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Inward FDI in Italy: some recent trends

Sebastiano Comotti & Riccardo Crescenzi

London School of Economics

r.crescenzi@lse.ac.uk

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@crescenzi_r

Executive Summary

- In 2021/22 Italy has experienced a **significant growth in inward foreign capital** relative to pre-pandemic levels
- In comparison to pre-pandemic levels new annual **greenfield FDI inflows have grown by 33%**, inward **cross-border M&As by 14%, Venture Capital** and **Private Equity** by **250%** and **50%** respectively.
- In most areas the growth rate from pre-pandemic levels **has outpaced growth in European peers** over the same period
- Sectoral and functional analysis suggests that the **National Recovery and Resilience Plan (NRRP)** might have been a facilitating factor, together with structural reforms currently underway
- For all forms of foreign investment, Italy is still punching significantly below its weight relative to other European economies, pointing to the importance of:
    - Continued **reforms** and consolidation of **stability and regulatory certainty.**
    - Attraction of **'quality' FDI** with an emphasis on those that can offer opportunities **to link up to Global Value Chains and upgrade.**
    - Targeted investment promotion consistently with the **priorities of the National Recovery and Resilience Plan (NRRP)**.
    - Dedicated **efforts for regions in Southern Italy** through targeted **evidence-based interventions**

Introduction

This presentation offers some preliminary stylised facts on the recent evolution of inward Foreign Direct Investment (FDI) in Italy, covering both new greenfield investment and Mergers and Acquisitions (M&A).

Venture Capital and Private Equity are also covered, based on third party *ad hoc* survey data, given their developmental potential for the Italian economy.

The presentation aims to offer some tentative input to support policy decisions based on data, recent academic literature and ongoing LSE research on FDI and their impacts on economic development, employment and recovery.

The wider collaboration between the London School of Economics (LSE) and the Italian Ministry of Economic Development (MISE) aims to support the evidence-based implementation of the Recovery and Resilience Facility and NextGenerationEU in Italy.

The ‘old’ & the ‘new’ world

Key pre-existing trends simultaneously reinforced during and after the **pandemic**:

Geo-political tensions and conflicts, global FDI flows stagnation, re-organisation of supply chains

New forms of **innovation in response to Covid-19 and for recovery** (e.g. Work-from-Home and digital transition; net zero targets etc.)

Unprecedented shift in public policy paradigm and resources mobilised for recovery (e.g. NextGenerationEU)

Radically different framework conditions for the internationalisation of firms, FDI attraction and retention

New opportunities and challenges for economic development strategies

The Importance of Foreign Direct Investment

Foreign Direct Investment (FDI) plays a key role in shaping economic development trajectories in advanced and emerging economies, in both leading and less advanced regions[1].

A large and growing body of research[2] has shown that inward and outward FDI – when some key conditions are in place in the investing company and the host economy – can boost innovation, employment, economic growth and make possible to link-up to Global Value Chains (GVCs).

- For example, recent research has looked at innovation across the globe, covering more than 40 years of patent data. Econometric analysis has shown that inward FDI has a positive causal effect on local innovation rates. Foreign research activities help their host regions climb fourteen centiles in the global innovation ranks in a five year period[3].

Public policies have an important role to play for FDI recovery after the pandemic: FDI responds to targeted promotion efforts.

- For example, recent research on the impact of national and regional Investment Promotion Agencies (IPAs) in Europe has shown that these organisations are highly effective in attracting FDI to their jurisdictions. Less advanced regions with active IPAs can attract (up to) 71% more FDI in targeted sectors vis-à-vis regions without a dedicated agency[4].

Key definitions

This presentation tracks FDI by looking at:

- **Greenfield FDI projects** – such as a company setting up (or expanding) a physical presence in a foreign market.
- **Cross-border M&A deals** – defined as having more than 10% foreign ownership and including acquisitions, mergers, demergers, joint ventures and minority stakes.

In order to capture the most recent post-pandemic trends we include both announced and completed projects and deals.

The presentation also covers the **foreign component** of:

- **Venture Capital** – defined as the equity financing transactions of businesses at the set-up stage or during their first few years of existence, including 'start-ups'.
- **Private Equity** – are private equity funds making direct private equity investments (investment in or acquisition of private companies not listed on a public stock exchange).

All charts are based on a comparison between pre-pandemic average values and estimates for 2021-2022 average values, in order to capture possible recovery trends and signals. Data for 2020 has been excluded due to the direct impact of the pandemic on all indicators. Where possible, information for 2022 has been estimated and projected to annual values based on data for Q1 & Q2 2022.

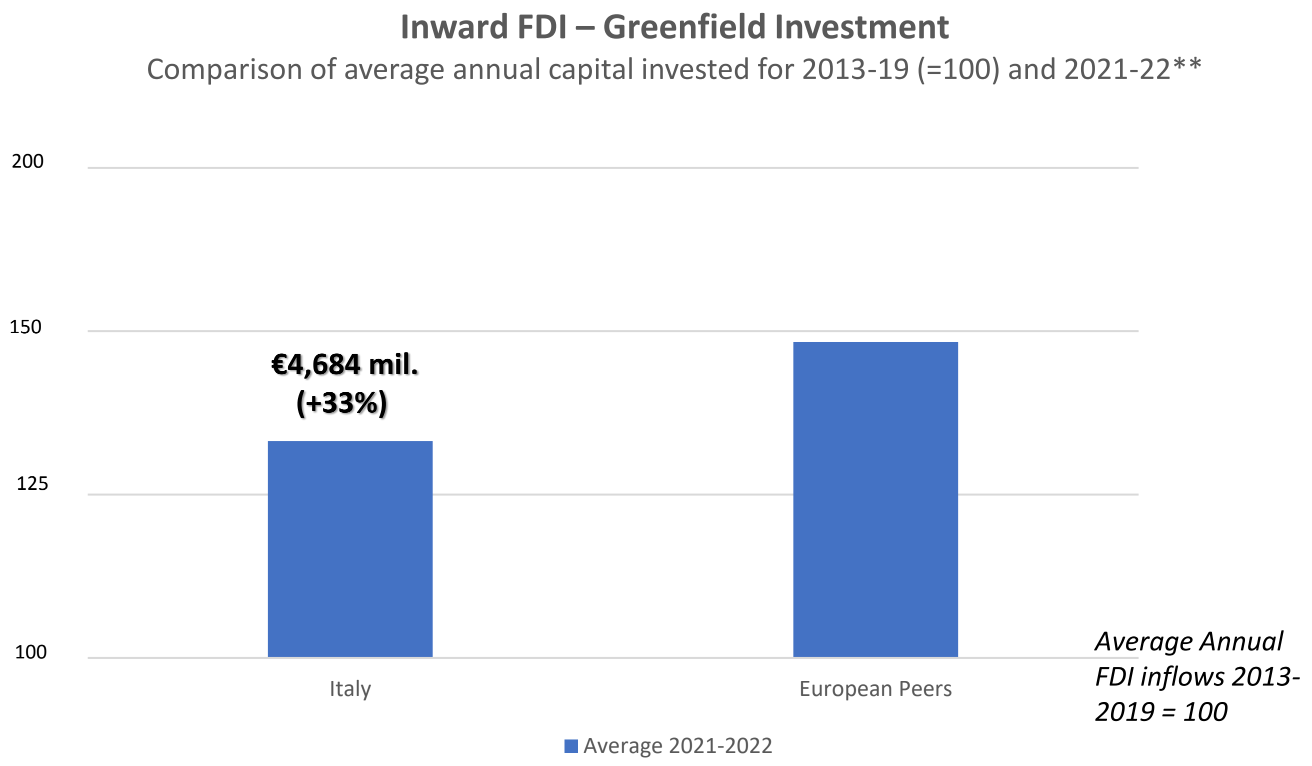
Data Sources

The source of **Greenfield FDI** data is Orbis Crossborder Investment collected and maintained by Bureau van Dijk (Moody's company). Orbis data have been checked for robustness against other data sources including the United Nation Conference of Trade and Development (UNCTAD), the World Bank and Financial Times' FdI-Markets.

The source of **cross-border M&A** data is UNCTAD based on information reported by Thomson Reuters. M&A data are recorded on a net basis, i.e. expressed as differences between gross cross-border acquisitions and divestment by firms in/from a particular country or in/from a particular industry. Transaction amounts recorded in the UNCTAD M&A statistics are those at the time of closure of the deals, and not at the time of announcement. The M&A values are not necessarily paid out in a single year.

While **Venture Capital** and **Private Equity** data do not meet the OECD Benchmark Definition of FDI in full, some data are presented based on information collected with ad hoc surveys by EY Venture Capital Barometer and European Data Cooperative (EDC). Data reported in this presentation are based on estimates of the foreign component of these flows.

Inward Greenfield FDI after the pandemic



Source: BVD Orbis Crossborder Investment

Notes:

* The group of 'European Peer' used as a benchmark includes France, Germany, the Netherlands and Spain. The value reported is an unweighted average. Data for Germany are still provisional and to be verified by the data provider

** Information for 2022 has been estimated and projected to annual values based on FDI project data for Q1 & Q2 2022. The estimated annual average value of FDI inflows for 2021-2022 in Italy is 4,684 million euros and 16,753 million euros for its European Peers as listed above.

According to OECD data, in 2021 **average FDI inflows in OECD countries have bounced back to their pre-pandemic (2013-2019) levels, with a further upward trend in Q1 2022 (21% increase in Q1 2022** compared to **Q1 2021)**.

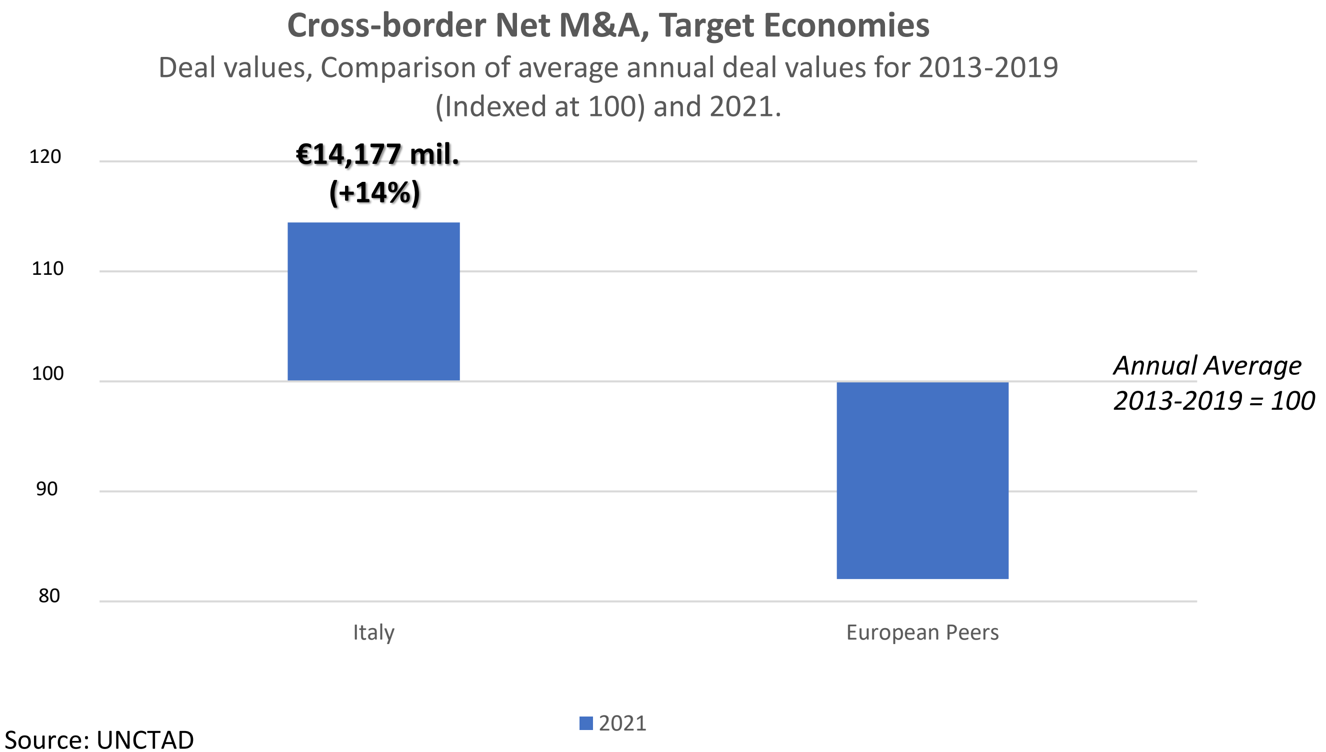
Italy has significantly exceeded its average annual pre-pandemic inward FDI performance **(+33%).**

While Italy shows **lower greenfield inward FDI** flows in comparison with other major EU economies, r**ecovery to pre-pandemic level has been rapidly achieved**.

This positive trend remains to be consolidated in the more demanding and globally volatile situation of Q3 & Q4 2022.

Inward Cross-border M&A after the pandemic

Foreign companies abroad acquiring companies in Italy



Source: UNCTAD

Notes: M&A data are recorded on a net basis, i.e., expressed as differences between gross cross-border acquisitions and divestment by firms in/from a particular country. The group of 'European Peer' used as a benchmark includes France, Germany, the Netherlands and Spain. The value reported is an unweighted average. The value of total net cross-border M&A deals for 2021 is 14,177 million euros for Italy and 16,528 million euros is the average value for its European Peers as listed above.

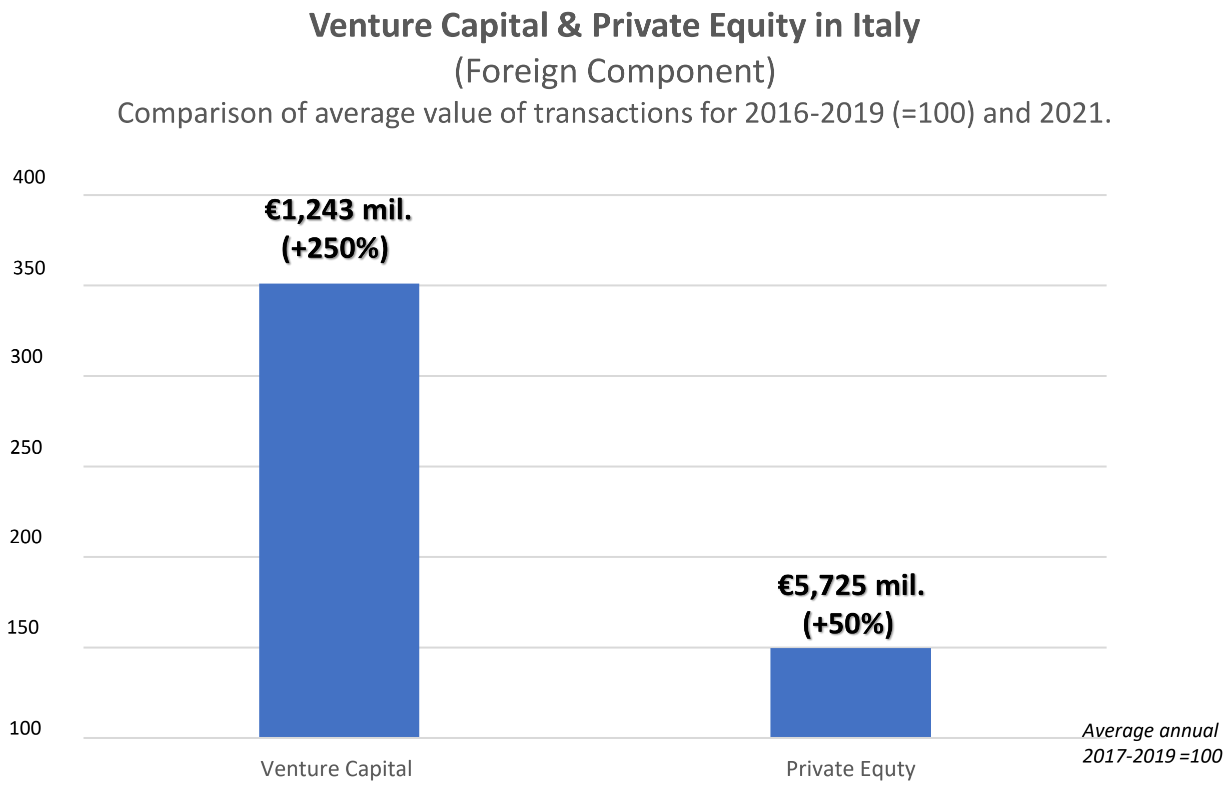
The global market for M&A has been particularly dynamic in 2021, following the progressive phasing out of Covid-19 restrictions.

The interest of foreign investors for the acquisition of Italian targets exceeded pre-pandemic levels in 2021.

Overall, Italy has a significantly stronger post-pandemic net position than other similar EU economies

Italian companies have also been very active in terms of both domestic transactions (internal consolidation) and some major acquisitions of target companies in foreign countries (outward M&A, e.g. Stellantis, Luxottica).

Foreign component of Venture Capital and Private Equity after the pandemic



Source: EY Venture Capital Barometer and European Data Cooperative (EDC).

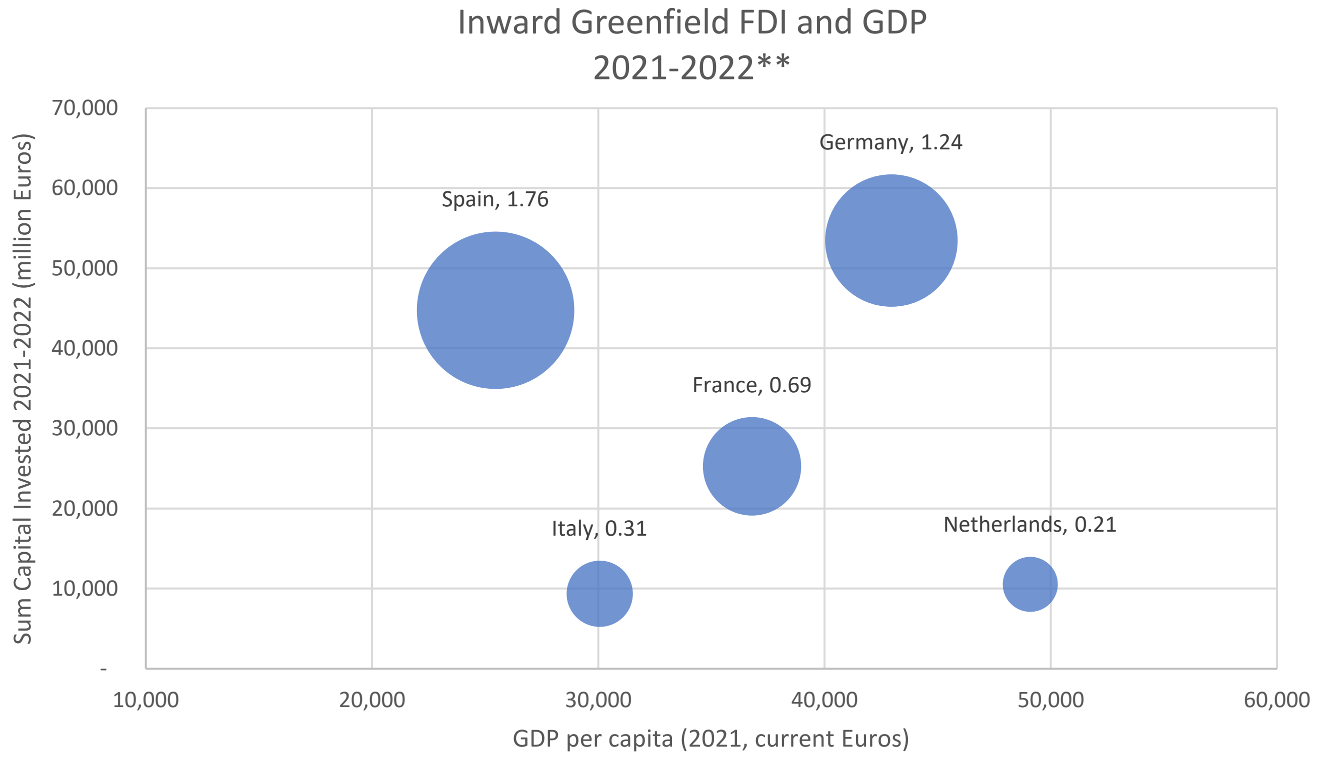
Note: Foreign Component -49% in 2021 in comparison with 2017-2019 average. The value of all Venture Capital deals for 2021 is 1,243 million euros and Private Equity 5,725 million euros.

Invest Europe data suggest that private equity & venture capital firms invested €138 billion into European companies in 2021, showing a 61% increase vis-à-vis the pre-pandemic annual average 2017-2019.

The increase in the significance of these inflows in the post-pandemic period has been substantial for the Italian economy, both in comparison with other forms of inward investment discussed above and in comparative terms with other European economies.

The stabilisation of these inflows into longer term investment remains a key priority for public policies in 2022.

Room for further growth: Inward FDI and Productivity



Source: BVD Orbis Crossborder Investment, World Bank Indicators, EC Economic Forecast (Spring 2022)

Notes: Size of the circles proportional to the ratio greenfield FDI inflows value / GDP per capita. FDI data for Germany are still provisional and to be verified by the data provider

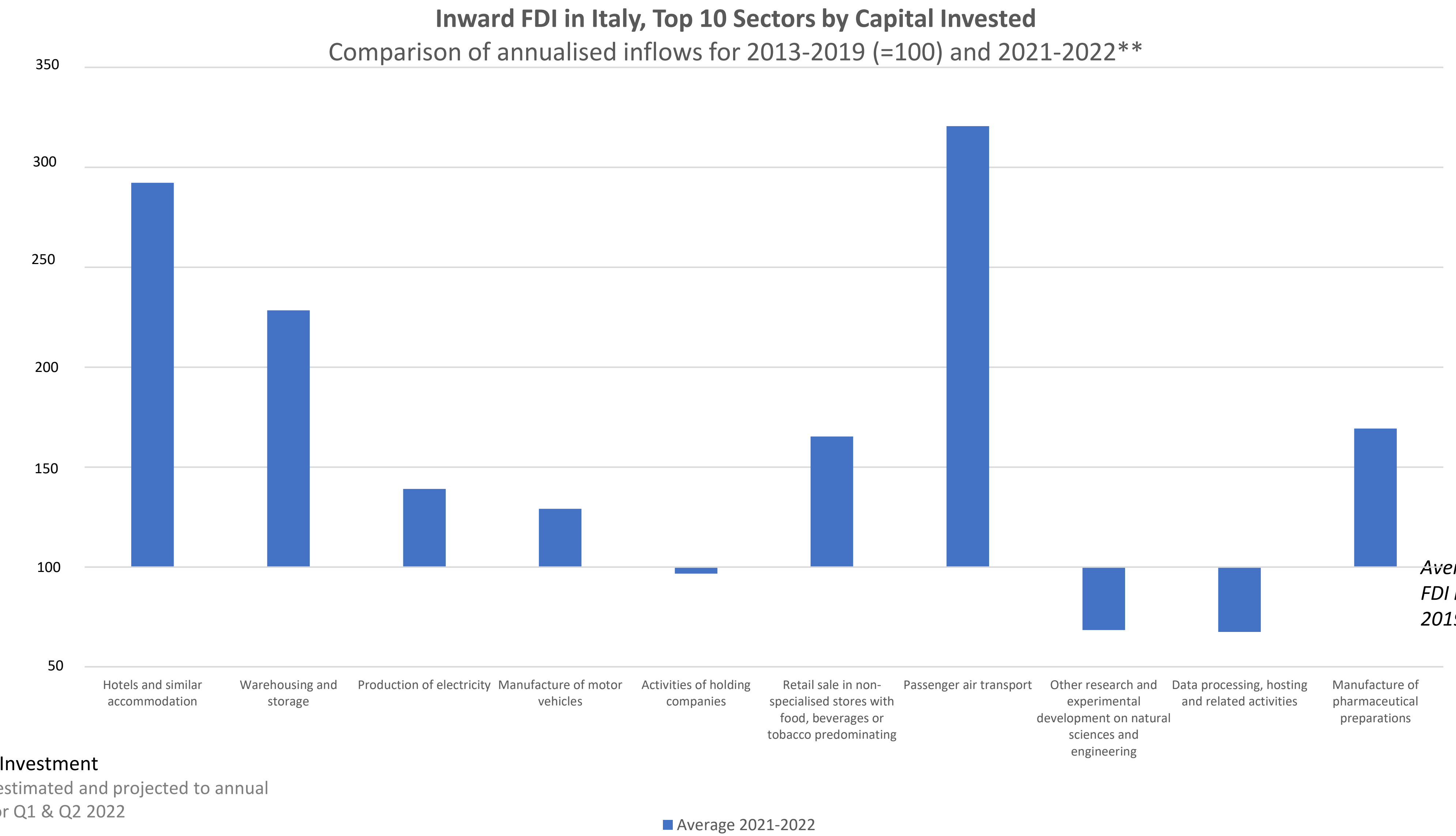
** Information for 2022 has been estimated and projected to annual values based on FDI project data for Q1 & Q2 2022

Given the size of its economy and its productivity levels, Italy still punches below its weight in terms of inward FDI after the pandemic.

For each Euro of GDP per capita France is able to attract 0.69 Million Euros of new inward greenfield FDI while Italy 0.31.

This shows that Italy has still a significant room for further growth in FDI attraction and internationalisation of its economy, if appropriate reforms and measures are put in place to support this process in line with other major EU economies.

Inward greenfield FDI in Italy: key sectors (1)



Sectors ordered left to right based on ranking of total capital invested 2021-2022

Average Annual FDI inflows 2013-2019 = 100

Source: BVD Orbis Crossborder Investment

** Information for 2022 has been estimated and projected to annual values based on FDI project data for Q1 & Q2 2022

Inward greenfield FDI in Italy: key sectors (2)

Some changes are visible in the sectoral composition of the inward greenfield FDI after the pandemic shock.

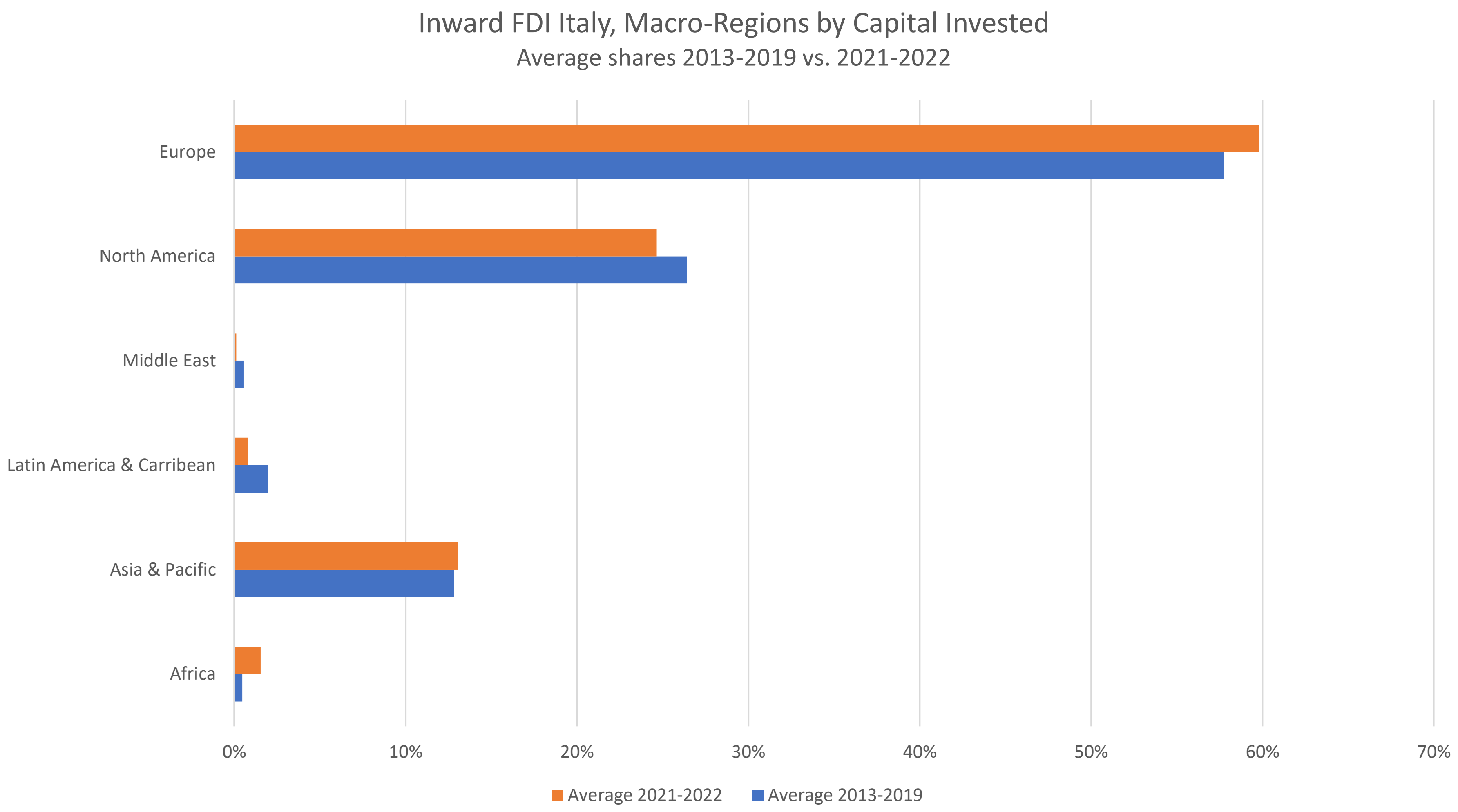
Significant rebound of sectors linked with end of mobility restrictions and the recovery of tourism (i.e. ‘Hotels’ and ‘Passenger Air Transport’) as well as ‘retail’ and ‘warehousing’.

Interesting upward trend in three key sectors associated with the priorities of the National Resilience and Recovery Plan: ‘energy’, ‘automotive’ and ‘pharmaceutical’.

‘Research and Experimental Development’ and ‘Data processing and hosting’ are top-10 sectors in terms of the absolute value of the investments in post-pandemic phase, even if they have not fully recovered pre-pandemic levels

Consolidation of these trends in second half of 2022 remains key.

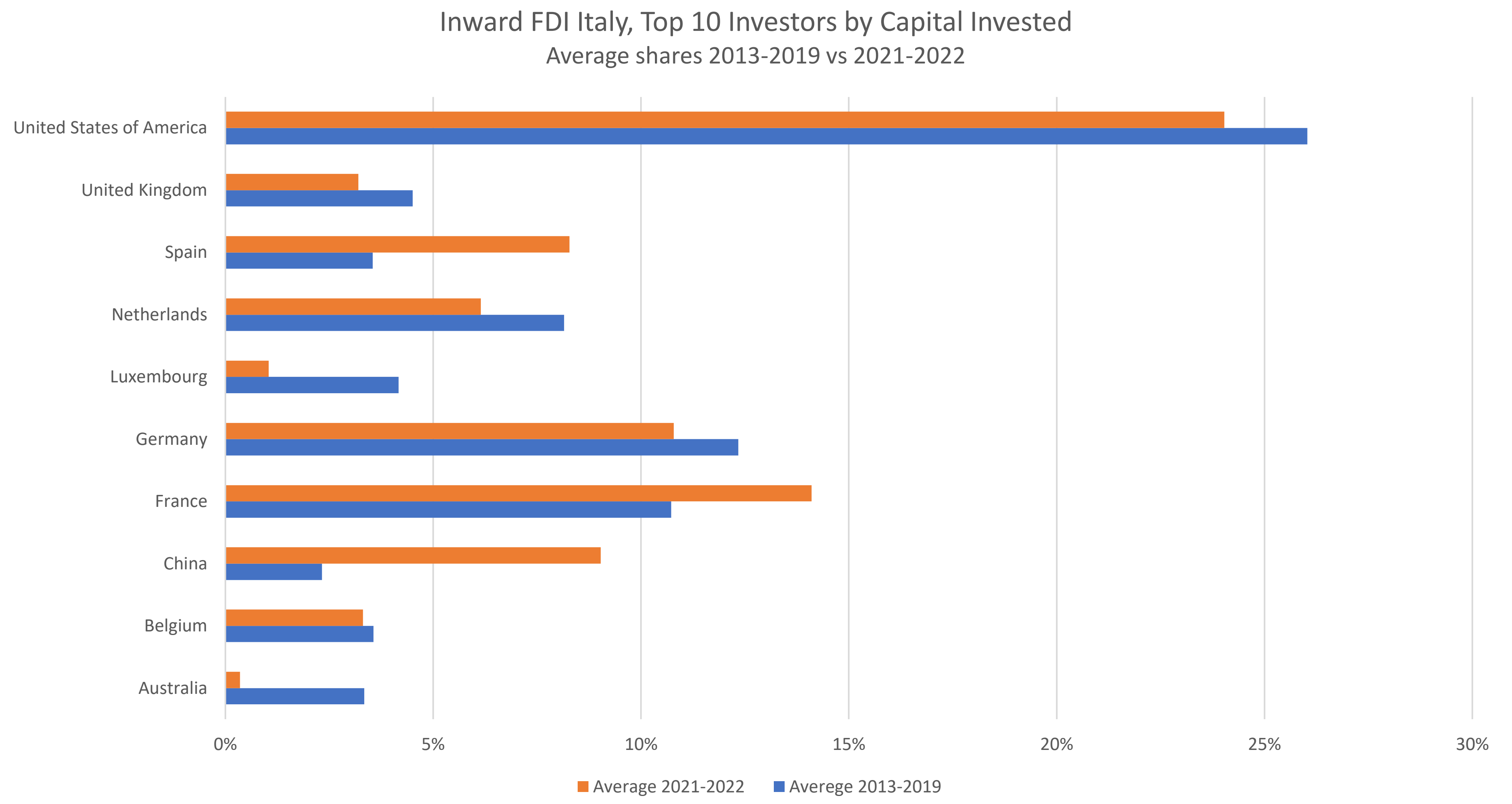
Inward greenfield FDI in Italy: key sources (1)



Source: BVD Orbis Crossborder Investment

Note: Data for 2022 cover Q1 & Q2

Inward greenfield FDI in Italy: key sources (2)



Source: BVD Orbis Crossborder Investment

Note: Data for 2022 cover Q1 & Q2

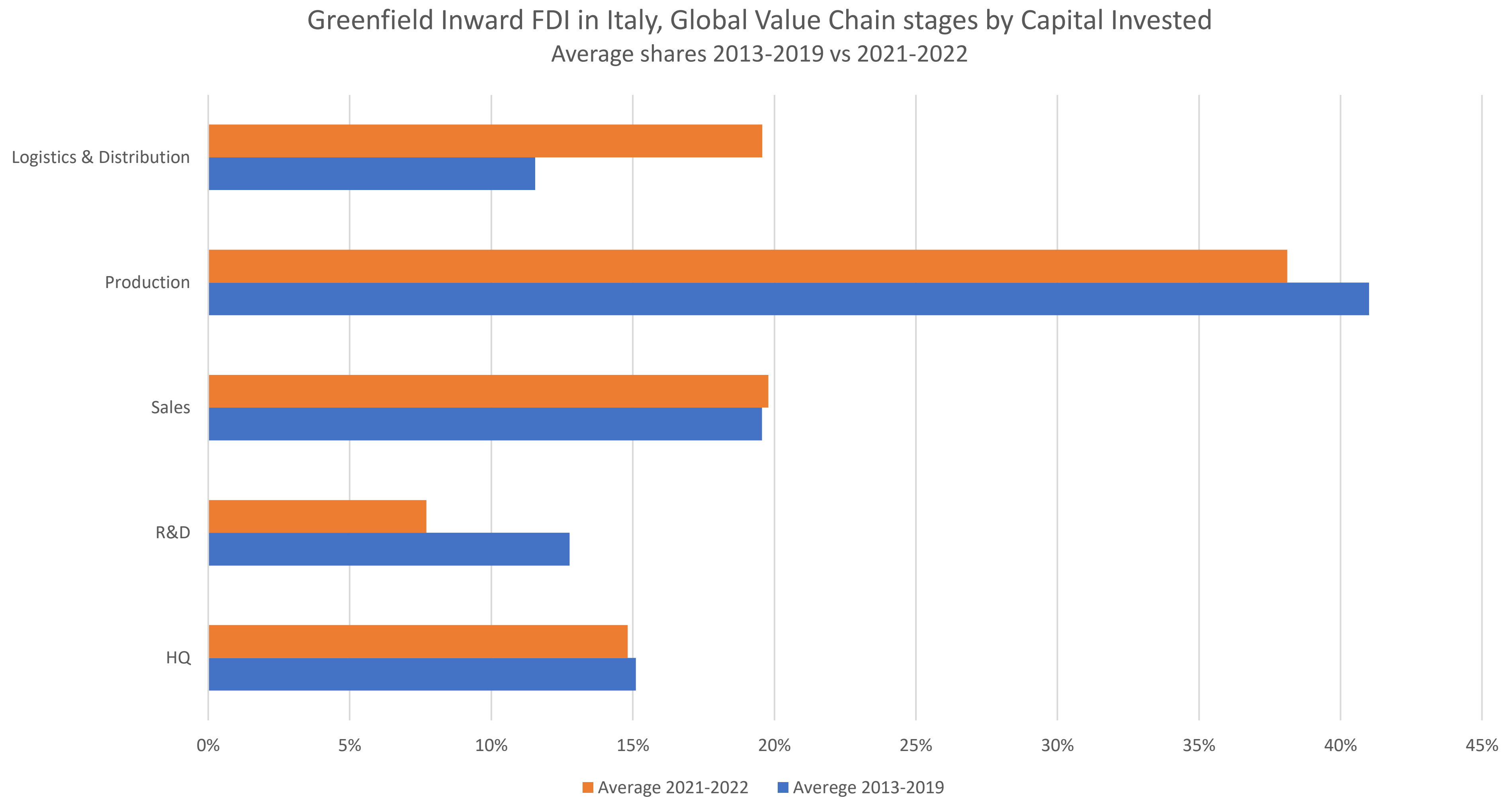
Inward greenfield FDI in Italy: key sources (3)

The position of Italy in terms of inward greenfield FDI is centred in Europe and North America. The importance of Europe as a source of greenfield investment has grown after the pandemic in line with a possible trend of reinforcement of European Value Chains.

Within the EU Spain plays a growing role. Brexit seems to have only marginally affected UK inward investment .

The consolidation of the role of China (and Asia more generally) is visible but the centrality of the USA remains undisputed.

Inward FDI in Italy: GVC stages (1)



Source: BVD Orbis Crossborder Investment

Note: Data for 2022 cover Q1 & Q2 – Classification of FDI projects in 'GVC stages' based on Crescenzi et al. 2014. The classification excludes some business functions that cannot be univocally linked with a GVC stage: Entertainment, Agriculture, Banking & Finance, Commercial Real Estate, Health, Hotels, Residential Real Estate, Utilities.

Inward FDI in Italy: GVC stages (2)

The classification in 'Global Value Chain' stages looks at the position of each new foreign investment project along the value chain from R&D and product design to production and then sales and distribution, cutting across sectors and focusing on functions[5].

The 'smile curve' of value creation suggests that most of the value added is generated by activities at the initial (e.g. R&D, design) and final (e.g. marketing) stages with production becoming gradually less important.

The analysis of new greenfield investment projects suggests that inward FDI in Italy are moving downstream with more activity in logistics and distribution than before the pandemic at the expenses, at least in the short run recovery stage, of upstream 'R&D' activities.

Some remarks (1)

Significant post-pandemic dynamism challenged by difficult global economic conditions in 2022.

Italy has still significant room for growth in comparison with other EU economies.

Some interesting signals in terms of emerging sectors and markets

Position for growth in American and Asian FDI due to possible on-shoring/re-shoring adjustments catalysed by geopolitical factors

Position for growth in Europe with reference to European Value Chains

Upward trends in key sectors linked with the National Recovery Plan

Downstream shift in terms of value chain positioning: opportunities to reinforce upstream foreign activities

Some remarks (2)

At this important turning point for Italian internationalisation trajectory is key to:

- Maintain momentum on **reforms** undertaken.
- Consolidate **stability and regulatory certainty**, especially with respect to digital markets.
- Focus **on ‘quality’ FDI** with an emphasis on those that can offer opportunities **to link up to Global Value Chains and upgrade.**
- Also consider actions for **active internationalisation and trade** in a systematic manner (coordination).
- Maintain focus on **R&D and innovation** with coordinated policies for **domestic eco-systems.**

Some remarks (3)

- Work on targeted investment promotion consistently with the **priorities of the National Recovery and Resilience Plan (NRRP)**.
- Opportunities from Important **Projects of Common European Interest (IPCEI)** where consistent with NRRP and part of a wider strategy for local impacts (in particular in Southern Italy).
- More research is urgently needed in order to **evaluate the impacts of existing tools** and policies and support the **design of new evidence-based interventions** (e.g. how effective are current investment promotion efforts in different NRRP priority areas? How to improve impacts and returns on investment?).

Endnotes

1 – See Crescenzi, Harman and Arnold (2018) for the OECD & Comotti, Crescenzi & Iammarino (2020) for the European Commission

2- Crescenzi and Harman (2022) offers a review of the key literature

3 - Crescenzi, Dyèvre, & Neffke (2022)

4 - Crescenzi, Di Cataldo & Giua (2021)

5- For a discussion of the methodology see Crescenzi, Pietrobelli & Rabellotti (2014)

Key References

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- *Read also our LSE GILD Blog column :* https://blogs.lse.ac.uk/gild/2019/02/21/what-policies-work-for-fdi/

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About the authors

Sebastiano Comotti is an economist with a background in development economics. He has worked for private and public international organisations with a focus on MNEs, FDI, and GVCs and how these factors shape local, regional, and national economic development. He holds a MSc in Local Economic Development from London School of Economics and BA in Economics from Bocconi University. He is also a member of the Institute of Economic Development.

Riccardo Crescenzi is a Professor of Economic Geography at the London School of Economics and is the current holder of a European Research Council (ERC) Grant. He is also an Associate at the Centre for International Development, Harvard Kennedy School of Government, Harvard University. Riccardo has served as the Rapporteur of the High Level Expert Group on Innovative Cities established by the European Commissioner of Research and Innovation. He has also provided academic advice to, amongst others, the European Investment Bank (EIB), the European Parliament, the European Commission, the Inter-American Investment Bank (IADB), the OECD and the World Bank. His research is focused on Regional Economic Development and Growth, Innovation, FDI, Multinational Firms and the analysis and evaluation of public policies. His teaching focuses on the economics of local and regional development. He is the Editor of the LSE Blog "Global Investments and Local Development"

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