, automation of tasks and processes, and the internet of things. These technological solutions enable global businesses to optimize capacity, maintain inventory, and manage logistics. Relatedly, a sizeable share of respondents (33 percent) report taking steps to better understand their tiered structures of suppliers (such as through supplier mapping), and thus gain greater visibility into potential vulnerabilities of their supply chains.

A substantial share of MNEs (37 percent) are undertaking more significant adjustments to their supply chains, diversifying their suppliers or countries from which they source products and services. About one in five respondents is undertaking changes to diversify production locations. A small but significant share (14 percent) reported shifting production sites closer to consumers by nearshoring or reshoring.

Major changes to global value chains such as diversification and geographic relocation of production sites are likely to take time to implement, so it is possible that the early trends identified in this survey data will strengthen. If this eventuates, the implications for global trade and investment are likely to be significant.

Figure 3: MNE responses have focused on supply chain optimization and resilience

Question: To counter the effects of COVID-19, how has your company adjusted its business strategy?



Source: Computation based on the July-August 2020 Investor Confidence Pulse Survey.
Note: for these questions no time period was specified.

GOVERNMENT SUPPORT FOR FOREIGN INVESTORS

In responses to the first global pulse survey, investors indicated that tax relief, financial support such as loans and grants, and relaxed labor and business regulations would be the most important areas of government support for MNEs. Over subsequent months, many countries around the world have instituted business support programs to counter the adverse economic impact of the pandemic (see IMF 2020).

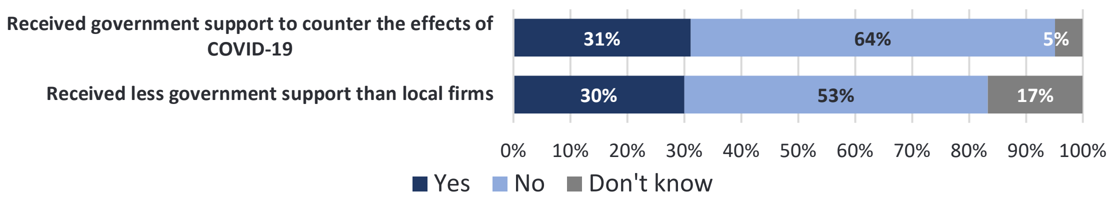
Despite the high demand for government support and prevalence of policy responses, results from the second global pulse survey indicate that two-thirds of MNEs have not received any government assistance to counter the effects of the pandemic. A sizeable share of MNEs (30 percent) also report receiving less government support as compared with local businesses (non-MNEs).

For those respondents that believed that they received less support, the primary reasons cited include that MNEs are typically not eligible for support (53 percent). This may be due to foreign ownership restrictions applied to government support policies and programs, or other eligibility criteria such as company size or industry that may rule out MNE affiliates.

Respondents also cited having less information about government support (35 percent) or being eligible but less favored as compared to local firms (24 percent), as common reasons for receiving less support. These results highlight the need for fair implementation and wide dissemination of information about support policies to ensure MNEs are fully able to access the support available.

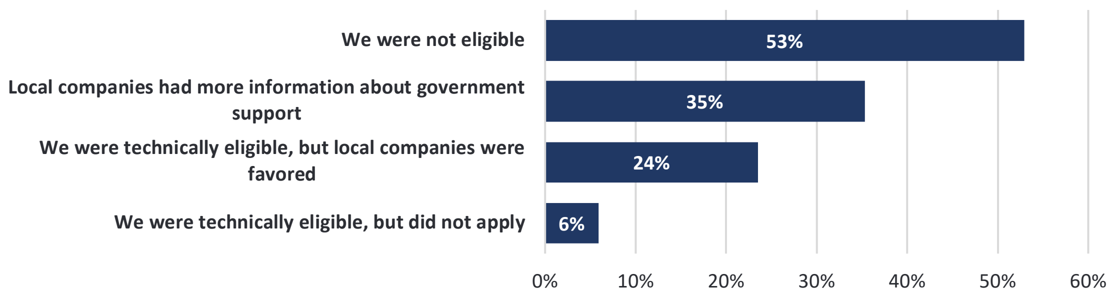
Figure 4: Many MNEs have received little or no government assistance

Question: Has your company received any national or local government support to counter the effects of COVID-19 on your business?



Of companies that indicated they received less support (n=17):

Question: If your company recieved less support, why has your company received less support from the government as compared to other local companies (non-MNEs) in your industry?



Source: Computation based on the July-August 2020 Investor Confidence Pulse Survey.
Note: for these questions no time period was specified.

THE CHANGING POLICY ENVIRONMENT FOR FOREIGN INVESTMENT

Business support policies and programs have not been the only policy response to the pandemic affecting MNEs. Many governments have been introducing changes to foreign investment rules over recent months. Among developed economies, the EU introduced new guidance on FDI screening in March 2020 that emphasizes protecting strategic health-related industries, and countries including France, Germany, the United Kingdom, Australia, and Canada have all tightened their FDI screening regimes. China, India, and South Africa have all also made changes.

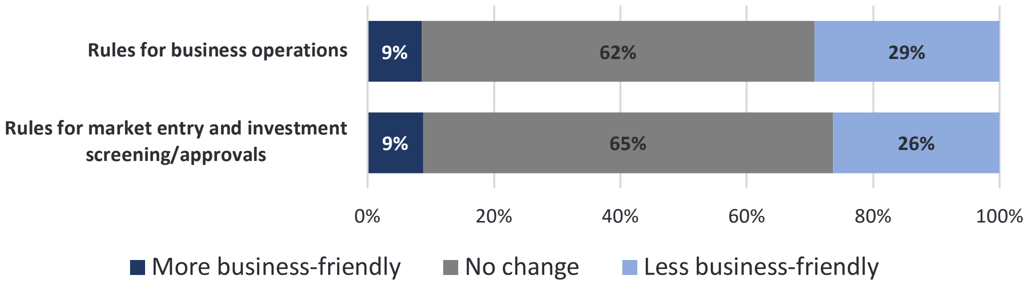
The move to a more restrictive regulatory environment for FDI continues a trend of rising protectionism that started with withdrawals from trade and investment agreements in recent years and includes a rise in the number of new policy measures restricting investment, often related to national security (UNCTAD 2020).

Results from the second global pulse survey demonstrate that MNEs are witnessing these changes to the business environment first-hand. Over a quarter of MNEs indicated that rules for business operations and market entry for foreign investors have become less business-friendly in their country of operation as a result of COVID-19.

While the majority of MNEs reported no change, and a small number (9 percent) reported improvements, the evidence of tightening of FDI rules in some countries accords with wider trends. A more restrictive policy environment for foreign investors could limit the scope for FDI to be able to contribute to a robust economic recovery in many countries.

Figure 5: MNEs report that foreign investment rules are becoming more restrictive

Question: As a result of COVID-19, how has the policy environment for foreign investors/MNEs changed in your country of operation?



Source: Computation based on the July-August 2020 Investor Confidence Pulse Survey.

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