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

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Abhishek Saurav, Peter Kusek, Ryan Kuo
Global Investment Climate
World Bank Group

WORLD BANK GROUP

KEY FINDINGS

The prevalence of pandemic-induced shocks is increasing, exacting an unusually high toll on MNEs:

- In the last 3 months, the pandemic has affected 80% of MNEs. On the supply side, three in four MNEs report a decline in supply chain reliability. On the demand side reduced final and intermediate consumption has reduced revenues and profits for four in five MNEs. Consequently, more than 60 percent of MNEs are experiencing decline in liquidity of about 28% on average.
- In the next 3 months, the impacts are likely to become more prevalent: More than 85% of surveyed MNEs expect deteriorating business operations.
- Over the next 3 months, most rapidly intensifying effects are slated to be with respect to Availability of Finance / Liquidity (13pp); Investment (12pp); Employment (9pp).

MNE responses point to three high-priority areas of rapid-response policy support, namely:

- Providing tax relief (including tax cuts, tax credits, deferred payments);
- Catalyzing financial support (special low-interest lines of credit, grants, broad-based subsidies, and loan guarantees) to counter the liquidity crunch; and
- Relaxing labor or business regulations to reduce costs, support recovery, respond to changing world of work.

INTRODUCTION

The COVID-19 pandemic has severely impacted multinational enterprises (MNEs) globally. Existing global value chains (GVCs) on which the majority of MNEs rely have been disrupted, and a series of demand and supply shocks threaten the viability of many businesses. The pre-COVID-19 global environment for foreign direct investment (FDI) was already characterized by rapidly eroding investor confidence due to trade and investment policy uncertainty, flagging global growth, falling commodity prices, and rising protectionism. The COVID-19 crisis presents a new, unprecedented source of investor risk that is depressing investor confidence.

Recent business surveys have attempted to assess the effects of the COVID-19 pandemic on businesses and future investment by directly asking corporate decisionmakers:

- YPO's global survey of chief executives[2] shows that more than half (51%) of respondents view the pandemic as a severe business risk. Risk perceptions are high in Africa (68%), Middle East and North Africa (61%), Asia (54%), and Latin America (53%). Globally, 11% of chief executives report that businesses survival is a risk over the next year. This risk is most severe in the hospitality/restaurant (41%), aerospace/aviation (30%), education (19%), and retail and wholesale sales (19%) sectors. In emerging markets, revenue declines are reported by respondents in India (54%), Mexico (50%), and Brazil (34%). About 35% and 25% of respondents globally expect declines exceeding 20% in total fixed investment and employment.
- A PricewaterhouseCoopers (PwC) survey of global CFOs[3] finds that over two-thirds (70%) of CFOs are greatly concerned about the effects of the pandemic on their operations, with 80% expecting a decrease in revenues. Respondents are focusing on containing operations costs (77%) and deferring or cancelling planned investments (65%). The effects on the workforce are likely to materialize through temporary furloughs (42%) and layoffs (28%) over the short term. Several businesses (45%) plan to leverage government support, mainly related to tax deferrals and deadline extensions.
- Mercer's live global survey[4] to assess the impact of the pandemic on businesses finds that 87% of respondents anticipate moderate to high impacts on their financial performance. 27% of respondents reported that workforce productivity had been negatively impacted and was lower than normal.

To complement these insights and assess the impact of the pandemic on MNE affiliates in developing countries, the World Bank Group conducted a foreign investor pulse survey in March 2020. This survey covered three components: the actual effect of the pandemic on businesses in the past 3 months, the likely effect of the pandemic in the next 3 months (forward-looking), and areas for policy support measures.

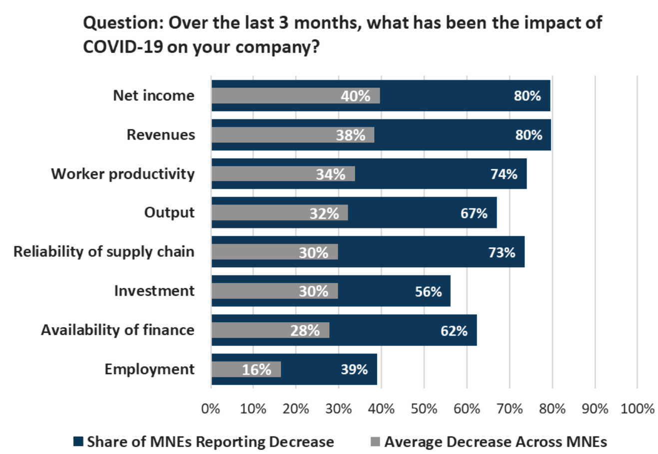
EFFECTS OF COVID-19 ON FOREIGN INVESTORS IN THE LAST THREE MONTHS

Within a short period of time, the COVID-19 pandemic has subjected MNEs to a series of adverse shocks. Over 60 percent of the world's 100 largest MNEs have made downward revisions to their earnings projections (UNCTAD 2020). Relatedly, the top 5,000 MNEs, which account for a significant share of global FDI, have revised their 2020 earnings estimates downwards by 30% on average.

Survey data show that the successive and cascading effects of the pandemic-induced demand and supply shocks on MNEs in developing countries is acute (Figure 1). Demand has fallen sharply due to mobility restrictions, precautionary behavior, and high uncertainty. Reduced consumer spending and corporate orders have depressed MNE sales, especially in sectors such as travel, tourism, entertainment, and construction. Nearly four in five MNEs report reductions in **revenues and profits**, on average by about 40 percent. The pandemic is also affecting the **availability of finance** for businesses, with over half of all respondents (62 percent) are experiencing reduced availability of finance.

On the supply side, three in four MNEs report declines in **supply chain reliability**, hampering their access to raw and intermediate production inputs. On top of direct pandemic-related impacts, access to inputs is likely further disrupted by the inability of suppliers to meet contractual obligations, rising freight costs, and competitors paying premiums to build input reserves. In addition, declines in worker health, restrictions on movement, and alternative work arrangements (e.g., remote work and distributed work locations) have required a shift away from 'normal' work environments, adversely affecting **worker productivity**. More than 70 percent of MNEs report an average 34 percent decline in worker productivity. The aggregate effects of these shocks include average reductions of roughly one third in **output** (experienced by two thirds of businesses)[1] and **investment** (experienced by 56% of businesses). The shockwaves are also reaching companies' workforces: Two in five businesses report declines in **employment**, on average by 16 percent.

Figure 1. The COVID-19 pandemic has already adversely affected a vast share of MNEs



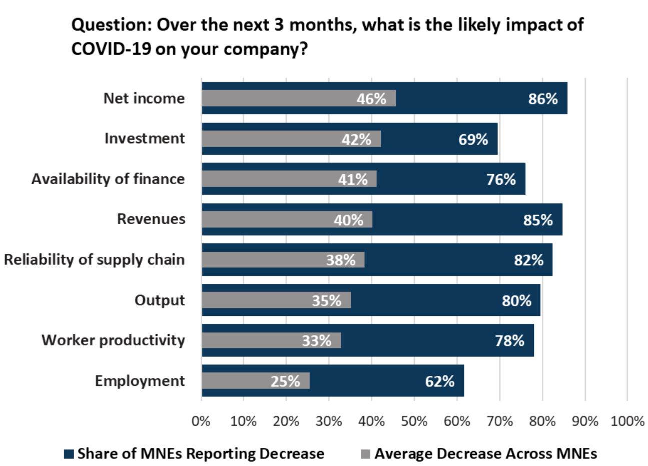
Source: Computation based on the March-April 2020 Investor Confidence Pulse Survey.
Note: The reference period of last three months ranges approximately from January to March 2020.

[1] The decline in production output registered in survey data may have fallen not only in response to lower demand and supply constraints, but also due to the fall in commodity prices resulting from lower industrial demand.

ANTICIPATED EFFECTS OF COVID-19 ON FOREIGN INVESTORS IN THE NEXT THREE MONTHS

Even more worrisome than the effects experienced during the last three months are companies' expectations about the next three months (roughly April – June 2020), with performance anticipated to deteriorate along every single measured dimension (Figure 2): More than 85% of surveyed businesses expect that their **revenues and profits** will decline, on average by more than 40%. Four in five businesses expect an average 35% reduction in **output**. Impacts are particularly likely to worsen with respect to **employment**: Three in five business expect to reduce employment, on average by a 25%. In addition to the likely downsizing of the workforce, the most precipitous declines are anticipated in the **availability of finance** (by 41%) and in **investments** (by 42%).

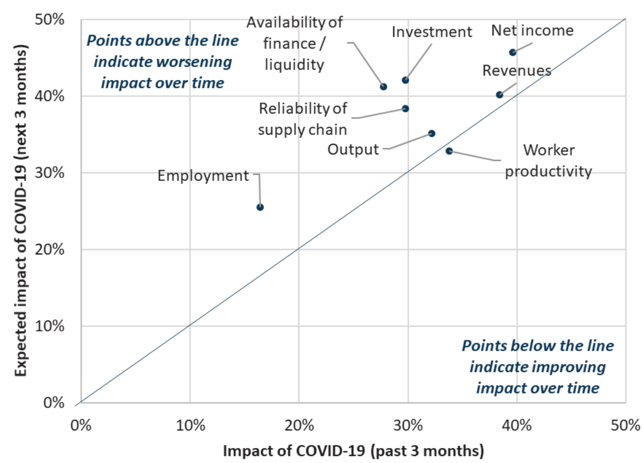
Figure 2. The prevalence of pandemic-induced shocks is likely to increase



Source: Computation based on the March-April 2020 Investor Confidence Pulse Survey.
Note: The reference period of next three months ranges from April – June 2020.

In addition to the increase in prevalence of pandemic-induced shocks affecting MNEs, a major cause for concerns is that the effects are intensifying, i.e. driving deeper over time (Figure 3). Beyond the effect already actualized in the first quarter of 2020, MNEs report further deterioration on almost all metrics covered in the pulse survey. The most precipitous anticipated declines are predicted in the reduced **availability of finance** / **liquidity** (13pp), likely driven by falling revenues and diminishing profits. Similarly, **investments** are reported to further decline by 12 percentage points driven by increasing uncertainty. And as businesses face limited ability to afford the pre-crisis wage bill and reduce demand for labor as production falls, employment is likely to decline. Businesses report a further 9 percentage point decline in **employment** over the next three months.

Figure 3. The adverse effects are likely to intensify over the next three months



Source: Computation based on the March-April 2020 Investor Confidence Pulse Survey.
Note: The reference period of last three months ranges approximately from January to March 2020 and next three-month ranges from April – June 2020.

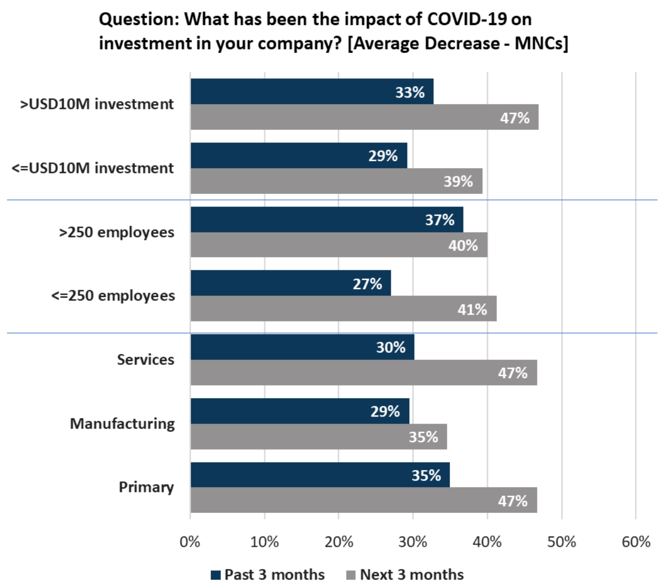
INVESTMENT OUTLOOK IN TIMES OF HEIGHTENED UNCERTAINTY

Several aspects of the pandemic (e.g., its continued spread and the development of treatments) remain uncertain, and no consensus exists regarding how long the pandemic will continue to arrest economic activity. The limited ability to forecast the likelihood of future events and outcomes has meant that business uncertainty has spiked (Bloom 2014; Knight 1921). This uncertainty is reflected in the high values registered in 2020 in the World Pandemic Uncertainty Index (Ahir, Bloom, and Furceri, 2018).

The heightened uncertainty is likely to translate into additional coordination and transaction costs as MNEs re-assess business models under new market conditions. Driven by increasing business uncertainty, MNEs are likely to adopt a "wait and see" approach and delay or cancel planned investments, which otherwise would have occurred towards maintaining production capacity and technological upgrades.[6]

Well over half of all MNEs report having reduced investments in their operations in the last three months, with a decline of 30 percent on average (Figure 1). Larger investors, with over USD 10 million in host economies have experienced a 4-percentage point larger decline in investments (Figure 4). This difference is expected to further increase to 8 percentage points in the next 3 months. In the last three-month period, the services and manufacturing sectors have experienced similar magnitudes in average investment decline (about 30 percent). Given the sharp decline in commercial activity in services sectors such as travel, tourism, food service, and entertainment, the effects are expected to further intensify to an average 47 percent decline over the next three months.

Figure 4. High uncertainty is resulting in steep decline in investments



Source: Computation based on the March-April 2020 Investor Confidence Pulse Survey.
Note: The reference period of last three months ranges approximately from January to March 2020 and next three-month ranges from April – June 2020.

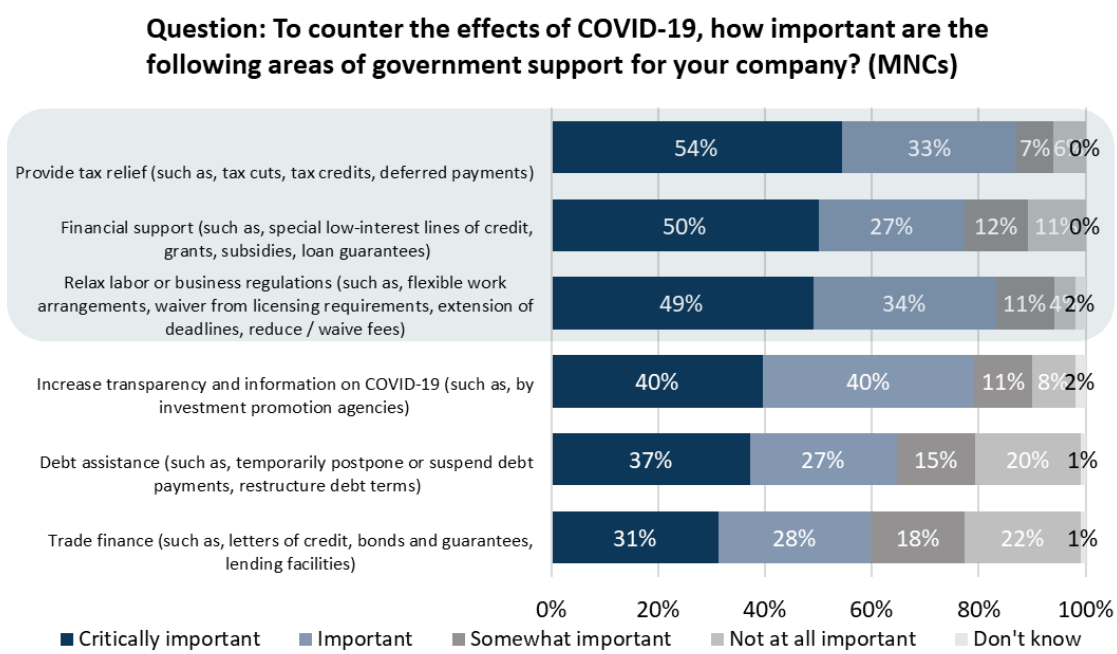
The gloomy outlook shared by survey respondents is consistent with emerging evidence on declining investment activity. In February 2020, new cross-border acquisitions fell below US$10 billion from the normal monthly average of US$40-50 billion[7]. Estimates from UNCTAD (2020) suggest that global FDI can decline up to 40 percent in 2020. The world's largest 5,000 MNEs, who account for a significant share of global FDI, have revised their earnings estimates downwards by an average of 30%. Since a major share of FDI materializes through reinvestment earnings, reduced earnings in MNEs will limit re-investments.

CRITICAL AREAS OF POLICY SUPPORT

Recognizing the urgency of the situation not just for MNEs but for the private sector overall, governments around the world have begun instituting active fiscal policy measures nearing USD 8 trillion (IMF 2020). Fiscal support has typically included tax relief (tax cuts, tax credits, VAT exemptions, deferred payments), wage subsidies, and capital support to vulnerable businesses. Simultaneously, several central banks have eased monetary policy to maintain market liquidity and provide relief to lending institutions and borrowing businesses (IMF 2020). Monetary policy measures have typically included reduction in interest rates, regulatory forbearance, loan guarantees, and financing and credit provision for businesses. The World Bank Group foreign investor pulse survey confirms the critical nature of these measures for foreign businesses. The pulse survey results point to three high-priority areas of rapid-response policy support (Figure 5):

- *Providing tax relief* (including tax cuts, tax credits, deferred payments) is important or critically important for nearly 9 in 10 businesses. Consistent with similar "keep the lights on" support provided to businesses to stay afloat during previous crises, providing tax credits, waivers, deferrals, VAT exemptions, and reduction in social security contributions can go a long way in stabilizing the private sector.
- *Catalyzing financial support* to counter the liquidity crunch caused by falling cash flows and access to financing is viewed as important or critically important by more than 75 percent of surveyed MNEs. These support programs could include special low-interest lines of credit, grants, broad-based subsidies, or loan guarantees. Extending support to businesses adversely affected by falling sales or supply-side shocks can mitigate the effects of the pandemic and improve investor confidence.
- *Relaxing labor or business regulations is considered important or critically important* by more than 80% of the surveyed businesses. Regulatory flexibility to reduce costs and support recovery could include fee waivers and reductions for standard business permits and licenses, extension of deadlines for regulatory filings (e.g., tax filings), and new regulations to respond to the changing world of work characterized by flexible and remote work arrangements.

Figure 5. Demand for Policy Support: Tax Relief, Financial Support, Relax Regulations



Source: Computation based on the March-April 2020 Investor Confidence Pulse Survey.

As the COVID-19 pandemic spreads and its economic impact deepens, governments must act resolutely and effectively in order to maintain private sector vitality and to restore investor confidence. It is important that the measures they deploy are *timely, time-bound, targeted,* and *transparent*. Right now, governments have to do all they can to limit the health, economic, financial, and corporate distress. The prospects for recovery rest squarely on the breadth and depth of policy support extended to the private sector in the face of these unprecedent global shocks. Governments will also have to begin planning for the next phase of economic policies to steer the economy back to a new normal.

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[1] Such as, lower demand for goods and services from consumers and producers; changing consumption behavior; labor and skills shortage; lower worker productivity; reduced access to raw and intermediate inputs due to disrupted supply chains, among others.

[2] 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 mid-April 2020 and includes more than 3,500 respondents from 109 countries. More information: https://www.ypo.org/2020/04/latest-ypo-survey-explores-covid-19-business-outlook/

[3] A global biweekly survey of finance leaders. Results are based on biweekly updates as od April 28th and April 14th, 2020 and includes more than 800 respondents from over 20 countries. More information: https://www.pwc.com/gx/en/issues/crisis-solutions/covid-19/global-cfo-pulse.html; https://www.pwc.com/gx/en/issues/crisis-solutions/covid-19/global-cfo-pulse/april-14.html

[4] A global live survey results are effective as of April 27th, 2020 and are automatically updated with new data. Results are based on more than 700 respondents. More information: https://www.mercer.com/our-thinking/career/covid-19-global-survey-coronavirus-impact-to-global-market.html

[5] This short, English-language, web-based survey was sent to known email addresses of MNEs, leveraging existing sampling frames for developing countries. To extend reach, the survey was also circulated through countries' Investment Promotion Agencies (IPAs) to known foreign investors. The period of data collection was March 24 – April 24, 2020. Data underlying the analysis comprise 105 MNE affiliates from 26 developing countries. The results of the pulse survey are not generalizable to all developing countries but are indicative of the experience of MNEs operating in developing countries.

[6] Investment in MNE affiliates comprise capital allocation by parent firms and reinvestment of profits from host country operations.

[7] Thomson Reuters Refinitiv Mergers and Acquisitions Database. https://www.refinitiv.com/en/financial-data/company-data.

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investmentclimate@worldbank.org