Pondering FDI in crisis: Investment could drop or it just might rise

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WITH US$1.8 trillion, world foreign direct investment (FDI) flows 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 recession on FDI flows this year and next?

Several forces are at work, best discussed in terms of the three sets of FDI determinants: economic conditions, the regulatory framework and investment promotion.

If we are lucky, as far as the first set 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 FDI flows.

Even from the narrow perspective of FDI, the proposals by Jeffrey Sachs (Financial Times, October 27) and George Soros (Financial Times, October 29) on avoiding a global recession should be heeded.

If Asian countries and especially China should further stimulate domestic demand, it would be even more attractive for multinationals to increase investment in those markets (although China, with US$84 billion of FDI inflows, was already by far the largest emerging market host country in 2007).

Similarly, if Asian firms are less affected by the crisis, they may accelerate their outward FDI. Chinese outward FDI, for instance, which 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.

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

Moreover, undervalued or distressed 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 rock-bottom, before investing abroad.

If so, there is a chance that FDI outflows from emerging markets (which were US$300 billion in 2007) could possibly hold up, a least this year.

This possibility depends on the openness of the regulatory framework for FDI, especially in developed countries.

Protectionism

While this is, grosso modo (roughly), most likely assured, there are 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 exacerbate the negative economic factors. It is here where investment promotion comes in: Investment promotion agencies worldwide can be expected to make an extra effort to convince their governments to keep the investment climate welcoming.

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(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.)

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Recession hits luxe-hungry low-end buyers

After recession

AS 2009 shapes up to be the most challenging year in more than a generation for luxury items such as high-end apparel and fragrances, marketers' plans for targeting aspirational 16-year-olds and expanding rapidly into the new money hubs of Russia or the United Arab Emirates are suddenly out.

What's now in for marketing luxury in this difficult era is pampering the wealthiest and most loyal customers with everything from monogrammed shirts to personal in-home visits.

“I really think the foundation of luxury is customer service — that is what we are hearing,” said Cori Galpern, worldwide marketing and advertising director for Tom Ford International.

“I think what we'll see because of the economic crisis is that you lose a certain amount of that aspiration customer. Somebody who will buy a couple pairs of shoes over the course of the year is making other choices. The core for a luxury brand is a customer with very considerable wealth.”

In a recession in which even upscale consumers may find themselves strapped for disposable cash, it is a bad strategy to chase customers too far down the economic ladder.

“We don't want to see huge price cuts that will create a lower-priced brand,” said Brad Farrell, skincare brand manager for L'Oreal Paris.

Many luxury marketers said their firms remain hopeful that the next couple of years will bring expansion into some of the world's fastest-growing economies, including the so-called BRIC nations of Brazil, Russia, India and China, as well as the oil-rich Middle East.

But they added that the rapidly evolving financial turmoil could hinder some of their most ambitious ideas.

Alexandra Gillespie, who launched her own FLR Group for luxury marketing after a stint as senior vice president of Gucci, warned about “focusing too much on the luxury sector in emerging markets” because they, too, have been deeply affected by the economic downturn.

Many experts believe that the economic pain of the deepening recession could fall disproportionally on these marketers of high-end perfumes, trendy clothing or sleek fashion accessories.

Conspicuous consumption seems practically un-American in these troubled times, according to some observers.

Renowned trend analyst Faith Popcorn recently said, “If you go up Madison Avenue (in New York), past Fendi and Prada, those stores are empty. Women are shopping in their own closets. You feel shame in buying even if you can buy.”

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

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 for high-end luxury companies than for large mass-market consumer goods firms, which typically seek to identify sizable 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.

“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.”

Miuccia 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 Abouchalache said that demand for a consumer product like Cheerios 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 consumers.

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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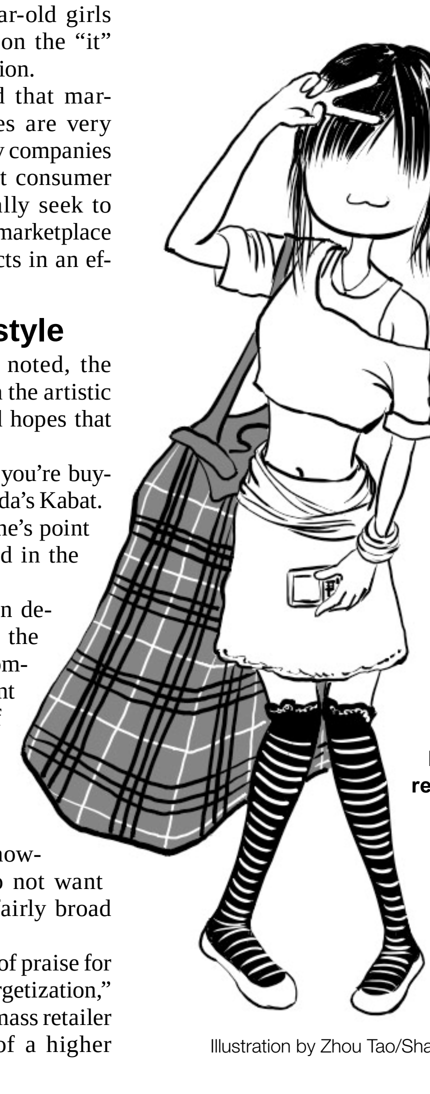

Before recession

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