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Focus on Economics

»» Large German firms invest roughly the same amounts at home and abroad

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According to a key finding of the new KfW Foreign Investment Monitor, in 2014 a good half of Germany's large enterprises with an annual turnover of more than EUR 500 million made foreign investments, each investing an average sum of EUR 125 million. This was primarily used to expand or modernise existing locations. Foreign investment is playing an increasingly important role for enterprises. Nearly three fourths reported that the share of foreign investment in their total investment has increased significantly since the turn of the millennium. However, nine in ten enterprises investing abroad regard these activities as complementary, not as a substitute for their activities at home. This is consistent with the fact that they have invested more than the same amount in Germany, EUR 135 million, in addition to their foreign investment. For these enterprises, the main motivation to invest outside national borders is to expand, that is, to open up new markets, and Europe is the number one target continent. At country level, however, the USA and China are the first choice. Companies intend to maintain roughly the same level of investment, with 52 % looking to continue investing abroad in the current three-year period (2015 to 2017) and spend EUR 340 million, each, on average across this period. Expansion remains by far the most important motive. Europe will remain the most important region for foreign investment, but at country level Poland could overtake France as the most important European destination.

New KfW Foreign Investment Monitor

Cross-border investment is playing an increasingly important role alongside traditional export business. Foreign investment is important for an enterprise, not just to open up international markets, but also to seize comparative cost advantages along the value creation chain and thus, to secure its own exports. Yet this topic is statistically underexplored. Across the year 2015, KfW Research therefore surveyed all of the nearly 1,700 enterprises in Germany whose annual turnover exceeds EUR 500 million in the context of the KfW Foreign Investment Monitor, which was set up as a pilot project. The survey was responded to by 300 enterprises, a response rate of 18 %.[1]

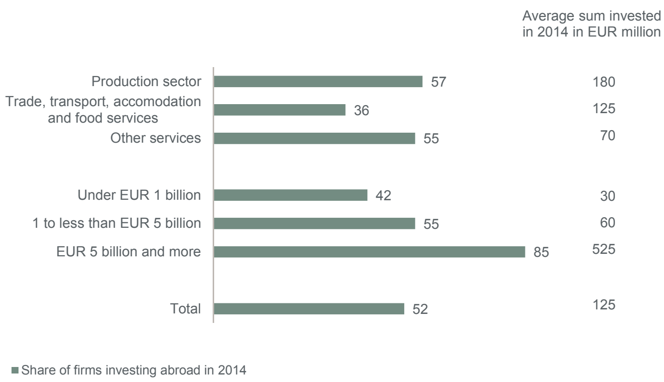
More than half of all enterprises invest abroad

Large enterprises take the lion's share of German foreign investment (for its importance to SMEs see Box 1). More than half of them (52 %) reported having invested outside Germany in 2014, the most recent year for which current data was available at the time of the survey. Each enterprise that made investments abroad spent an average of around EUR 125 million. It invested another EUR 135 million on average within Germany. The total investment volume for each enterprise investing abroad thus amounted to EUR 260 million.

The share of enterprises investing abroad and the average sum they invested also increased with their size (Figure 1). Accordingly, 42 % of the "small" large enterprises with an annual turnover of less than EUR 1 billion invested some EUR 30 million on average, while the share of large enterprises investing abroad that generate at least EUR 5 billion in annual turnover was 85 %. They invested just over half a billion euros outside Germany in 2014.

Figure 1: Share of large German enterprises investing abroad

In per cent



Source: KfW Research

The sector comparison reveals some notable differences. Firms in the production sector are particularly strong with 57 % of the enterprises engaged in foreign investments and an average investment sum of EUR 180 million, while "only" 36 % of enterprises in trade, transport, accommodation and food services invested abroad. Nevertheless, firms in this relatively more domestically focused services segment that invested abroad did spend an average EUR 125 million in 2014.

Box 1: Foreign investment by German SMEs

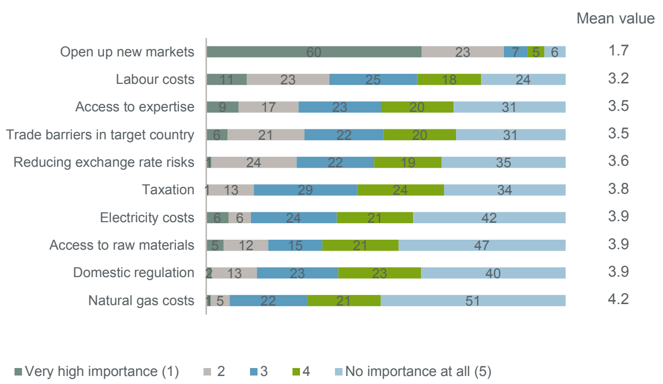
Along with large enterprises, large SMEs with an annual turnover of EUR 50 to 500 million also invested substantially beyond Germany's borders. Some of the "hidden champions" – which are important for Germany's economic performance – ultimately fall into this size class as well. On the basis of the KfW SME Panel, the proportion of these enterprises that invested abroad is roughly one fifth, or an estimated 2,700 companies. Because of the very high number of small and micro enterprises, however, the share of foreign investment across the SME overall sector – all companies with up to EUR 500 million annual turnover – is only 3 %.[2] This paper does not consider SMEs as its focus lies on the analysis of our large enterprise survey findings.

Highest priority: to open up new markets

When enterprises invest abroad, their main focus is business expansion. Well over 80 % of enterprises attach high or very high importance to opening up new markets. Only a good 10% admit that this motive has little or no importance for their foreign investment at all. If we combine all responses we arrive at a score of 1.7 points on the predefined five-point response scale on which 1 means "very high importance" and 5 means "no importance at all" (Figure 2).

Figure 2: Motives for foreign investment in 2014

In per cent; mean value in scale points



Source: KfW Research

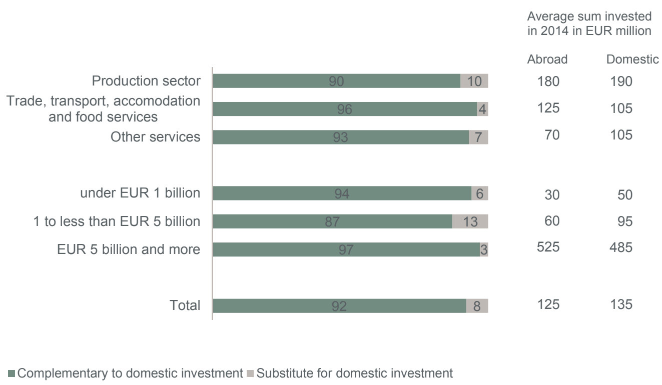
That makes expansion by far the most important motive. With a mean score of 3.2 points, lower labour costs are in second place, followed by access to expertise and overcoming trade barriers in the target country, each with 3.5 points. Reducing exchange rate risks and taxation follow in fifth and sixth place, with 3.6 and 3.8 points, respectively. Electricity costs, access to raw materials and domestic regulation occupy 7th to 9th place as investment motives, with 3.9 points each. The cost of natural gas as a motive for foreign investment clearly comes last. Nevertheless, rapid conclusions must be avoided. The generally low importance of natural gas costs, but also of electricity costs, as a dominant motive for investing outside Germany is not a sufficient reason for energy policy to broadly dismiss any knock-on effects it may have on Germany's attractiveness as a business location. If companies for which electricity or natural gas costs play a substantial role represent key enterprises that have numerous interconnected supply and service relationships, and perhaps even radiating R&D activities, much is at stake despite their relatively low number. An energy price-driven exodus would have a particular impact on regions in which such enterprises are domiciled, as they would have to cope with a loss of value creation and innovative strength that would likely go far beyond the migrating enterprise itself.

Foreign investment complements domestic business

When asked about the relation of domestic to foreign investment, the surveyed enterprises provided a clear answer. Ninety-two percent of all large enterprises investing abroad regard those activities as complementary to their domestic investment activities. This is also reflected by the fact that enterprises with foreign investment have also invested some EUR 135 million in Germany in addition to the average EUR 125 million they invested abroad (Figure 3).

Figure 3: Relation of domestic to foreign investment

In per cent



Source: KfW Research

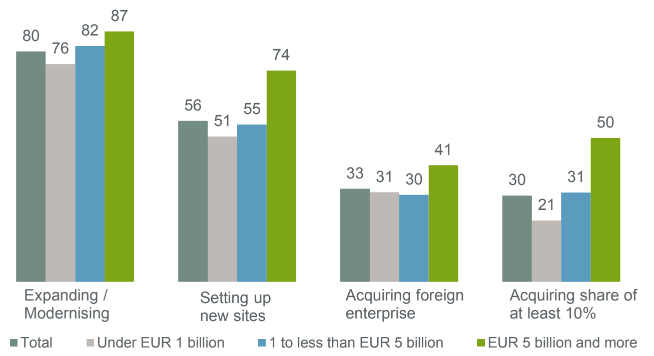
The differences between sectors and business sizes are negligible. Only firms in the production sector and "medium-sized" large enterprises with a turnover of EUR 1–5 billion tend to see their foreign investment activities somewhat more as a substitute for their domestic activities.

Expansion and modernisation dominate

Eight in ten internationally active enterprises conducted their investments by expanding or modernising existing production, distribution or service locations abroad (Figure 4). Among enterprises with a turnover in excess of EUR 5 billion the proportion of firms that built on existing foreign locations of their own was as high as 87 %.

Figure 4: How foreign investment is realised

In per cent, multiple responses were possible



Source: KfW Research

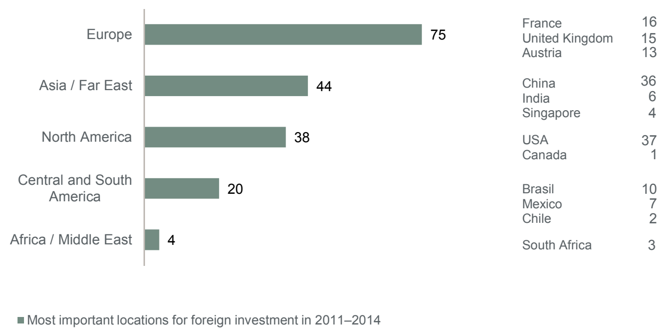
Fifty-six per cent of the surveyed enterprises invested abroad by setting up new sites. Very large enterprises were significantly more active in this group as well, at 74 %, than enterprises with an annual turnover of less than EUR 5 billion. One third of enterprises investing abroad took over an existing foreign enterprise or its physical capital, while 30 % opted for acquiring a share of at least 10 % in a foreign business.

Europe is clearly the main focus of foreign investment

Europe is by far the most important location of German enterprises' foreign investment; it is the main focus of three fourths of the surveyed enterprises (Figure 5). Forty-four per cent are drawn to Asia / the Far East while 38 % of enterprises stated North America as a location for their investments. Central and South America and, in particular, Africa and the Middle East so far play only a minor role.

Figure 5: Main locations of German foreign investment from 2011 to 2014

In per cent, multiple responses were possible



Source: KfW Research

Although the preferred continent for foreign investment is clearly Europe, at country level there are different preferences. The USA and China are by far the most popular destination countries. For 37 % and 36 % of the surveyed businesses, these two countries are the focal areas of foreign investment and they are also among Germany's most important export markets. In third place is France, the first European country, regarded as the most important location by 26 % of businesses, followed by the UK and Austria with 15 % and 13 %, respectively.

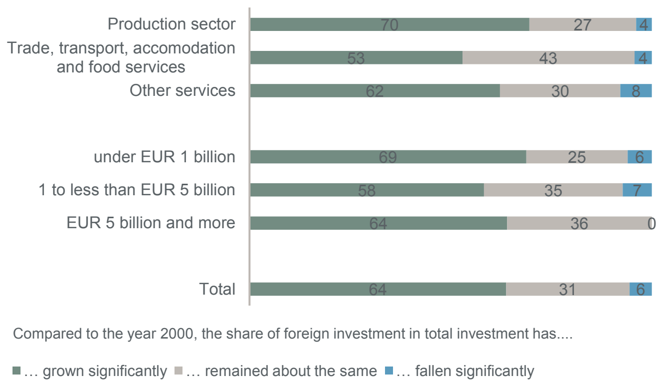
Foreign investment is now much more important

Increasing globalisation and Germany's pronounced export orientation have made foreign investment considerably more important. Almost two thirds of the surveyed businesses stated that the share of foreign investment in their total investment has grown significantly in the last one and a half decades (Figure 6).

By contrast, only 6 % of businesses indicated that it had become much less important. Around one in three enterprises saw no major change in the ratio of domestic to foreign investment. The production sector (70 %) and "small" large enterprises with less than EUR 1 billion in annual turnover (69 %), in particular, indicated that foreign investment had become significantly more important for them in relation to domestic investment.

Figure 6: Importance of foreign investment – change since the year 2000

In per cent



Source: KfW Research

Extrapolated to the macroeconomic level[3], foreign investment by large German enterprises in 2014 represented nearly one third of gross fixed capital formation by all companies in Germany; business investment as defined in the national accounts amounted to EUR 350 billion.[4] This type of comparison with the macroeconomic figures of the Federal Statistical Office and other acknowledged accounts such as the balance of payments statistics of the Deutsche Bundesbank and the long-established KfW SME Panel is likewise a suitable instrument for verifying the plausibility of the new survey data obtained from our KfW Foreign Investment Monitor (see Box 2).

Box 2: Verifying the plausibility of the survey

Survey data are inevitably fraught with estimation uncertainties, so their plausibility needs to be verified. We therefore extrapolated the large enterprises' investments in Germany and abroad according to our new KfW Foreign Investment Monitor to the macro level and compared these figures with suitable indicators from other recognised statistical reporting formats[5]:

Domestic investment 2014	EUR billion	Source
Large enterprises	158	KfW Foreign Investment Monitor
SMEs	202	KfW SME Panel 2015
Sum	360	
Business investment	350	National Accounts, May 2016

Investment abroad 2014	EUR billion	Source
Large enterprises	108	KfW Foreign Investment Monitor
SMEs	unkown	
Sum	unkown	
Direct investment (outward)		
Stock at year-end 2013	1510	Balance of Payments Statistics
Stock at year-end 2014	1649	Balance of Payments Statistics
Change in stock during 2014	138	
Flow 2014	86	Balance of Payments Statistics
Average (change in stock / flow)	112	

Domestic investment by large enterprises and investment by SMEs, which are marked off separately by the KfW SME Panel, amounted to EUR 360 billion. This total comes very close to the volume of business investment determined according to the concepts of the national accounts as the "natural" benchmark of EUR 350 billion. The difference of around EUR 10 billion can be seen as an expression of inevitable statistical fuzziness.

For foreign investment, however, there is no precise benchmark. Alternatively, direct investment as shown in the balance of payments statistics can be used, even if it is based on a financial concept of investment that does not strictly match our real economic concept of investment in terms of fixed capital formation we examine here. Furthermore, data on direct investment are published both as flows and as stocks, but the changes in stocks do not match the corresponding flows because of different valuation and selection methods. The differences between stock and flow statistics can actually be quite significant, so we used both distinctions. We found that foreign investment by large enterprises lies roughly halfway between the two benchmarks from the balance of payments statistics. A further element of fuzziness in this context is the as yet unknown volume of foreign investment by SMEs in the year 2014. But here, too, the level appears to be quite plausible.

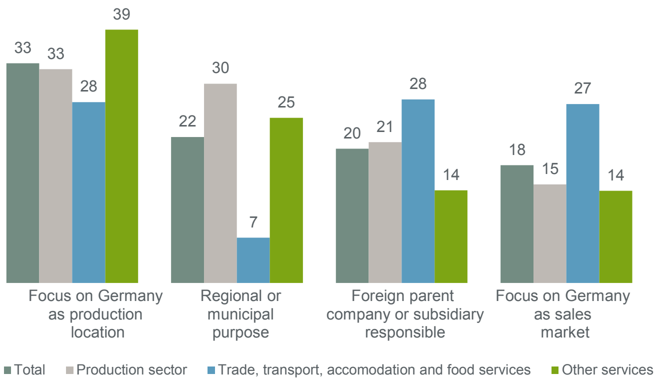
All in all, the diagnosis suggests that the figures determined by the KfW Foreign Investment Monitor, in particular the total numbers, are fairly close to the unknown "true" values. However, it must be kept in mind that breakdowns along the enterprises' branch of industry or size class are based on relatively small case numbers, leading to higher estimation uncertainty of these detailed figures.

Forty-five per cent of large enterprises do not invest abroad

Some 45 % of large German enterprises did not invest abroad in the years 2011 to 2014. Asked why they had not done so, 33 % of companies with no foreign investment responded that they focused exclusively on Germany for their production location (Figure 7).

Figure 7: Reasons for not investing abroad

In per cent, other reasons 10 %



Source: KfW Research

If the enterprise has a municipal or regional purpose and is thus primarily focused on the local market it has no need to invest abroad either. For 22 % of respondent enterprises that was the reason they were not investing abroad. One in five enterprises indicated that the foreign parent company or subsidiary was responsible for deciding on foreign investment. Eighteen per cent consider Germany to be the sole market for their products and services and therefore have no inclination to invest abroad.

Steady outlook

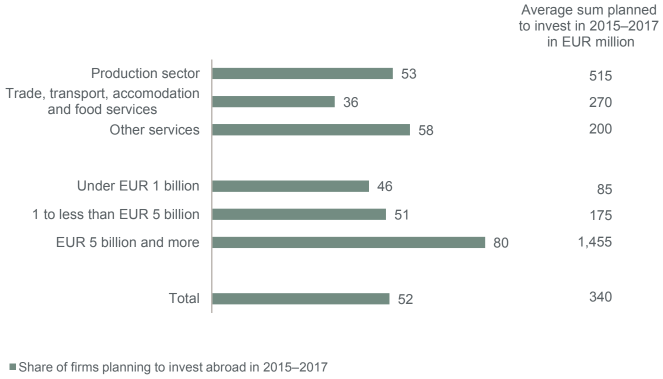
Large German companies can be assumed to roughly maintain their level of foreign investment activity. Fifty-two per cent intend to invest outside Germany in the current three-year period 2015 to 2017 – exactly the same proportion of companies as in the year 2014 (Figure 8).

As in 2014, it is especially the very large enterprises with more than EUR 5 billion in annual turnover that plan to continue investing abroad, with eight in ten of these enterprises expressing such plans. Firms in the production sector, however, want to scale back their activity slightly, with 53 % of companies in this segment planning to invest abroad, down from 57 % in 2014.

Investment volumes also remain very steady. If we break down the planned investment expenditure for the three-year period 2015 to 2017 to average annual amounts, we see that they are roughly equal to the expenditure on foreign investment in 2014 – always considering the statistical uncertainty involved in surveys of this type.

Figure 8: Share of large enterprises planning to invest abroad in 2015 to 2017

In per cent



Source: KfW Research

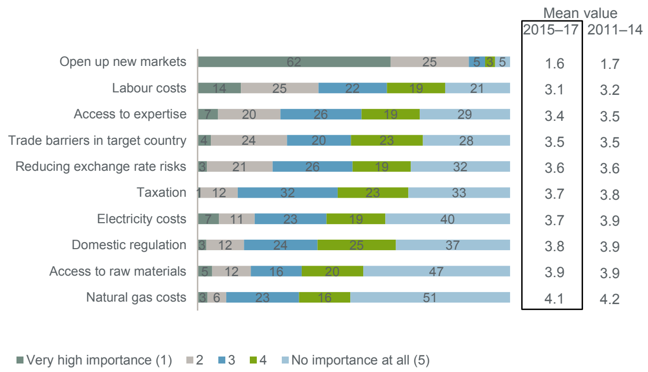
Expansion remains the dominant motive

Expansion is and remains the primary motive for foreign investment (Figure 9). Eighty-seven per cent of businesses planning to invest abroad in the years 2015 to 2017 attach high or very high importance to opening up new markets (median value of all responses on the rating scale of 1 to 5: 1.6 points).

Between the projects planned and those realised in 2014, the remaining investment motives also remained largely unchanged. Neither did any change occur in the hierarchy of motives, nor was there any significant variation in the average rating of their importance. Electricity costs showed the highest relative difference, although their importance in the planning of foreign investment increased only moderately. The medium rating shifted from 3.9 to 3.7 points, the lower figure expressing higher importance given the structure of the rating scale.

Figure 9: Motives for foreign investment in 2015 to 2017

In per cent; mean value in scale points



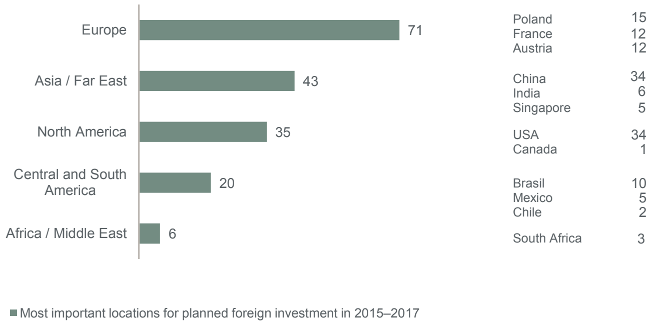
Source: KfW Research

Europe retains top spot

Europe has held on to its position as the preferred target region for German foreign investment (Figure 10). European countries were the most important investment locations for 71 % of large enterprises in the ongoing three-year period 2015 to 2017. That is a slight decline on the 75 % during the years 2011 to 2014. Asia/the Far East ranked second at 43 %, followed by North America, at 35 %. By contrast, one in five enterprises regarded a Central or South American country as an important location. Africa and the Middle East took 6 %.

Figure 10: Main locations of German planned foreign investment in 2015 to 2017

In per cent, multiple responses were possible



Source: KfW Research

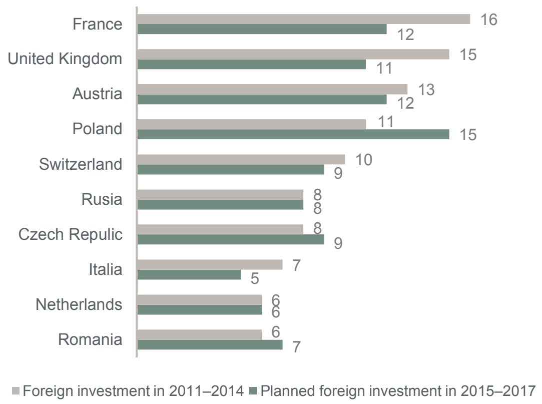
For the time being, the USA and China will remain the most important destination countries for German foreign investment. A good one third of large enterprises count the two economic powerhouses among their preferred targets for future projects. Far behind, at 15 %, is Poland, the first European country included among the enterprises' most important locations, followed by France and Austria, each with 12 %.

France and the UK are losing importance

While the preferred destinations for investment in regions outside Europe will largely remain steady for the foreseeable future, noticeable changes are imminent inside Europe (Figure 11).

Figure 11: Most important European investment locations in 2015 to 2017 compared with 2011 to 2014

In per cent, multiple responses were possible



Source: KfW Research

German businesses plan to make Poland their preferred European destination for foreign investment. Fifteen per cent of enterprises referred to the neighbouring country to the east as one of the most important locations for their investment plans in the years 2015 to 2017. Between 2011 and 2014

Poland was only mentioned by 11 % of companies and ranked fourth in Europe.

The losers will presumably be France and the UK, which lost four percentage points each. France will have to surrender its top position to Poland while the UK will slip from second to fourth place. Given the unexpected vote of the British people to leave the EU it can be assumed that the UK would drop to a much lower rank today. After all, during the survey period the possible Brexit received only marginal attention most of the time and was not yet seen as a significant risk in the public debate. Nevertheless, Poland has become significantly more EU-sceptical since its last change of government, something German companies planning to invest there will presumably have noted with a certain degree of concern. Italy is set to lose some of its appeal as an investment location for German businesses, too (minus two percentage points). The importance of Austria and Switzerland will also drop by one percentage point each. ■

[1] They provided information on their investment behaviour at home and abroad, both in their retrospective on the years 2011 to 2014 and in their planning for the years 2015 to 2017. As the survey focused on the real economy it did not include the financial sector.

[2] See Bacher, A.: Unternehmensinvestitionen im Tief: Gehen die Unternehmen ins Ausland? (Trough *in* business *investment - are* firms *investing abroad?*) (in German) , KfW Research, Economics in Brief No. 35 (16 January 2014).

[3] The data were extrapolated using the following simple formula: macroeconomic investment in EUR = average investment per investing enterprise in EUR x proportion of investing enterprises in the sample x number of enterprises in the population.

[4] We define "business investment" as gross fixed capital formation by non-governmental sectors excluding dwellings.

[5] Specifically: KfW Research, Volume of tables KfW SME Panel 2015, Table 1 (Indicator "Total investment volume"); Federal Statistical Office, Fachserie 18, Series 1.2 (May 2016), Table 3.11 (Indicator "Business investment" calculated as gross fixed capital formation by non-governmental sectors excluding dwellings of non-governmental sectors); Deutsche Bundesbank, Statistical Supplement 3 to the Monthly Report – Balance of payments statistics (April 2016), Table I.9.c (flow variable for indicator "direct investment") and Table II.8.a (stock data for indicator "direct investment").