

3 Country risks and Austrian direct investment abroad

Roberto Codagnone¹

In this section, we analyze stocks of Austrian outward direct investment (outward FDI) in connection with country-specific investment risks for the period 2007 to 2018.

We see that Austria's outward FDI is mainly concentrated in countries representing a low investment risk. Over time, the importance of these low-investment risk countries (or risk group) has strongly increased: In 2007, 61.7% of stocks of Austrian outward FDI were attributable to this group; by 2018, this share had risen to 83.2%. By comparison, 12.4% of these stocks were invested in countries representing medium investment risk and 4.4% in high-investment risk countries in 2018. For the years 2019 and 2020, preliminary data on stocks of outward FDI indicate no significant changes in the distribution among these risk groups.

In terms of distribution among industries, financial and insurance services still attract the largest investment volume – in each risk group, in total and for the entire observation period. However, over time, the relevance of this industry has declined.

The country risk associated with an investment is reflected in its profitability, which is least volatile in countries representing low investment risk, followed by medium- and high-investment risk countries. Investments in high-investment risk countries have proven very profitable since 2015.

3.1 Introduction

The decision to make a direct investment abroad depends on market- and country-specific aspects that companies need to carefully evaluate and consider. For example, the return that can be generated plays an important role; however, when making their investment decisions, companies also need to factor in risks that might materialize and negatively affect their business activities.

In this section, we aim to establish and analyze the relationship between investment behavior underlying Austria's outward FDI and country-specific risks. In a first step, we explain, in greater detail, the data basis used and the OECD country risk indicator, which quantifies the investment risk associated with specific countries. Subsequently, the data on stocks of Austrian outward FDI are enriched with the corresponding country risks, presented for the time series from 2007 to 2018 and broken down by industries. In a last step, the profitability of investments is analyzed for the different risk groups. It is important to note that direct investments can be driven by different motives; our focus here, however, is on the returns that can be generated.

3.2 Data and OECD country risk indicator

The present analysis covers the period from 2007 to 2018 and is based on annual data on Austrian enterprises' stocks of outward FDI, which are collected annually by the OeNB. It is worth pointing out that the period under review is extraordinary, as it starts close to the beginning of the financial and economic crisis of 2008, which was soon followed by the sovereign debt crisis in 2010.

¹ Oesterreichische Nationalbank, External Statistics, Financial Accounts and Monetary and Financial Statistics Division, roberto.codagnone@oenb.at.

The present analysis excludes real estate investment and special purpose entities due to a lack of economic activities.

To be able to consider the investment risk of countries it is necessary to select an indicator that adequately captures this risk. To this end, we use the country risk classification compiled and published by the OECD². This OECD indicator is helpful when analyzing direct investments, as it primarily considers two main categories:

1. Transfer and convertibility risk: This refers to the risk that governments might impose capital or exchange controls that make it difficult for an entity to convert local currency into foreign currency and/or transfer funds to creditors located outside the country.
2. Force majeure: This generally includes the risk of political unrest and instability, such as expropriation, civil disturbance, war and natural disasters.

Covering 201 countries, the country risk classification has been compiled and published by the OECD since 1997, with several updates each year. For the purposes of our analysis, we will use the first score assigned each year under the country risk classification for the entire year under review. The classification is based on a scale from 0 to 7, with 0 representing the lowest and 7 the highest investment risk. However, the OECD does not classify all of the 201 countries listed – which is explained by two reasons: For one thing, very small countries (so-called microstates) are not assessed, as this would represent a disproportionately high administrative burden. For another, the assessment also excludes OECD countries as well as euro area member states with a high level of GDP per capita, based on the assumption that these countries represent low risk. The country risk classification relies on a two-step methodology. In a first step, a quantitative model constructed specifically for this purpose (Country Risk Assessment Model – CRAM) produces first country risk values. In a second step, these values are checked for plausibility by country risk experts from OECD member countries and adjusted where necessary. To allow for a clearer analysis, the individual risk scores are grouped together into risk groups. The risk scores 0 to 2 represent low risk, 3 to 5 show medium risk, and the risk scores 6 to 7 indicate high investment risk.

3.3 Direct investment and country-specific investment risk

This subsection will provide an overview of the risk structure of Austrian direct investment abroad. In 2018, 55 foreign countries (51.4%) in which Austrian enterprises held FDI were classified as low risk; 22 countries (20.6%) were assessed as representing medium risk, and 30 countries (28%) were categorized as high risk. Charts 12 and 13 show Austrian stocks of outward FDI in Europe for the years 2007 and 2018 broken down by these risk categories. In both years, all countries in the western, northern and southern parts of Europe were classified as low risk.

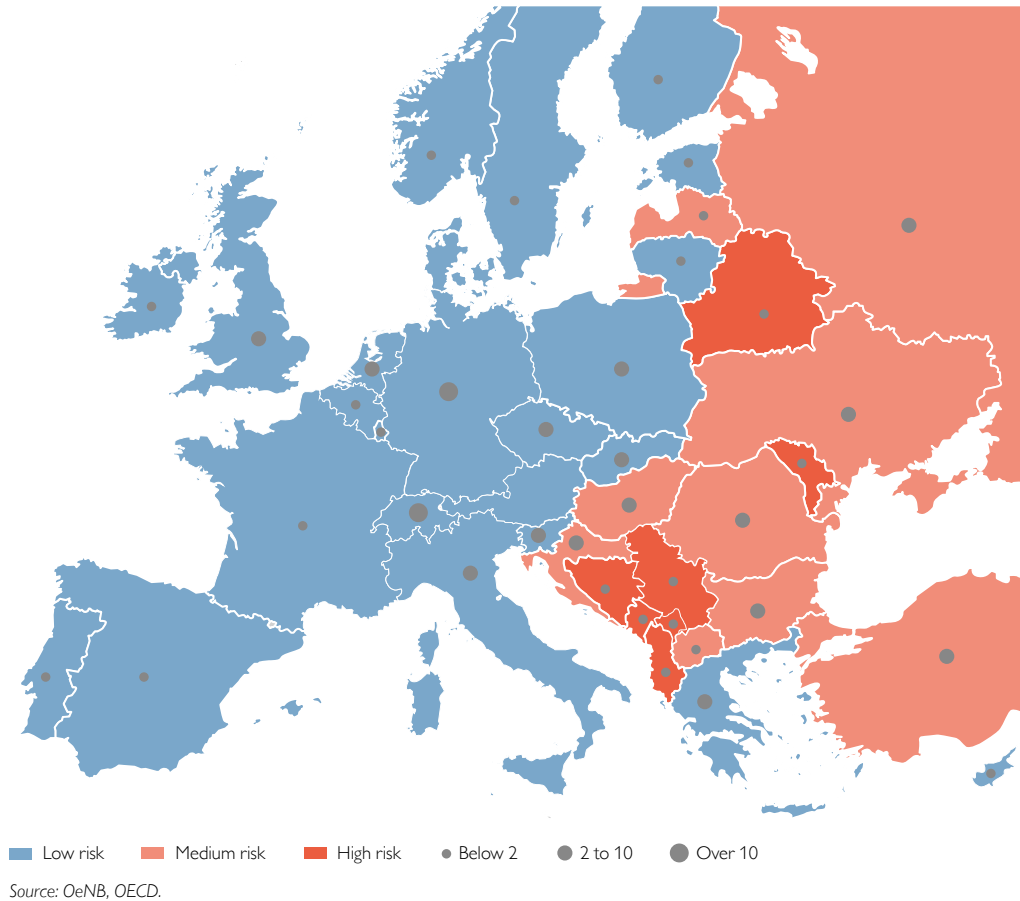
There were, however, changes in risk classification for some countries in Central, Eastern and Southeastern Europe (CESEE). Serbia, for instance, transformed from a high-investment risk country, as assessed in 2007, to a country

² <https://www.oecd.org/trade/topics/export-credits/arrangement-and-sector-understandings/financing-terms-and-conditions/country-risk-classification/>.

Chart 12

Stocks of Austrian outward FDI in Europe in 2007

EUR billion

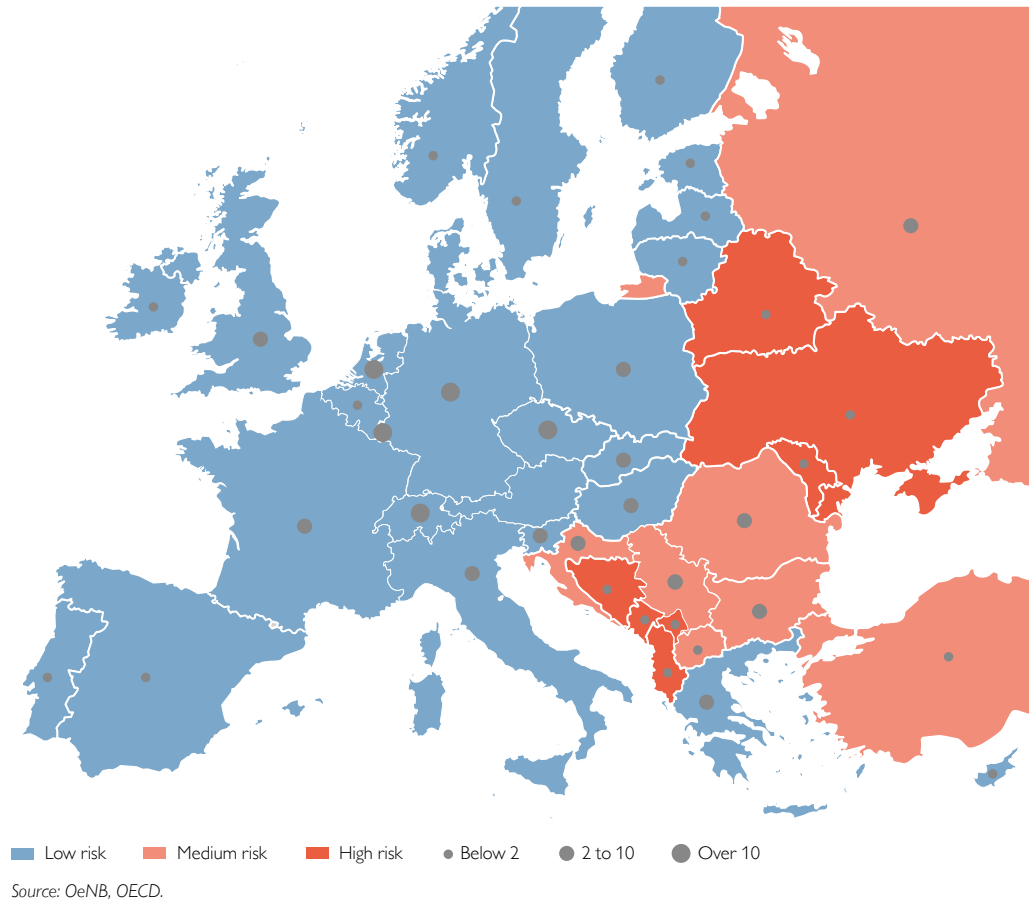


representing only medium investment risk in 2018, which was accompanied by an increase in stocks of Austrian direct investment in the country. Ukraine, by contrast, saw a deterioration of its investment risk classification and a reduction of Austrian FDI.

If we look at the stocks of Austrian outward FDI (chart 14), we see that the relative share of investments in low-investment risk countries has constantly risen since 2007. At 84%, this share reached a high in 2017, declining only marginally in the following year (83.2%). This long-term rise is mainly attributable to a reduction of stocks in medium-investment risk countries. In 2007, 28.7% of stocks of Austrian outward FDI had still been held in countries representing medium investment risk; this share has decreased since then, amounting to only 12.4% in 2018. A similar picture emerges if we look at the development of direct investment in high-risk countries. In 2007, 9.6% of stocks of Austrian outward FDI had been held in countries representing high investment risk.

Stocks of Austrian outward FDI in Europe in 2018

EUR billion



Over the years, this share has declined, reaching 4.3% at the end of the period under review. However, this decline can, in part (circa 20%), be attributed to reclassification effects, i.e. to changes in the risk group categorization of individual countries over time. Preliminary data on stocks of outward FDI suggest that there were no significant changes in the distribution of investment stocks in 2019 and 2020.

In a next step, we will show stocks of Austrian outward FDI broken down by industries and risk groups. Chart 15 breaks down stocks of FDI in low-investment risk countries into the three industries that attract the highest average investment volumes. As we can see, the importance of financial and insurance services has declined somewhat in this respect. In 2007, 44.1% (EUR 27.5 billion) of all outward FDI in low-risk countries had been recorded in this industry; by 2018, this share had declined to 31.1% (EUR 51.4 billion). Over time, stocks of FDI attracted by the trade sector have slightly increased, their share rising from 13.4% (EUR 8.4 billion) in 2007 to 15.3% in 2018 (EUR 25 billion).

Chart 14

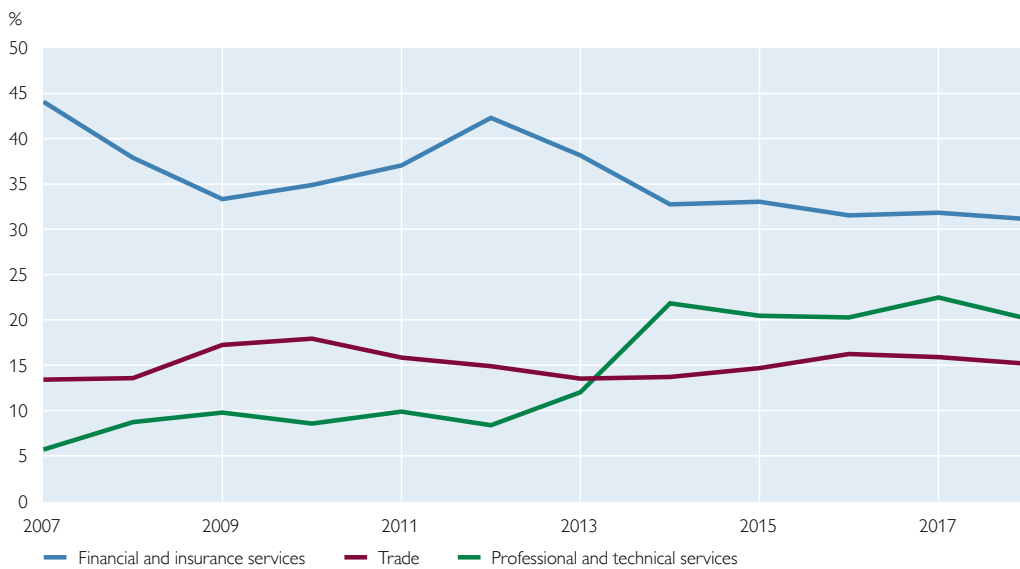
Stocks of Austrian outward FDI by risk groups



Source: OeNB.

Chart 15

Stocks of Austrian outward FDI in low-risk countries



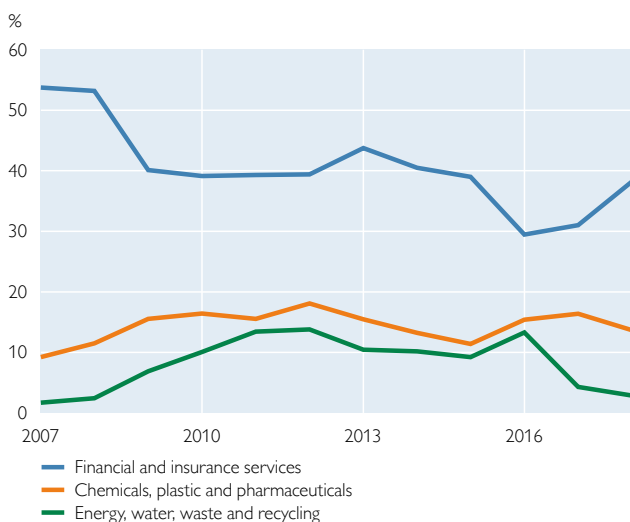
Source: OeNB.

Professional and technical services recorded a strong increase, from 5.7% (EUR 3.6 billion) at the beginning of the observation period to a share of 20.1% (EUR 33.2 billion) in 2018.

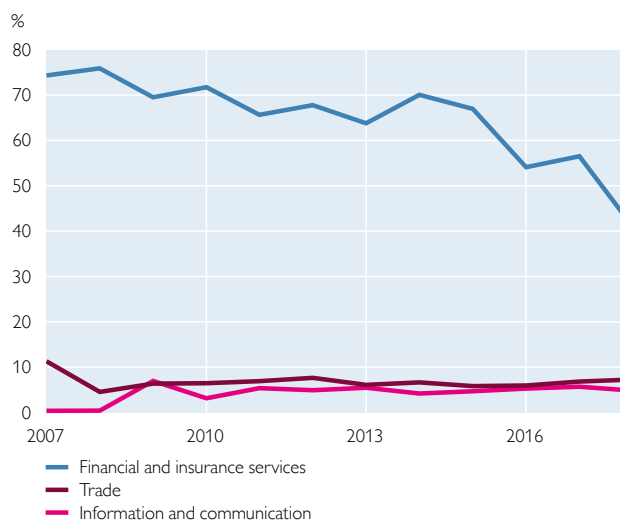
Chart 16 shows a breakdown by industries for countries representing medium and high investment risks. As can be easily seen, in these countries the largest stocks of Austrian outward FDI are also held in the financial and insurance services

Stocks of Austrian outward FDI by sector in medium- and high-risk countries

Stocks of Austrian outward FDI in medium-risk countries



Stocks of Austrian outward FDI in high-risk countries



Source: OeNB.

sector. For medium-investment risk countries, the share of this sector came to 53.7% (EUR 15.6 billion) in 2007. Over the course of the review period, this share came down to 38.2% (EUR 9.4 billion). The chemicals, plastic and pharmaceuticals industry, recorded an increase of 4.4 percentage points. While, in 2006, its share had still amounted to 9.2% (EUR 2.7 billion), stocks of outward FDI in this industry in 2018 accounted for 13.7% (EUR 3.4 billion) of the entire volume invested in this risk category. The third-largest stocks invested in this risk group are held in the energy, water, waste and recycling industry, whose share recorded an increase from 1.7% (EUR 490 million) in 2006 to 2.9% (EUR 702 million) in 2018.

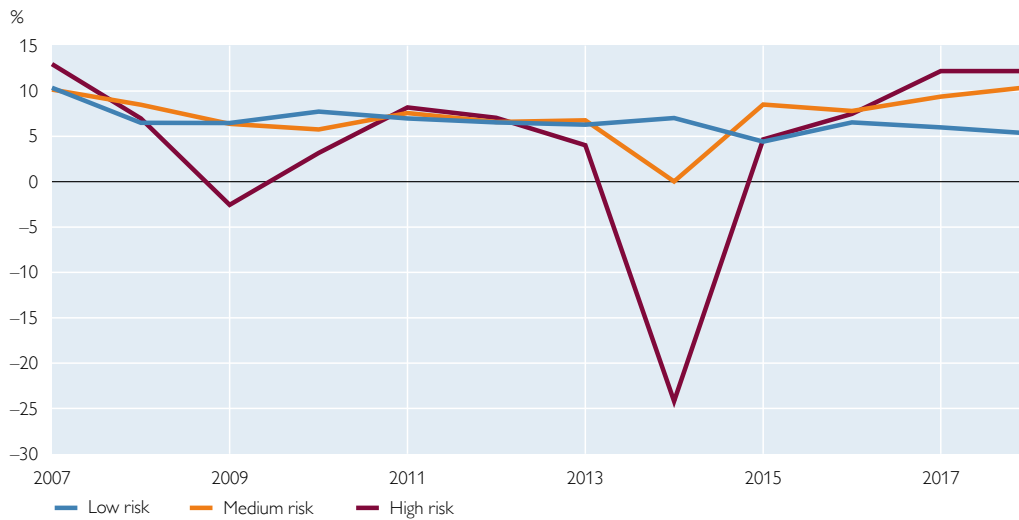
In high-investment risk countries, the relative share of financial and insurance services in overall stocks of Austrian outward FDI has also declined. While it had still amounted to 74.4% (EUR 7.3 billion) in 2006, it decreased over time to reach a low of 41% (EUR 3.6 billion) in 2018. The relative share of the trade sector has also seen a small decline, from 11.3% (EUR 1.1 billion) in 2006 to 7.3% (EUR 640 million) in 2018. By contrast, the information and communication sector, recorded increases, accounting for 4.8% (EUR 421 million) of stocks in high-investment risk countries in 2018.

3.4 Profitability of Austrian FDI broken down by risk groups

To assess the profitability of Austrian direct investments, returns are measured against stocks of outward FDI. Investment returns are made up of three components, i.e. distributed dividends, reinvested earnings and interest.

In line with the risk-return trade-off, potential profitability (and hence volatility) increases with risk. Chart 17 illustrates that this theoretical assumption is confirmed by returns on Austrian outward FDI. Austrian investments in low-risk countries record average returns of 6.7%, with a slight downward trend over the

Chart 17

Returns on Austrian outward FDI

Source: OeNB.

review period. Direct investments in countries that imply medium investment risk generate average returns of 7.3%. In countries that represent a high investment risk, however, profitability is subject to strong fluctuations. While, for example, in 2017 and 2018, investors had seen two-digit returns, 2014 brought a strong decrease, with losses around 24%. This negative outlier brings down the generally high level of investment returns to an average of 4.3%.

3.5 Summary

In the course of this analysis, data on outward direct investment by enterprises established in Austria for the period from 2007 to 2018 were enriched with the OECD country risk indicator to capture relationships between investment behavior and country-specific risks.

The results of the analysis show that Austrian direct investments abroad are mainly concentrated in countries that represent low investment risk. This phenomenon has become more pronounced over time: In 2018, 83.2% of stocks of outward FDI were held in low-risk countries. In terms of distribution among industries, financial and insurance services still attract the largest investment volume – in each risk group and in total. However, over the observation period, the relevance of this industry has declined.

We also found that direct investments in low-risk countries generate the most stable returns and the least volatility in terms of profitability. Investments in medium-risk countries are most profitable on average (in the observation period), yielding average returns of 7.3%. This country group records the second-highest level of volatility. Since 2015, investments in countries that imply a high investment risk have been very profitable, but they have also generated the most volatile returns over the entire observation period.

