Forfás Statement on Outward Direct Investment

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Forfás

Background

Inward Foreign Direct Investment (FDI) has played a significant role in the rapid economic growth which Ireland has experienced over the past decade. While indigenous enterprises have traditionally engaged overseas markets through exports, they are increasingly expanding their commercial presence and activities into overseas markets in the form of outward FDI or 'Outward Direct Investment' (ODI).

In 2001, Forfás published a 'Statement on Outward Direct Investment', which examined the scale and nature of the emerging trend of ODI from Ireland. Six years on, Ireland is rapidly becoming a net international investor as outward investment levels exceed inward investment. In this context, and in light of concerns about the possible impact ODI (and particularly off-shoring) may have on the economy, this 2007 Statement on ODI provides an update on current trends in Irish ODI, and presents the findings of recent Forfás research into the economic impact of ODI by Irish firms.

In its broadest form, ODI refers to the investment by Irish enterprises in foreign enterprises and commercial assets. Such investment can take several forms, including the establishment of a ‘Greenfield’ operation in an overseas location, a merger with or acquisition of an existing overseas enterprise, or the establishment of a joint venture in an overseas location.

In general, companies engage in ODI with the objective of enhancing corporate profitability. More specifically, companies are motivated to engage in ODI for one or more of the following reasons:

- To pursue foreign market opportunities;
- To access productivity enhancing factors of production (e.g. skilled labour, low cost raw materials, labour, etc.); and
- To maintain the international competitiveness and long run survival of the company.

Profile of ODI from Ireland

The stock of ODI from indigenous Irish firms rose by almost 325% between 2000 and 2005.[1] Ireland became a net international investor for the first time in 2004 as investment outflows exceeded inflows. This rapid growth in outward investment from Ireland contrasts with the global trend in overseas investment which experienced modest growth over the period (Table 1).

Table 1: Growth in the Stock of Global and Irish ODI 2000-2005

	2000	2001	2002	2003	2004	2005
Global ODI Stock $Bn	6 471	7 011	7 684	9 046	10 325	10 672
% change on previous year		8%	10%	18%	14%	3%
Irish ODI Stock $Bn	27.9	40.8	58.8	74.4	104 .9	117. 9
% change on previous year		46%	44%	27%	41%	12%

Source: UNCTAD World Investment Database

[1] The stock of ODI indicates the value of fixed and current assets and investments in overseas subsidiaries from a country.

Research published by Forfás in March 2007 shows that ODI activity being undertaken by Irish enterprises is principally directed towards Western European countries (58% of investments), and the UK in particular[2]. Eastern Europe is the second most important destination for Irish ODI, followed by North America (see Table 2 overleaf). Interestingly, relatively little ODI by Irish firms has been directed to the developed and developing Asian economies to date.

While a broad range of Irish enterprise is now investing overseas, the bulk of ODI is being undertaken by firms in a relatively small number of sectors. The 'Business & Financial Services' sector is the largest source of Irish ODI, accounting for approximately 21% of investments. The 'Food & Beverage' sector is the second largest source of ODI from Ireland, followed by the 'Property, Tourism & Leisure' sector. These three sectors alone account for approximately 57% of Irish ODI. Other sectors which heavily engage in ODI include the 'Heavy Industry' sector and the 'ICT sector' (see Table 3 below).

Table 2: Destination of Irish ODI 2002-2006

	2002-2006	
Region	**No of Investments**	**%**
Africa	6	3%
Developed Asia Pacific	6	3%
Western Europe	123	58%
Developing Asia Pacific	13	6%
Eastern Europe	31	15%
Latin America	7	3%
Middle East	3	1%
North America	23	11%

Source: LOCOmonitor (2006)

[2] O'Toole, R. (2007), "Outward Direct Investment and Productivity", in "Perspectives on Productivity", Forfás

Table 3: Sectoral Composition of Irish ODI 2002-2006

	2002-2006	
Industry Sector	**No of Investments**	**%**
Business & Financial Services	44	21%
Chemicals, Rubber & Plastic	12	6%
Consumer Products	2	1%
Electronics	2	1%
Food, Beverages & Tobacco	14	7%
Heavy Industry	38	18%
ICT	27	13%
Life Sciences	9	4%
Light Industry	13	6%
Logistics & Distribution	2	1%
Property, Tourism & Leisure	31	15%
Transport Equipment	18	8%

Source: LOCOmonitor (2006)

Manufacturing is the most common form of activity undertaken by overseas subsidiaries of Irish firms (approximately 26% of overseas affiliates). This is followed by 'business services' (21%) and construction (12%). Interestingly, there are a number of foreign affiliates engaged in R&D activities (3%), Logistics (7%) and Sales & Marketing (8%).

Economic Impacts

While Ireland has been a significant beneficiary of globalisation over the past decade, more recent trends have raised concerns amongst the public and policy makers about the potential negative impacts of globalisation on employment in Ireland.

Although the economic benefits of export activity from Ireland are well understood, the net implications of ODI for the Irish economy have only recently received detailed scrutiny. In order to better inform policy makers and the enterprise development agencies, Copenhagen Economics ApS was contracted to undertake quantitative (econometric)[3] and qualitative research to estimate the direct and indirect costs and benefits that accrue to the Irish economy from indigenous firms engaging in ODI.[4]

The research identified a range of direct and indirect costs and benefits resulting from ODI which impact the firm itself, its stakeholders and the Irish economy as a whole. These costs and benefits are profiled in Appendix I.

[3] Econometrics is the application of statistical mathematical methods to describe the relationships between economic forces such as investment, employment, interest rates, etc.

[4] The full report can be accessed on the Forfas website at http://www.forfas.ie

Measurable Impacts

Combining literature review, case study and econometric analysis, the research arrives at the following findings in relation to measurable impacts:

- On average, ODI has a positive impact on the domestic employment levels within investing firms, and mildly positive employment spillovers for enterprises in related up and downstream industries.[5]
- There is a positive correlation between ODI intensity by companies and changes in the skills profile within those companies, indicating a growth in the share of high skilled employees in their domestic operations.
- ODI is correlated with a positive impact on the productivity of the investing firm, although there appears to be no discernable spillover impacts (positive or negative) on the productivity of other firms in the economy.
- The impact of ODI on the profitability of investing firms and on other firms in the economy is hypothesised to be positive. However, due to data constraints, econometric analysis to validate this proved inconclusive.

Overall the research concludes that ODI by indigenous firms has a net positive impact on the economy (see Table 4, below). However, the employment churn resulting from ODI can have specific implications for those in low skilled employment, particularly in regional locations.

Table 4: Summary of measurable economic effects of ODI

Impact of ODI on:	Investing indigenous Irish firm	Other indigenous firms	Net effect on the economy
Employment	Increases	Increases mildly	Positive
Productivity	Increases	Unchanged	Positive

Source: Copenhagen Economics

It is important to note that while every effort has been made to refine the econometric analysis, it is extremely difficult to prove causation. To a certain extent, the higher levels of productivity and employment experienced by firms engaging in ODI relative to those non-ODI firms may be a function of better management and competitive advantages within these overseas investing enterprises, rather than the ODI itself.

[5] Spillovers refer to secondary side effects that impact on other enterprises in the economy.

Summary & Conclusions

The level of overseas investment by Irish businesses has increased rapidly in recent years, a trend likely to continue for the foreseeable future as the Irish enterprise base matures. Outward direct investment is a logical and inevitable stage in the international expansion of an enterprise, driven by competitive forces and customer demands.

To date, the majority of ODI from Ireland has been directed to the UK and Western Europe, although going forward investment flows to Eastern Europe and Asia are likely to steadily increase. These overseas investments are predominantly made by enterprises in Business & Financial Services sectors, the Heavy Industry sector, and the Property, Tourism and Leisure sector. As ODI becomes more prevalent, we are likely to see other industry sectors leverage opportunities through overseas investment.

The econometric and case study analysis undertaken by Copenhagen Economics illustrates that ODI has an overall positive impact on the economy. This does not ignore the potential costs that offshoring can have for workers in low value/skilled employment who are made redundant (and their local communities).

In our globalised economy, the State cannot prevent these negative side effects of a predominantly positive phenomenon. Instead, the State can focus its efforts on stepping up supports for vulnerable workers to enhance their portfolio of skills, so that all workers can benefit from the opportunities that ODI presents.

Appendix I: Profile of Benefits and Costs

Positive effects of ODI at firm level

Potential impact	Benefit to the investing company	Role of ODI in creating the benefit
High	Increased revenues from market expansion	ODI gives access to new consumer markets for existing products.
	Strengthened relations with key clients	Some Irish firms invest overseas in order to develop their relationship with overseas clients. Stronger relations to the client may trigger the development of new products and services via innovation. Furthermore, going abroad can be the only option for Irish suppliers when a large international customer leaves Ireland. In such cases, going abroad can help partially sustain Irish operations.
	Cost savings on labour and input costs	ODI allows companies to access lower cost factors of production (land, labour, technology, capital, etc). This can improve the productivity or profitability of an enterprise. Cost savings from international investments have been crucial for sustaining the Irish operations of a number of indigenous enterprises.
	Source new talent and technologies	ODI can be undertaken solely for the purpose of accessing specific knowledge or technology not available in Ireland. If such knowledge or technology is successfully repatriated, it can improve employment, productivity and profitability.
Medium	Repatriated profits	Profits generated abroad can be repatriated home and used for investment or distributed as dividends. While most of the interviewed companies have stated profit repatriation is their goal, it takes time for foreign operations to become profitable. Profits earned may be used to finance organic growth of the foreign operations.

Negative effects of ODI at firm level

Potential impact	Cost to the investing company	Role of ODI in creating the cost
High	Increased risk exposure	Operating abroad subjects the company to new sources of country-specific risk.
Medium	Technology poaching	Core competencies of Irish companies may be stolen by foreign competitors. Foreign competitors can then challenge the Irish company both in the domestic as well as foreign market.
Low	Start-up costs abroad	Start-up costs abroad are large and foreign establishment is risky. The emergence of new business risks can be costly for Irish companies without prior experience with ODI.
	Higher HQ overheads	Foreign establishment in almost all cases increases headquarter overheads. If not controlled, higher costs of doing business at home can jeopardise the viability of foreign operations.
	More demand for intermediation	Going abroad may increase the demand for downstream and/or upstream intermediation services, such as supply or distribution.

	Transportation costs	Foreign investment increases transportation costs. Where this is an issue (e.g. countries with poor transport connections to Ireland), the parent company stands to lose.
	Loss of local networks and creation of new ones	ODI involves discontinuing relations with existing networks, such as suppliers and distributors. Concurrently, new networks must be created, which is costly and risky, in terms of contracting.

Positive Economy Wide Impacts of ODI

Potential impact	Benefit on the economy - level	Role of ODI in creating the benefit
High	More employment in high-value added functions	By becoming more productive, ODI firms create high-value adding jobs in the economy. Creation of such jobs is desirable as they are sustainable.
	Supporting new investment in Ireland	Case evidence points to ODI being complementary to new investment in Ireland. Although companies may shut down their productive assets in Ireland, and invest abroad, the successful ones are found to generate sufficient investment in Ireland to offset the negative effects.
Medium	More income and corporate taxes	Greater profitability of ODI companies will increase government revenue from corporate tax. Greater employment will increase revenue from income tax. In Ireland, the latter effect appears more important, as discussed later.
	Stronger comparative advantages	Companies successful with their ODI are more competitive internationally. Greater competitiveness of individual Irish companies translates into strengthening the Irish comparative advantages stemming from specialisation.
	Facilitating knowledge spillovers in the IT sector	The IT industry appears to be positively affected in terms of the potential for knowledge spillovers. Case evidence shows examples where such spillovers have taken place, resulting in the creation of new successful Irish IT companies.
Low	Better recognition of Ireland abroad	The ‘country-of-origin’ effect may boost demand for Irish products from overseas. Furthermore, successful presence of Irish companies abroad makes it easier for other companies to follow suit.

Negative Economy Wide Impacts of ODI

Potential impact	Cost	Driver
High	Loss of jobs in lower value activities	ODI frequently results in low value added activities being relocated offshore – with a loss of jobs in the home country. The negative consequences are borne by a range of stakeholders, spanning employees to local communities.
	Economic insecurity and instability of employment	The possibility of moving workplaces outside of Ireland may instil feelings of insecurity and instability among employees.
Medium	Foregone profit tax revenues	Locating offshore companies may seek the possibility of tax diversion, e.g. through the use of transfer pricing schemes. While collecting information on this issue is difficult, the low Irish corporate tax rate is likely to mitigate against this.
	Less demand for intermediation	Irish companies may choose to internalise certain functions previously provided by Irish suppliers or distributors engaged in international activities.
	'Made in Ireland' threatened	Investing abroad for cost optimisation purposes threatens the perception of the quality of Irish products.
	Market structures more concentrated	By becoming more productive and increasing scale, ODI companies may displace smaller domestic competitors.
Low	Regulatory 'race to the bottom'	Sustaining workplaces in Ireland is a political objective. ODI companies may use their bargaining power to lobby for favourable regulation in particular areas, in exchange for sustaining jobs.