Evaluation

of

NZTE investment support activities

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* The Ministry of Business, Innovation and Employment Ministry came into existence on 1 July 2012. The new Ministry integrates the functions of the former Ministry of Economic Development, Department of Building and Housing, Department of Labour and the Ministry of Science and Innovation.

MED1375533

Abbreviations

ANZCERTA	Australia New Zealand Closer Economic Relations Trade Agreement
BIT	Bilateral investment treaty
CER	Closer Economic Relations
DEI	Direct Economic Impact
DTT	Double taxation treaty
EGA	Economic Growth Agenda
FDI	Foreign Direct Investment
GCF	Globally Competitive Firms
IIA	international investment agreement
INZ	Investment New Zealand
LBD	Statistics New Zealand's prototype Longitudinal Business Database
MED	Ministry of Economic Development
MNE	Multinational enterprises
NZTE	New Zealand Trade and Enterprise
ODI	Outward Direct Investment
PIE	Portfolio investment entities
SME	Small and medium-size enterprises
SPE	Special purpose entities

Executive Summary

1. The evaluation examines, in the first section, the role of foreign direct investment (FDI) and outward direct investment (ODI) in New Zealand's economic development. Subsequent sections examine NZTE investment team's contribution to attracting foreign direct investment and supporting outward direct investment of benefit to New Zealand.

Background

2. Government agreed in 2007 that NZTE and Investment New Zealand (INZ) target high-quality inward investment and support outward direct investment by New Zealand firms on a case-by-case basis where the investment is high quality and generates productivity improvements in domestic firms.

3. Since 2007 the policy environment has changed, including development of New Zealand's bilateral investment and trade relationships with Australia and China.

4. The 2010/11 output agreement with the Minister requires an evaluation report on "the economic development value of Investment New Zealand". This report meets the requirement. It incorporates feedback from businesses, from NZTE and other government agencies and the result of research into FDI impacts in New Zealand.

The role of direct foreign investment in our economy

5. International direct investment by multinationals can:
   - promote growth and employment;
   - serve local enterprise development;
   - help to improve the competitive position of both host and home economies;
   - provide an important source of capital;
   - encourage the transfer of technology and know-how; and
   - also generate productivity improvements in domestic firms (spillover effects).

6. Foreign direct investment (FDI) in New Zealand has consistently been higher than outward direct investment (ODI) of New Zealand. This has resulted in a negative net direct investment position. New Zealand recorded FDI of $16.2 billion and ODI of $5.9 billion between 2007 and 2010; total FDI stock was $92.5 billion and total ODI stock was $21.4 billion at the end of 2010. Australia is the most important source and destination of New Zealand's direct investment.

Findings

The economic value to New Zealand of FDI depends on its qualitative aspects, including the scope for spill-over benefits.

7. New Zealand is very dependent on FDI as a key source of investment, skills and trade development, and opportunities.

8. International evidence and studies on New Zealand show that direct investment (inward and outward) is linked to economic growth, but the magnitude of the effect is small. The role of foreign ownership has been overstated compared to the influence of other (structural) factors. Improvements in technology, efficiency and productivity at the firm level tend to have a considerably greater effect on stimulating growth. Additional benefits (spillovers[1]) of direct investment do not occur automatically, but depend on the characteristics of individual firms and the wider economy.

9. A key finding of the study is that benefits of "high quality" investment are highly dependent on compatible company and country characteristics. The level of absorptive capacity[2] in New Zealand appears, from MED research, to be a bottleneck in the investment climate in order to make the country more attractive for "high-quality" FDI.

    - The New Zealand evidence on wider benefits (knowledge or productivity spillovers) from FDI to the local economy suggests that such benefits are more likely for exporting firms, and are small elsewhere.

    - FDI can enhance competitive pressure to innovate and up-skill, thus indirectly enhancing economic growth. Pinpointing evidence of these dynamics is tricky and therefore the benefits might be underestimated. However, absorptive capacity remains an issue here too.

FDI is attracted here by desire for enhanced market access, know-how and other resources.

10. New Zealand is highly successful in attracting FDI, with the largest share continuing to come from Australia. Foreign-owned firms now account for over 50% of business revenues, almost 60% of value added and 45% of employment.

11. Foreign companies identified a) reduced costs (efficiency seeking), b) access to new products and/or technologies, and c) improved market access to New Zealand (market seeking) as the main sources of value. Equally, New Zealand companies, contemplating ODI, identified a) improved market access to other countries, b) reduced risk through diversification and c) access to new products or markets as the main direct sources of value to them.

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[1] Positive spill-overs occur when benefits accrue to those not involved in a transaction. In the case of FDI, spill-over benefits would include the generation of new knowledge and skills which are eventually available to firms in an industry or the wider economy to increase their competitiveness.

[2] Absorptive capacity is a firm's ability to use new information and knowledge to commercial ends. Absorptive capacity can be developed through more R&D, better knowledge management and human resources, or increased supplier and client integration.

12. Additional evidence showed that foreign businesses investing in New Zealand benefited from the existing leading-edge knowledge of purchased New Zealand companies and that acquired businesses benefited from distribution channels of MNEs that otherwise would not have been accessible.

There is a 'market failure' case for government intervention, particularly to promote FDI projects that can clearly enhance economic growth.

13. The economic rationale for government support in attracting quality investment and supporting outward investment is based on market failure (e.g. barriers to obtaining critical information) and the generation of positive externalities (e.g. knowledge spill-overs to a firm that is not directly involved in the transaction).

14. Barriers to FDI include limited knowledge about the characteristics of New Zealand as a place to invest. Other barriers faced by foreign investors are access to the right contacts and networks, access to information not otherwise available, and guidance in navigating the legal and regulatory framework in New Zealand.

15. There is evidence of productivity enhancing spillovers for some types of inward investment. As these benefits cannot be fully internalised by the foreign investing firm, the inference is that markets unaided would not deliver optimal levels of FDI.

The effectiveness of policies seeking to attract FDI is less clear. NZTE estimate the net economic benefit to New Zealand attributable to NZTE's involvement in FDI/ODI. For 2009/10 this was $77m. Looking at what businesses said about the counterfactual, the net effect of NZTE involvement is difficult to estimate.

16. Governments in most countries have put policy measures in place to encourage multinationals to establish local affiliates in the hope of generating benefits from international direct investment. It is less clear if these policies are effective.

17. Overseas evidence suggests that the most effective strategies are those which are very well integrated with government priorities. This requires a close co-ordination of foreign investment policy with other policies such as innovation policy.

18. Most firms contemplating FDI or ODI projects have sufficient internal resources to manage their international investment decision and see no need to use NZTE services for investment purposes. Accountants and law firms are used if external information or expertise is sought. Almost 40% of surveyed firms were not aware of NZTE investment services. Some firms will seek NZTE help with government contacts and essential information about New Zealand. NZTE influence on FDI decisions is mainly due to helping inward investors to facilitate access to contacts and information that is not otherwise readily accessible.

19. For those potential FDI interests that significantly engage with NZTE, the investment team contributes to and closely supports the process by facilitating engagement with key contacts and other leads in New Zealand. They also provide detailed sector knowledge, market insights and other information that can increase New Zealand's competitive edge in attracting investment.

20. There is some evidence, e.g. the premium tourism market, of the ability of the NZTE investment team to contribute to high quality investment in ways likely to benefit the New Zealand economy. For FDI, benefits of NZTE involvement cannot be quantified and it is unclear whether government is able to intervene effectively.

The scope for facilitating ODI has been small.

21. International evidence shows that less productive companies choose exporting over direct investment in their internationalisation strategy because high fixed costs and risks are associated with such investment. The evidence of a clear ranking between New Zealand firms that export and those that conduct ODI is, however, weaker. The number of New Zealand companies engaged in ODI is low and accordingly the number of ODI companies assisted by the NZTE investment team is very low.

Recommendations

The evaluation findings show that the net benefits from NZTE services have (with some exceptions) been modest. The conclusion is that there needs to be clearer expectations for explicit investment results that NZTE is able to help deliver.

The evaluation has identified the following issues for further consideration:

The expectations, as to what particular outcomes of particular benefit to New Zealand can be achieved, merits further clarification.

22. There is a role for NZTE in assisting firms to attract quality investment and to internationalise through outward investment. Necessary FDI promotion activities are “investor servicing” that involves assisting potential or committed investors by providing information, acting as a point of enquiry and helping analyse business opportunities. However, the impact of such works is often limited, and expected outcomes should be clarified in the light of what can realistically be achieved. Important factors for international investment (e.g. market size and growth) are to a large extent outside the direct scope of government policy.

The focus on ‘high quality’ FDI should be elaborated, for example to identify if there are particular sectors/functions where spill-overs and other potential net benefits to New Zealand are more likely to occur and, if so, confirm these in the policy expectation.

23. The current FDI approach is focused on attracting “high quality” investment that results in a targeted FDI strategy. Identifying and measuring “high quality” investment has become more complicated due to the fragmentation of the global production process. The challenge for this approach is to design a coherent and efficient strategy that takes account of other characteristics of New Zealand. A more differentiated approach including prioritising in terms of particular sectors and/or functions with clear cost advantage (e.g. R&D activities) seems to be warranted.

Consideration should be given to achieving greater value from complementary aspects of innovation policy and FDI promotion.

24. The magnitude of positive knowledge spillovers through FDI depends on the absorptive capacity of domestic companies for advanced technology and/or knowledge of international investors or MNEs. We should aim for integrated direct investment and innovation initiatives that foster innovation and improve the absorptive capacity of domestic companies. More insights are also needed on how FDI work can better respond to the growing importance of innovation and global innovation networks.

Consideration could be given by government to seeking a more competitive promotion facility by, for example, empowering NZTE to leverage support for specific FDI initiatives from across relevant portfolios.

25. FDI attraction and support for ODI strategies should not be used in isolation of other work to support New Zealand business growth. An integrated approach should cover different policy instruments, including support for private R&D, skill development and immigration, access to public research, and innovation networking. This requires a closer co-operation between NZTE and e.g. the Department of Labour, Ministry of Environment, and Ministry of Science and Innovation.

More information and insight is needed on where ODI support may be relevant and how this relates to other support for internationalisation and growth.

26. Exporting is still the preferred way of internationalisation for New Zealand companies and outward direct investment is often perceived as too risky for most New Zealand firms, given their size and capabilities. Given the low number of ODI cases and the close link between international investment and international trade, the evaluation calls for a better understanding of how New Zealand and its companies can enhance their connectedness in global networks, e.g. explore how New Zealand positions itself within international networks of companies and how the local economy can benefit from these networks.

27. The evidence showed that ODI support should be set into a new framework that focuses on firms which are seeking to grow and have the appropriate productivity and innovation characteristics to provide spill-over benefits to other New Zealand firms. Evidence also cautions against encouraging firms to engage in international investment when those firms lack the qualities necessary for sustainable business success.

Since this evaluation was completed in August 2011 the 'NZTE Capital Team' has restructured its operating model to explicitly increase investment that supports government business growth objectives. This means FDI and ODI that contributes to the Business Growth Agenda's goals.

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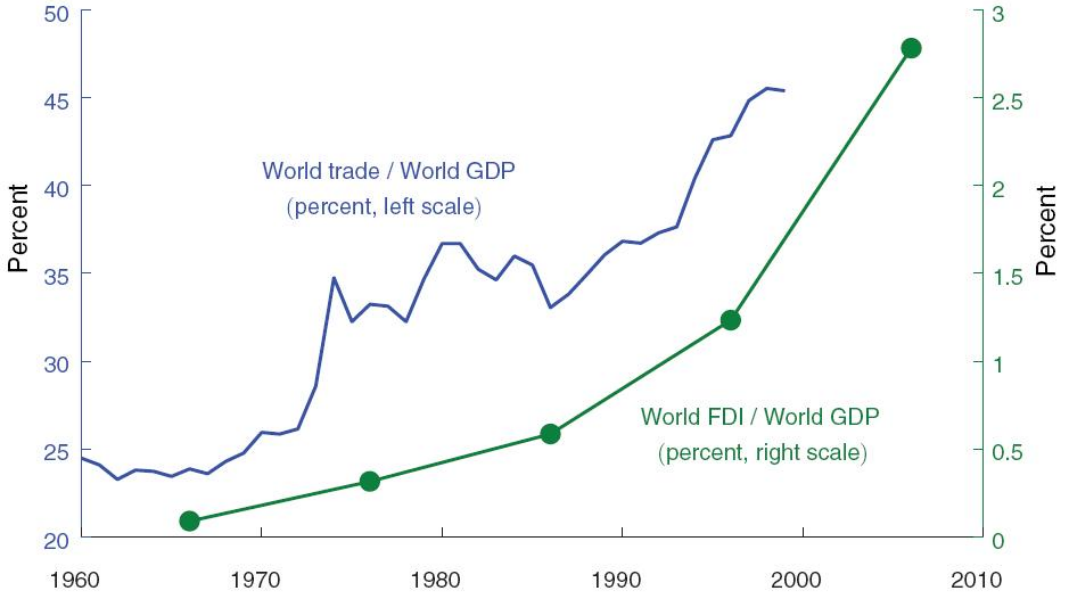
1. Costs and benefits of international investment

1.1 Growth of international investment

International investment has been a primary driver of globalisation over the last few decades, showing a growth rate significantly above world GDP growth. International investments (both direct and portfolio investments) have grown more strongly than international trade but are at the same time highly volatile. Foreign Direct Investment (FDI) as a share of world GDP has increased by a factor of 30 since 1965 (Figure 1-1). Inward FDI statistics measure cross-border investments that provide the means for creating direct, stable and long-lasting links between economies. Large multinational enterprises (MNEs) are traditionally the dominant players in such cross-border capital transactions due to their subsidiaries and affiliates abroad which increasingly export intermediate and final goods/services between them. However, small and medium-size enterprises (SMEs) have also become increasingly involved in foreign direct investment. The 'born global' path has been most closely associated with high-tech and knowledge-intensive firms which require rapid and timely internationalisation.

Figure 1-1 The Rise in Globalisation

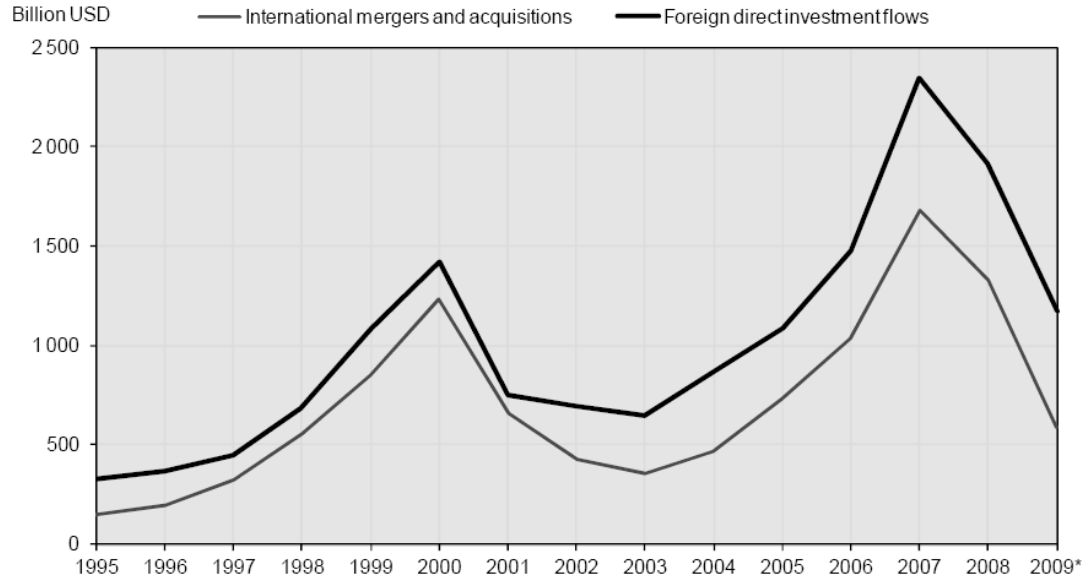


Source: Jones and Romer (2010)

Globalisation has benefitted from the liberalisation of capital movements through the elimination of restrictions on FDI. In addition, drastically reduced trade costs induced by technological progress have also made the integration of markets across borders easier. The decline in these costs has helped reduce economic distances and smoothed economic interaction among countries.

The rising flows and stocks of FDI reflect the increasing internationalisation of (multinational) companies and have resulted in an increasing interdependence between countries. Particularly mergers and acquisitions (Figure 1-2) largely aimed to restructure firms' activities have contributed to the strong surge in international investment flows.

Figure 1-2 FDI flows and mergers and acquisitions



Note: * estimates.

Source: OECD (2010a)

Production processes have become increasingly fragmented within global value chains (international production networks) as goods are produced sequentially in stages across different countries. The rapid fall in communication and co-ordination costs has facilitated this spatial distribution of production (Baldwin, 2006). Firms seek to optimise the production process by locating their various production stages across different sites according to the most optimal location factors across countries. As a result, companies have increasingly been restructuring their operations internationally (outsourcing and offshoring). Production in one location, in line with a country's comparative advantages, becomes less relevant.

MNEs are responsible for a large share of employment, turnover and value added in host countries. In 2007, MNE share in OECD manufacturing turnover ranged from nearly 80% in Ireland, 70% in the Slovak Republic, 55% in Belgium to just 3% in Japan. These figures indicate that strategic decisions taken at the international level by MNEs may generate major impacts on the economic structure of host countries.

Almost all governments try to attract international investments by multinational enterprises as these promote growth and employment by creating new jobs, realising new investments and bringing in new technologies. Policy makers are interested in the direct and indirect value that new international investments can bring to their

country. By encouraging multinationals to establish local affiliates host countries hope to generate technology transfer and/or other spillover effects[3] to local firms.

In the right policy environment, FDI can serve as an important vehicle for local enterprise development; help to improve the competitive position of both host and home economies; provide an important source of capital; and encourage the transfer of technology and know-how.

The literature on international investments and its determinants (which is vast) has attempted to explain the motives of international engagement by MNEs. The extensive list of determinants includes amongst others: tariff and investment barriers; growth and market size; distance; wage costs; average education; the presence of other MNEs; the regulatory framework; and property rights.

Rising levels of FDI and ODI concern many policy makers and some parts of the New Zealand public (De Raad, 2010). These concerns are twofold: 1) they stem from the perception that foreign companies (FDI, capital importing) take control of domestic assets and 2) that too much of domestic capital (ODI, capital exporting) goes abroad and depresses economic activity at home. Another potential issue is the impact of outbound foreign direct investment on domestic investment. OECD countries with high rates of outbound FDI in the 1980s and 1990s exhibited lower domestic investment than other countries, which suggests that FDI and domestic investment are substitutes. Better data (U.S. time series) tell a very different story, however. Those years in which American multinational firms have greater foreign capital expenditures coincide with greater domestic capital spending by the same firms. One dollar of additional foreign capital spending was associated with 3.5 dollars of additional domestic capital spending in the time series, implying that foreign and domestic capital are complements in production by multinational firms, Desai et al. (2005).

Due to a lack of clear analytical and empirical support for significant economic impact of FDI and ODI concerns have risen as to whether FDI and/or ODI is “good” or “bad” for the New Zealand economy, Treasury (2009). The next two sections will present data on international investment for New Zealand and summarises the insights from the literature and research findings.

1.2 Foreign Direct Investment in New Zealand

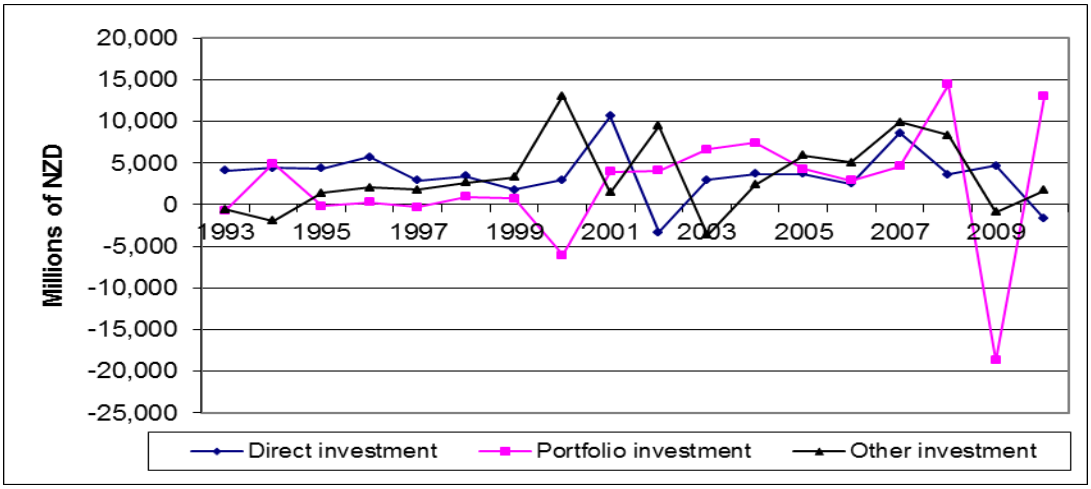
1.2.1 Components of Foreign Investment

FDI is just one element of foreign investment. The various components of foreign investment include: Direct Investment, Portfolio Investment, Financial Derivatives,

[3] Positive spill-overs occur when benefits accrue to those not involved in a transaction. In the case of FDI, The establishment of a foreign firm may bring new technologies or management techniques to the host country or can also contribute to the development of suppliers, better training, and transfer of skills. In some cases, other companies in the host country can also benefit from these new technologies. The paths of spillover effects are imitation, competition, skill acquisition and proliferation.

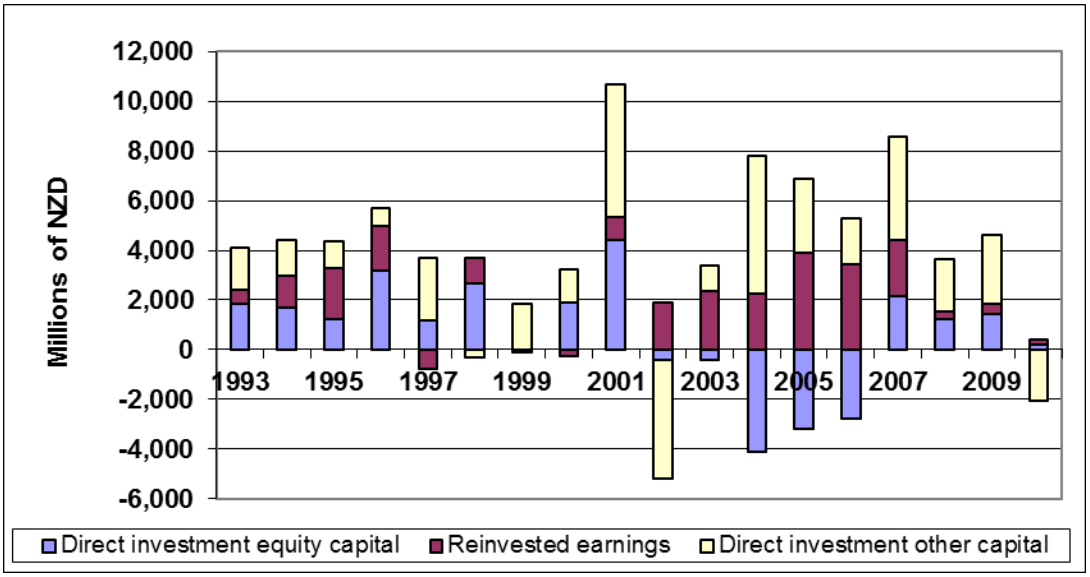
Other Investment and Reserve Assets. FDI itself is further broken down into Investment in Equity Capital, Reinvested Earnings and Investment in Other Capital[4].

Figure 1-3 Types of Inward Investment into New Zealand



Source: Statistics New Zealand

Figure 1-4 Components of FDI Inflows into New Zealand



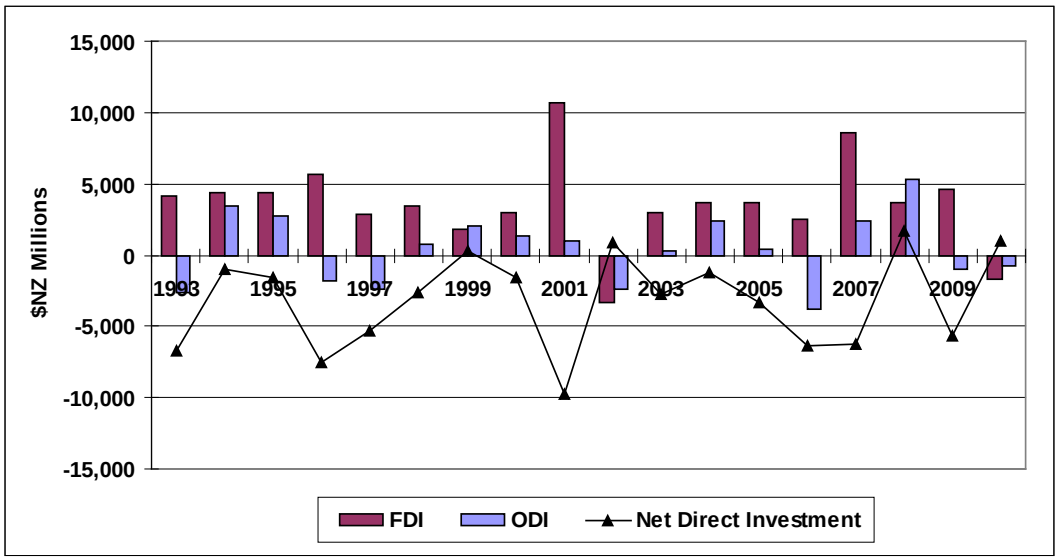
Source: Statistics New Zealand

[4] For definitions of all these components see: BoP Sources and Methods 2004. Available from: http://www.stats.govt.nz/browse_for_stats/economic_indicators/balance_of_payments/bop-sources-and-methods-2004.aspx

1.2.2 Foreign Direct Investment Flows and Stocks

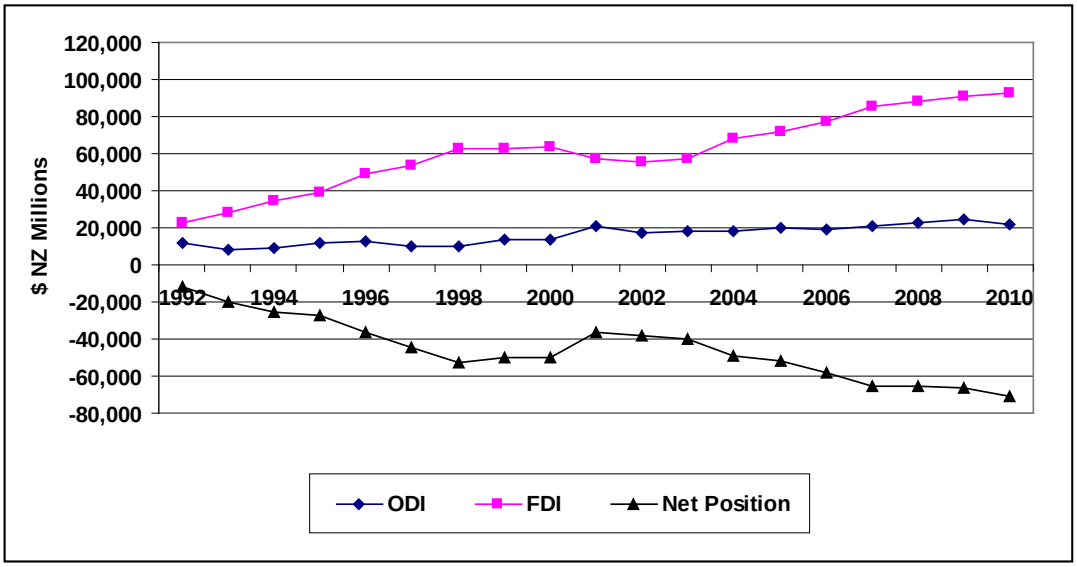
FDI flows into New Zealand have consistently been far higher than ODI flows out of New Zealand, with a consequent negative net flow of direct investment. This has resulted in a build-up of FDI stocks compared to ODI stocks and an increasingly negative net direct investment position, as shown below[5].

Figure 1-5 Foreign Direct Investment Flows in New Zealand



Source: Statistics New Zealand

Figure 1-6 Foreign Direct Investment Stocks in New Zealand



Source: Statistics New Zealand

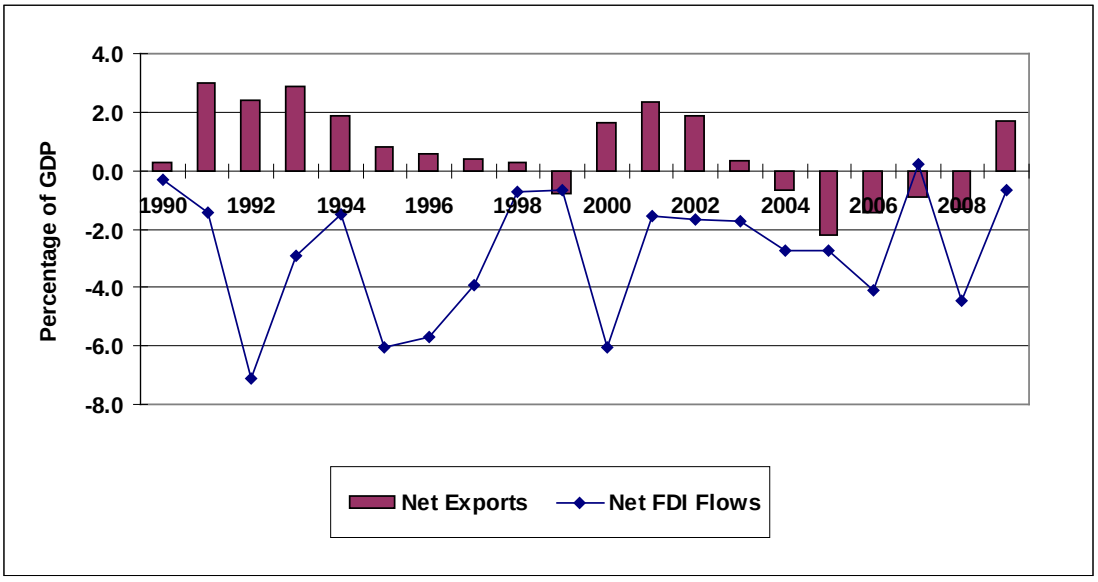
[5] Countries that have a similar ratio of higher FDI than ODI are some Eastern European transition countries (Slovac and Czech Republic, Poland, Hungary), Mexico and China. See also Figure 5-11 in Annex.

Note that there is a structural break in the data (shown in Figure 1-5 and Figure 1-6) due to the fact that in the June quarter of 2000 the definition of direct investment used by Statistics New Zealand changed from a 25% ownership threshold to the current 10% threshold[6].

It might be expected that this would lead to an upwards jump in the data at that point. However, although there is a slight rise in ODI, this is only temporary and not particularly large. In contrast to what might be expected, FDI is observed to actually decline for the two years following 2000. Regardless of this dip, the trend is clear: FDI flows into New Zealand are much greater than ODI flows out of New Zealand and therefore FDI stocks are growing at a faster rate than those of ODI.

FDI was an average of 14% of Gross Fixed Capital Formation between 1993 and 2010, although this was highly volatile. Figure 1-7 shows exports and FDI. Since 1990, net exports were mainly positive[7], whereas net direct investment was almost always negative.

Figure 1-7 New Zealand Exports Compared with Net FDI Flows as a Share of GDP



Source: World Bank

[6] Direct investment position data are stock data showing an economy's direct investment assets and liabilities at a given point in time. According to international standards, assets and liabilities should be valued at market prices prevailing on the date they are recorded in the statistics. Revaluations based on market valuation concepts can lead to changes in stocks although no significant FDI flows took place.

[7] Over the ten-year period from 1998 to 2008, relative goods export growth (i.e. export growth in New Zealand divided by growth for all OECD countries) was just above OECD average Figure 5-9 Annex). In the same period, the growth rate of service exports was below OECD average. Averaged over the three years to 2008, trade in services was slightly negative for New Zealand and large surpluses were recorded for United States and United Kingdom (Figure 5-10 in Annex).

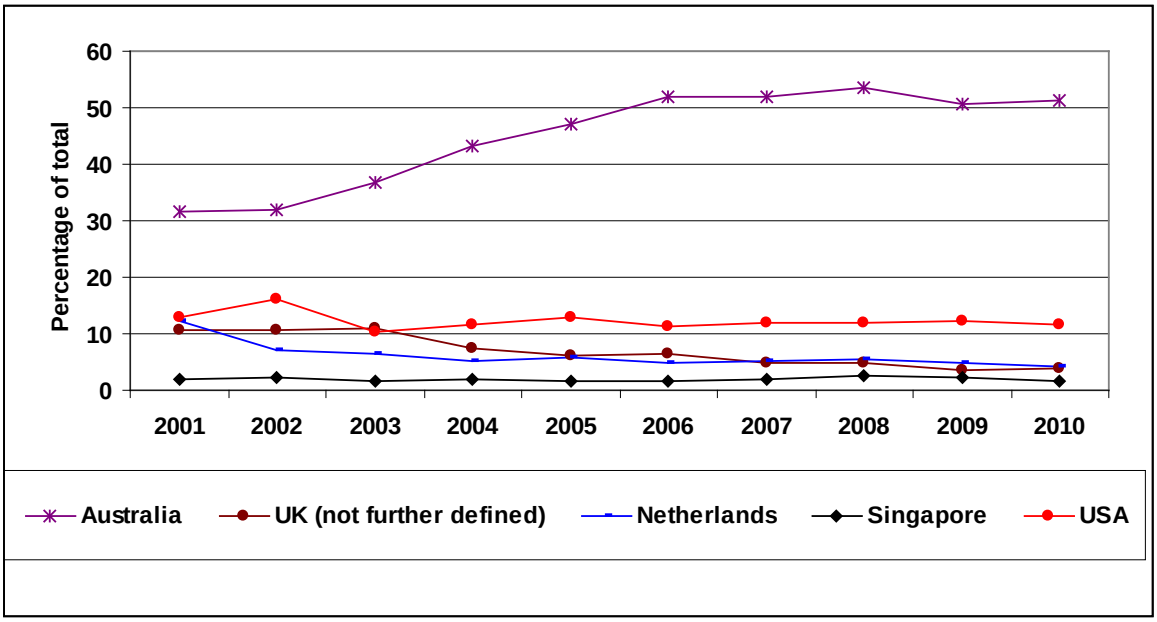
Investment by Industry

Statistics New Zealand does not currently produce figures for FDI and ODI by industry; part of the reason being issues with confidentiality in industries with only a small number of enterprises. In terms of total investment, financial and insurance services dominate the landscape, accounting for an average of 71% of total outward and 62% of total inward investment between 2001 and 2010. This is followed by manufacturing with 15% of total outward investment and 11% of total inward investment, public administration and safety with 6% of total outward investment and information, media and telecommunications with 5% of total inward investment[8].

Foreign Direct Investment by Country

Australia stands out as being both the major source and destination country for New Zealand FDI and ODI, followed by the USA and the UK. Since 2001, on average 45% of FDI came from Australia and 50% of ODI went to Australia.

Figure 1-8 New Zealand FDI Stocks by Source Country



Source: Statistics New Zealand

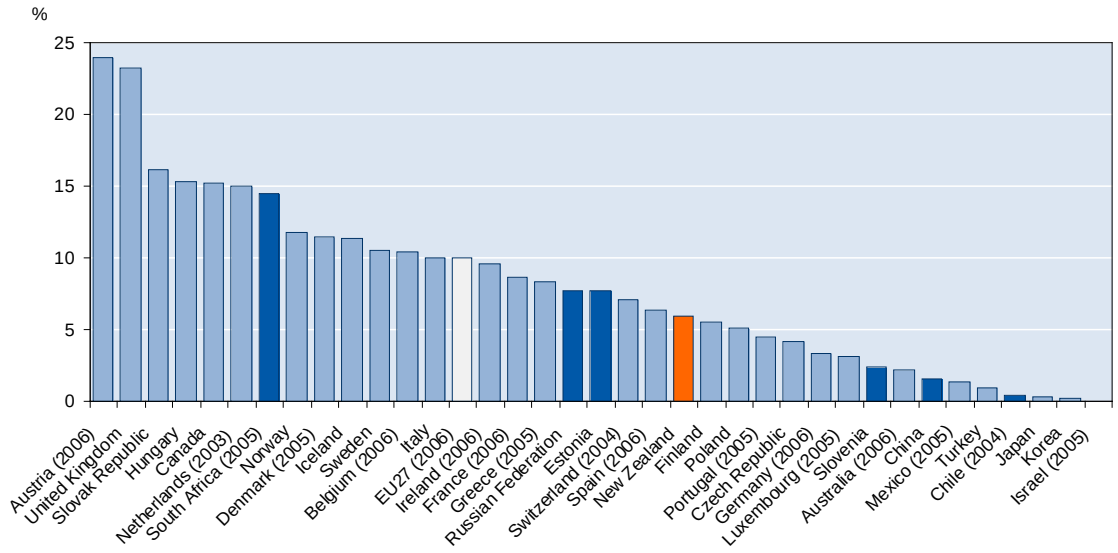
[8] Internationally comparable FDI statistics per industry are not readily available. However, foreign presence is somewhat less strong in the services sector than in manufacturing and there are important differences between individual industries and countries. In OECD countries, the financial sector has the largest foreign presence in some eastern European countries. A large share of turnover is realised by foreign affiliates of the many western European banks which built their positions after these countries joined the European Union.

Quality of FDI inflows

Most countries target their promotion and facilitation activities on “high-quality” investment. Quality FDI is seen as investment that significantly increases employment, enhances skills and boosts the competitiveness of local enterprises.

Exactly what constitutes ‘high quality’ FDI is difficult to define because it is a function of many different investment and country characteristics. Measuring is even more difficult. Given the difficulties of determining objective criteria for ‘high quality’ FDI it is only possible to measure quality indirectly. One proxy for “high quality” is R&D funded from abroad. Funds from abroad accounted for at least 15% of aggregate business R&D funding in Austria, the United Kingdom, the Slovak Republic, Hungary, Canada and the Netherlands.

Figure 1-9 Funds from abroad as a % of business enterprise R&D, 2007



OECD Economic Globalisation Indicators 2010

Another proxy for high-quality FDI is ownership of inventions/patents. Collaboration with foreign partners increasingly plays an important role as firms gain access to a broader pool of resources and knowledge at lower cost. The information contained in patents makes it possible to trace the internationalisation of technological activities and the circulation of knowledge among countries. Cross-border ownership of inventions/patents clearly reflects the internationalisation of science and technology activities. On average, 15% of all inventions/patents were owned or co-owned by a foreign resident in 2005-07, but the differences are substantial across countries (see Figure 5-1 and Figure 5-2 in Annex).

1.2.3 Firm level evidence

The prototype Longitudinal Business Database (LBD) administered by Statistics NZ contains a range of variables from different sources and captures the NZ business economy comprehensively. Although the standard threshold of 10% ownership defines FDI, in NZ almost all foreign firms have overseas ownership in excess of 50%. The total number of foreign firms in 2009 was 2,800. They generated over 50%

of total business revenues and almost 60% of value added, and provided around 45% of employment. These shares are high but not uncommon and are of the same magnitude as in some European countries (Figure 5-3 and Figure 5-4 in the Annex).

There is considerable variation in foreign ownership by size and industry (Table 1-1). Foreign ownership is highest in finance and insurance, mining, wholesale and communication services.

Table 1-1 Foreign Ownership of New Zealand Businesses

Percentage in 2009

	FDI	Up to half	Over half
Business size			
6–19 employees	5	1	4
20–49 employees	8	2	7
50–99 employees	20	3	17
100+ employees	30	3	27
Industry			
Agriculture, forestry & fishing	4	2	3
Mining	25	3	25
Manufacturing	9	2	7
Electricity, gas, and water supply	8	0	8
Construction	2	0	2
Wholesale trade	22	2	20
Retail trade	3	0	2
Accommodation, Cafes & Restaurants	3	2	1
Transport, postal & warehousing	8	0	8
Communication services	19	3	15
Financial & insurance	25	4	22
Rental, hiring & real estate	6	2	4
Professional, scientific & technical services	11	3	8
Administrative & support services	9	2	7
Education & training	8	2	6
Health care & social assistance	3	1	2
Arts & recreation services	2	1	2
Personal and other services	3	1	2
Overall	**7**	**1**	**6**

International comparisons of the average employment of foreign and domestic firms show that foreign firms in New Zealand are on average significantly larger than national firms (Source: OECD Economic Globalisation Indicators 2010, Figure 5-5 to Figure 5-8 in Annex). This is true for all countries and New Zealand is no exception, compare Table 1-2. In addition to being larger on average than domestic firms, foreign firms also display higher levels of labour productivity, average compensation per employee is higher for foreign firms than for national firms.

Table 1-2 Domestic and foreign firm characteristics in New Zealand

in thousand NZ$ except employment

Average firm	domestic	foreign
Sales	1,850	68,084
Value added[1]	644	29,761
Capital service	174	6,008
Employment	8	214

[1] Difference between sales and purchases.

However, to compare foreign-owned firms with domestic firms is not straight forward. A majority of the domestic firms in New Zealand are small independent firms, which may be different from foreign multinationals or even domestic multinationals in several important ways, e.g. in management skills and governance structure[9].

Foreign ownership or FDI has increased productivity. However, the dynamic effects of FDI on the productivity of other New Zealand firms, through productivity enhancing spillovers, is less clear. Evidence of significant productivity enhancing spillovers was found only for firms in the downstream segments of the supply chain, but negative spillovers that hurt the domestic firms in the upstream segment (Iyer et al, 2010).

Direct investment, growth, and productivity

Successful internationalisation through either exporting or investment abroad can provide significant growth opportunities for NZ firms beyond the constraints of a small domestic economy (MED, 2008). Although only a small fraction of firms export, they are usually larger and more productive than firms that serve only the domestic market. An even smaller fraction of firms engage in outward direct investment (ODI). Only the most productive firms become multinationals and only the most capable firms have the knowledge and managerial skills to undertake profitable ODI projects. However, there is weaker evidence for New Zealand of a clear ranking between firms that export and those that conduct ODI, Doan et al (2011). ODI projects may not be good for all firms and positive past experience may not carry over to future investments. It is likely that firms which benefited the most from ODI did so first and reaped the greatest benefits.

Given that only the most productive firms engage internationally it is not surprising that the absolute number of New Zealand firms investing abroad is low. Data from the BOS survey[10] indicates that only 4% of New Zealand groups have an ownership interest in an overseas company and international comparison shows that New Zealand's outward investment-to-GDP ratio is low and below OECD average. The

[9] Johansson et al (2008) state that therefore the relevant comparison should be between foreign and domestic firms belonging to a company group. Controlling for firm size, human capital and industry, they find that the foreign takeover of domestic firms is neutral with respect to labour productivity and innovation activities in Denmark, Finland, Norway and Sweden.

[10] The Business Operations Survey (BOS) includes those businesses which have Rolling Mean Employment (RME) greater than 6.

low ODI intensity should be interpreted with care. It does not necessarily point to a problem per se and relies on the assumption that New Zealand should have comparable value to other similar (small) countries.

The proportion of firms undertaking ODI projects increases with firm size. ODI is highest in communication services, finance and insurance, manufacturing, and wholesale. Greenfield investment is the most popular method of gaining overseas ownership interest or shareholdings (Table 1-3).

Table 1-3 ODI: Overseas holding by New Zealand businesses

Percentage 2009

	ODI	of			
		Joint Venture	Acquisition	Greenfield	Other method
Business size					
6–19 employees	3	0	0	1	1
20–49 employees	5	1	1	3	1
50–99 employees	9	2	2	4	2
100+ employees	12	2	5	6	1
Industry					
Agriculture, forestry & fishing	2	0	1	0	1
Mining	3	0	3	0	0
Manufacturing	7	1	1	4	1
Electricity, gas, and water supply	5	0	0	5	0
Construction	2	1	0	1	0
Wholesale trade	7	2	2	3	2
Retail trade	2	0	0	0	2
Accommodation, cafes, restaurants	3	0	1	2	0
Transport, postal & warehousing	3	1	0	1	1
Communication services	11	3	3	5	2
Financial & insurance	8	1	1	5	1
Rental, hiring & real estate	1	0	1	0	0
Professional, scientific & tech. services	6	1	0	4	2
Administrative & support services	3	0	2	1	0
Education & training	4	0	2	2	0
Health care & social assistance	2	0	0	2	0
Arts & recreation services	4	0	0	0	4
Personal and other services	2	0	2	0	0
Overall	4	**1**	**1**	**2**	**1**

1.2.4 International comparisons

Figure 1-10 and Figure 1-11 show the relative importance of the position of OECD countries as home or host of direct investments and provide the ranking of inward and outward FDI positions by relative importance measured as a percentage of their GDP.

In terms of real levels of investment stocks, the United States is the largest host and investor country representing around 25% of total OECD investments. In comparison to the size of its economy, United States' foreign investment from abroad represented only 18% of its GDP and its outward investments 24%. All other G7 countries and smaller northern European countries, Denmark, Finland, Norway and Sweden also exhibit relatively more important outward investments than inward investments.

Figure 1-10 Outward FDI position

OECD, % of GDP – 2007

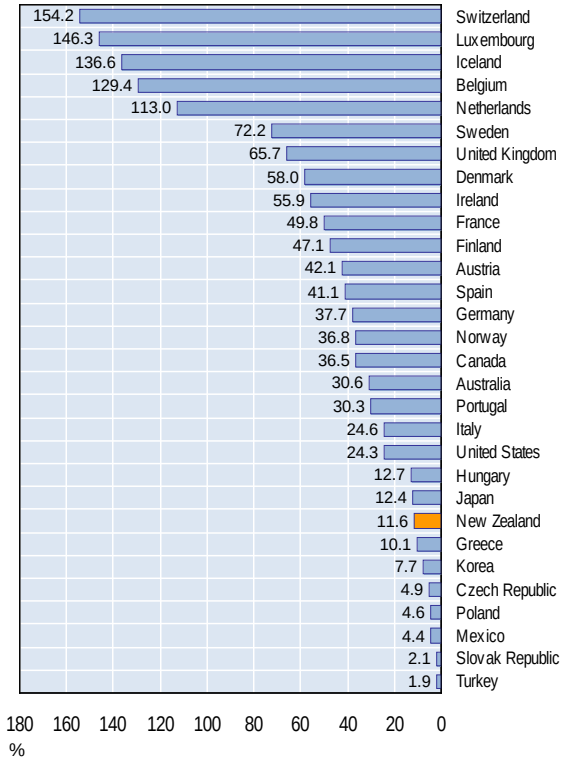
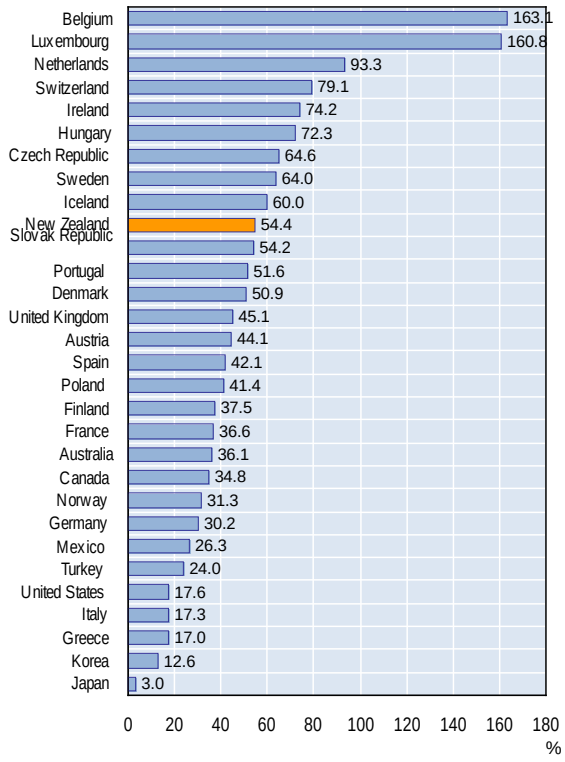


Figure 1-11 Inward FDI position

OECD, % of GDP – 2007



In contrast, poorer OECD economies are primarily recipients of FDI. Their ranking by relative importance as host of FDI, measured as a percentage of GDP, is as follows: Hungary (72%), the Czech Republic (65%), New Zealand and Slovak Republic (54%), Poland (41%) and Turkey (24%). Their outward investments were relatively small, with the exception of Hungary (13%) and New Zealand (12%)[11].

UNCTAD publishes an interesting Inward FDI Potential Index that ranks countries "*based on slow-changing structural factors… This index is thus constructed as the*

[11] The ratios for Belgium and Luxemburg (and to a certain extent also the Netherlands and Switzerland) are not fully comparable to other countries. These economies host special purpose entities (SPE). Multinational enterprises may use special purpose entities which are domiciled and registered in another country even if they have no physical presence in that economy. SPE are included in FDI statistics but account largely for funds in transit.

unweighted average of the normalised values of eight variables: rate of GDP growth, per capita GDP, share of exports in GDP, telephone lines per 1,000 inhabitants, commercial energy use per capita, share of R&D expenditures in gross national income, share of tertiary students in the population, and political and commercial country risk."

Care needs to be taken in interpreting this FDI Potential Index since it cannot capture the full extent of all social, political and institutional factors that affect FDI flows, although it is interesting to note New Zealand's gradual decline in ranking.

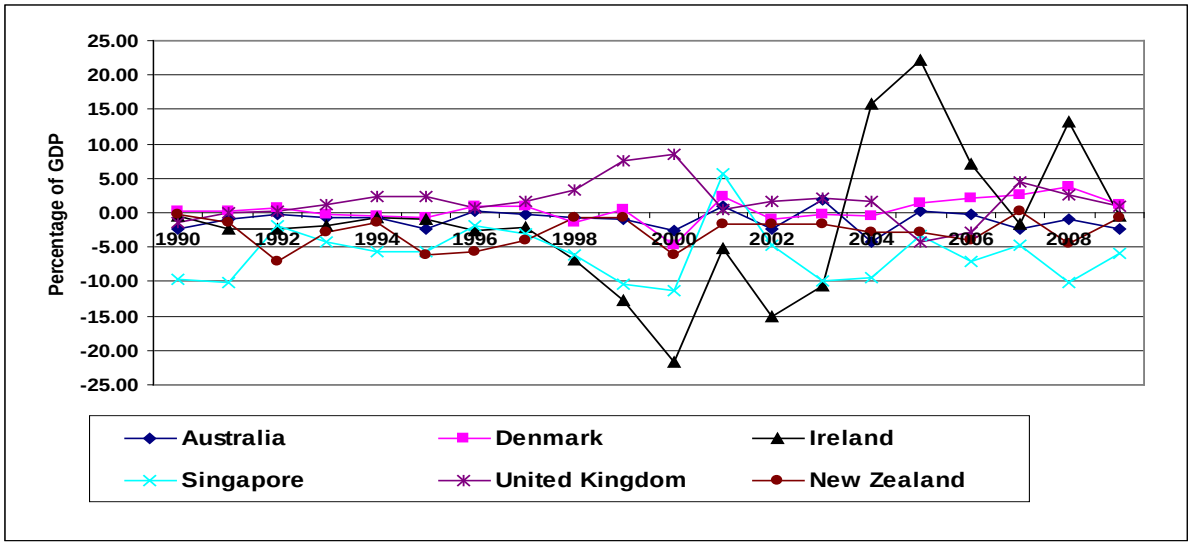
Table 1-4 Inward FDI Potential Index

Year	1990	1995	2000	2005	2006	2007	2008
NZ Ranking	26	26	28	33	36	36	38

Source: UNCTAD

In Figure 1-12, New Zealand has a more negative net FDI flow as a percentage of GDP compared to key comparator countries – with Singapore being the only country considered that consistently has a lower net flow position.

Figure 1-12 Country Comparison of Net FDI Flow as a Percentage of GDP



Source: World Bank

This is due in New Zealand's case to it consistently having the lowest average ODI flow as a percentage of GDP of all the countries considered and a fairly average FDI inflow, whereas Singapore is notable for consistently having a high FDI inflow as a percentage of GDP.

New Zealand has an average stock of FDI (weighted to GDP) compared to other OECD countries (Figure 5-11 in Annex).

1.3 Literature review

The key findings of the literature review are summarised and briefly discussed below.

FDI and ODI are associated with economic growth, but the magnitude of the direct effect is small, Alfaro and Chen (2010). Ghosh and Wang (2009) used OECD panel data for 1980-2004 and found that both FDI and ODI exert a positive influence on both host and source country economic growth, irrespective of any threshold requirements for human capital, income, infrastructure etc. This is likely to be because the OECD countries considered have already reached the threshold level of human capital stock and/or R&D and so these do not act as constraints on growth. However, the magnitude of the effect is small: the elasticity of GDP growth with respect to the stock of both inward and outward investment is approximately 0.01.

Other determinants of economic growth, such as innovation and skills, are likely to have a greater magnitude of direct effect on growth. FDI and ODI may have an indirect effect on these other determinants of growth by encouraging technology transfer, R&D, knowledge flows, skills acquisition etc.

Transmission mechanisms
There are a number of transmission mechanisms through which FDI could affect economic growth. These include:

- **Direct firm-level effects:** FDI can lead to increased capital, technology transfer and employment, generating more output through new or more productive firms. There is strong evidence that foreign-owned firms are generally more productive than domestic firms (Greenaway and Kneller, 2007; Hayakawa et al., 2010; including evidence for New Zealand, Sanderson, 2004; Fabling et al, 2008).

- **Indirect firm-level effects:** These involve both horizontal spillover benefits (between firms in the same industry) and vertical spillovers (between firms in the same supply chain). Horizontal spillovers can occur through things such as: imitation/observational learning, skills acquisition/movement of labour and competition. Vertical spillovers occur when one firm directly transfers technology and knowledge to another firm in its supply chain. The literature on the actual existence of horizontal spillover benefits is very mixed (Görg and Greenaway, 2004). New Zealand evidence on spillovers (Iyer et al, 2010) finds that vertical spillovers are more likely than horizontal spillovers and accrue to exporting but not to non-exporting firms, and particularly to downstream firms. This is supported by the other literature in this area, which generally suggests that either there is no evidence of positive spillovers from FDI and ODI (Vahter and Masso, 2005) or vertical spillovers are more likely than horizontal spillovers because firms have an incentive to intentionally share their firm-specific advantages (for example Javorcik, 2004).

- **Trade and internationalisation:** FDI and ODI can facilitate the international flow of intra-firm information and embed New Zealand firms in foreign networks.

Benefits do not occur automatically

The benefits from FDI do not occur automatically and might not materialise in reality. They depend on the characteristics of individual firms and the wider economy, Alfaro and Chen (2010)[12]. Spillover effects will only arise if local firms invest and learn to absorb foreign knowledge and skills. The magnitude of spillover effects and/or the speed of adoption of new technology by domestic firms are affected by:

- **Absorptive capacity:** the ability for an economy to gain from FDI via spillovers. This depends on factors such as human capital, infrastructure, financial markets and distribution networks (see also Box 1).

- **Contagion:** the extent to which the activities of the MNE pervade the local economy, such as networks and/or contracts. The closer these relationships, the larger the spillover benefits to domestic firms (Blalock and Gertler, 2008).

- **Technological gap:** a technological gap between foreign and domestic firms means that there are opportunities for domestic firms to exploit, but if the gap is too large, then the technology may be too advanced for the domestic firm to benefit from.

- **Exporter status:** exporting firms are better placed to gain from MNEs' presence in their own sector, as they already have international networks in place and are more likely to be close to the world technology frontier; as well as from supply chain linkages with MNEs (Iyer et al, 2010, Girma, 2005 and Girma et al. 2008, see also Fabling and Sanderson (2010))

There are indications that New Zealand experiences particular capacity constraints in some areas. When compared to comparator OECD countries, New Zealand is underdeveloped in certain financial markets (such as venture capital), a relatively low level of trade to GDP potentially pointing to a relatively low level of international connections, a low proportion of engineering graduates, relatively poor management capability and low expenditure on R&D (MED et al, 2011). The technological gap between New Zealand and other countries varies between industries.

The definition of 'high quality' FDI is country dependent and subjective

'High quality' FDI is generally seen to be FDI that has a greater effect on economic growth than other FDI (Alfaro and Charlton, 2007); for example, "the kind that would significantly increase employment, enhance skills and boost the competitiveness of local enterprises" (UNCTAD, 2006). Definitions of "high quality" FDI therefore vary across countries and are highly dependent on a range of investment and country characteristics; such as the industry of the investment, likely spillover effects to the domestic economy and the country's broader economic development goals.

[12] Evidence from micro level studies even suggest negative effect on plant survival and stability. It is argued that FDI from MNE are more 'footloose' by nature which makes them more volatile than purely domestic companies.

Location determinants in high-technology industries (as a proxy for high quality FDI) are the size of the market, the availability of high quality resources like scientific infrastructure and the supply of skilled labour, (potential) agglomeration effects arising from the proximate location of other companies and public knowledge centres. Cost considerations, including labour costs, appear more secondary than in other industries; instead, the quality of the location factors in the host country is much more important, OECD (2010).

Box 1 Absorptive capacity and FDI

On firm-level analysis, the general concept of absorptive capacity describes a firm's ability to recognize the value of new information and make effective use of it to commercial ends. Absorptive capacity depends greatly on prior related knowledge and diversity of background. This is also a reason for companies to invest in R&D instead of simply purchasing the results (e.g. patents) or mere adoption of knowledge and technology. A firm's investment in R&D impacts directly its absorptive capacity. The more a firm invests in research and development activities, the more it will be able to fully appreciate the value of new external information. The absorptive capacity plays an important role in successful business growth, and in innovation performance. When a firm wishes to acquire and use knowledge unrelated to its ongoing activity, it must develop absorptive capacity (R&D, knowledge management, organizational structures, human resources, external interactions, social capital, supplier integration, client integration).

Indicators to evaluate absorptive capacity are, e.g., the amount of R&D investment, the number of cross-firm patent citations, the number of new product ideas, the number of new research projects initiated, the number of patent, the number of new product announcements, or the length of product development cycle.

Recent surveys of the literature conclude that benefits from FDI do not accrue to all types of domestic firms, but depend on conditions in the host country. In particular, the absorptive capacity of domestic firms has been found to be an important determinant for whether or not domestic firms benefit from spillovers effects. R&D-intensive domestic firms enjoy more benefits than other firms (Girma at al. 2008, Girma, 2005, and Kinoshita, 2001).

Looking at specific activities like R&D and headquarters offers complementary insights. Location decisions for more adaptive R&D facilities are primarily demand-oriented and hence related to market proximity, as it is important to be close to 'lead users' and to adapt products and processes to local conditions. Location factors for more innovative R&D investments are more supply-driven consistent with the motivation of technology/knowledge sourcing: the host country's technological infrastructure, the presence of other firms and institutions that may create benefits which investing firms can absorb, access to trained personnel, established links with universities or government institutions, the existence of appropriate infrastructure for specific kinds of research, etc. The importance of labour costs for R&D personnel remains ambiguous; while being of limited importance until some years ago, there is some evidence pointing to a growing importance, particularly in emerging economies (OECD, 2010).

Impact of outward direct investment (ODI)

ODI involves shifting and/or expanding economic activities towards foreign sites. ODI allows firms to enter new markets, access new technology and import intermediate goods and services from foreign affiliates at lower prices, all of which increase firm profitability. The potential impacts of ODI are less studied and understood than the impact of FDI. There is the need to analyse the question both at the firm and industry level in more detail and to take spillovers into account in order to understand the impacts of ODI on the home economy. ODI does not necessarily reduce domestic investment because MNEs are able to access international finance by using global capital markets. The domestic economy benefits from this in the long run due to increased competitiveness of the investing companies and spillover effects to local firms.

However, firms must reach a productivity threshold before they are able to engage in ODI (Hayakawa et al. 2010). New Zealand has a low level of ODI (see Section 1.2.2, Figure 1-5 and Figure 1-6) and this may be due to few New Zealand firms having reached this threshold – possibly due in part to the constraints on absorptive capacity mentioned above. Firms in other countries are more likely to have entered a 'virtuous circle' of higher productivity levels and ODI contributing to firms' competitiveness in the form of higher and additional productivity growth.

Investment promotion policies

Government investment promotion policies are common, with the rationale being to bridge the gap between the private and socially optimal levels of FDI. In particular, governments seek to address market failures in the provision of investment information, in network and intermediation failures and in supporting firms to reach the productivity threshold required for successful ODI (see section 3.2 for a more in depth discussion of the policy rationale for New Zealand).

However, comprehensive cost-benefit analysis of these policies is not possible as accurate measurement of social benefits (e.g. spillover effects) is difficult.[13] Furthermore, spillovers may not only arise from foreign MNE but also from domestic companies, in particular domestic MNE. In addition, foreign MNE could also benefit from domestic companies through "reverse spillovers" (Iyer at al., 2011).

Concentrating FDI promotion activities on selected priority sectors rather than trying to attract all types of foreign investors is seen as best practice by investment promotion professionals (Harding and Javorcik, 2007) and policies in most OECD countries 'target' specific industries or activities. The importance of specific location factors for individual industries and business functions argues indeed for a more targeted approach and clear priorities. The existence of agglomeration effects between companies in the same industry also suggests potential advantages of such an approach.

[13] „Knowledge flows ... are invisible; they leave no paper trail by which they may be measured and tracked, and there is nothing to prevent the theorist from assuming anything about them that she likes.", Krugman (1991), p. 53

Countries outside the OECD increasingly target innovation-related activities in attracting international investments (Zanatta et al., 2008). China for example formulated a national development policy aimed at the technological and scientific upgrading of the Chinese economy through different initiatives and, in addition, foreign MNE affiliates were required to undertake R&D in some selected industries such as the automotive industry. India has implemented various initiatives to support the development of domestic innovation as well as the attraction of MNEs investing in R&D. Israel has focused on high technology for a long time in its economic development policy (defence related industries, ICT and biotechnology). A large number of high tech companies have been attracted to the country through R&D incentives, policies to stimulate capital investments, and incentives for the development of foreign venture capital.

Box 2 Singapore's FDI policy is not comparable with New Zealand's

Compared to many other countries, Singapore's FDI flow as a percentage of GDP is very high. The Singaporean government has worked hard to attract FDI, developing both FDI specific and supporting policies. Supporting policies have been aimed at creating an attractive business environment, and include: building high quality physical and social infrastructure, enhancing institutional transparency and IP protection in order to build foreign confidence, offering incentives to encourage innovation by firms operating in Singapore etc. (WTO, 2008). FDI specific policies have identified and focused on a few high growth, high value-added niches, e.g. ICT, chemicals, services, branch schools of world-class universities (MIT, INSEAD, John Hopkins University).

Biotechnology is a good example. In this area, Singapore has engaged in large expenditure on training and research, formulated a liberal immigration policy for experts, invested heavily in infrastructure, designed the regulatory framework around attracting biotechnology FDI, established a co-investment scheme and then marketed Singapore to the rest of the world as a destination for biotechnology FDI (Pereira, 2006).

New Zealand does not have the resources that would be required in order to follow Singapore's example of heavy investment and FDI incentives. There are, however, a few potential lessons to be learnt – in particular that Singapore has identified and consistently focused on capturing niche markets to achieve maximum effectiveness of their investment.

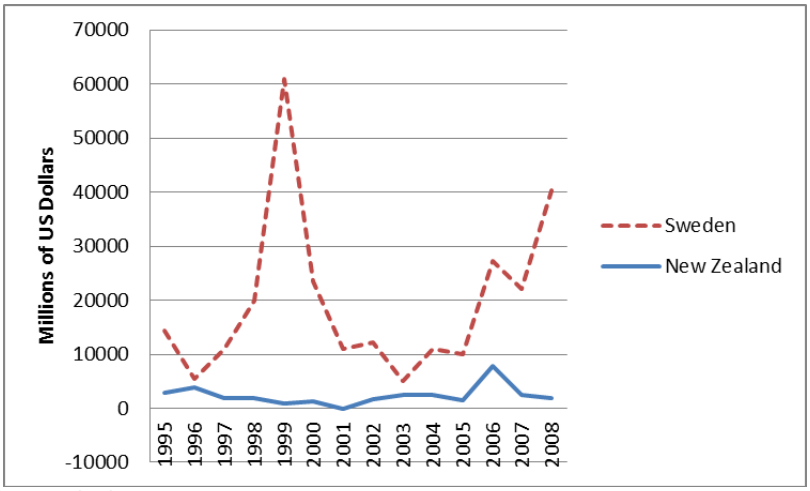
Empirical studies suggest that investment promotion leads to higher FDI inflows only in developing countries where red tape and information asymmetries are likely to be severe. Harding and Javorcik (2010) conclude that investment promotion does not seem to work in developed countries. Other factors for effective investment promotion appear to be: countries where English is not an official language; countries which are more culturally distant from the US; countries with less effective governments, higher corruption and cumbersome bureaucratic procedures, e.g., longer time period required to start a business or obtain a construction permit.

Similarly, attracting FDI inflow with the aim to upgrade the quality of exports is only a viable strategy for low and middle income countries. Harding and Javorcik (2011) found that there is a weaker and quantitatively smaller effect for developed countries where there is less of a technology gap to close.

Box 3 Sweden's Investment Promotion Agency (*Invest Sweden*) is Similar to New Zealand's

Invest Sweden offers very similar services to those of NZTE (assistance to foreign firms in: obtaining market information and analysis, searching for investment opportunities, finding potential business partners, organizing market visits, finding the right location / premise, business set up including regulations and accessing networks) yet FDI flows into Sweden are much greater than FDI flows into New Zealand. This suggests that there are other factors that determine FDI beyond the stated activities of the IPA. These could include differences in: general international connectedness, geographical location, management practices, exposure to shocks, sectors with comparative advantages etc.

FDI flows



Source: OECD

2. Introduction

2.1 NZTE investment team

Government activity to promote inward investment through Vote Economic, Industry and Regional Development (Vote E,I&RD) dates back to 2000 (DEV (00) Min 23/1 refers). "Investment New Zealand" was established by a Cabinet decision in April 2003 drawing on advice from the Boston Consulting Group (BCC, 2001). It was also a shift in investment policy from a focus on employment creation to targeting high-quality investment which provides "*significant net economic benefits to New Zealand either through productivity enhancing spillover benefits or increased capacity utilisation"* (CAB Min (02) 12/8 (49) refers). "Investment New Zealand" has been a specialist division within New Zealand Trade and Enterprise (NZTE) and maintained a separate brand identity and name until August 2010. The new name "NZTE Investment team" reflects its role as part of New Zealand Trade and Enterprise (NZTE).

An evaluation of Investment New Zealand (INZ) was completed in 2006 (MED, 2006). Related evaluations were completed in late 2006 on the Strategic Investment Fund: Major Grants and Loan Guarantees, on the Feasibility Study Grants and on the Visiting Investor Programme.

Government agreed in 2007 that NZTE and Investment New Zealand (INZ) target high-quality inward investment and support outward direct investment (ODI) by New Zealand firms on a case-by-case basis where the investment is high quality and generates productivity improvements in domestic firms (EDC Min (08) 13/3). The ODI work program is closely aligned with the government's Globally Competitive Firms (GCF) strategy of supporting capable New Zealand firms in becoming successful internationally.

Since 2007 the policy environment has changed, e.g. development of New Zealand's bilateral investment and trade relationships with Australia and China.

2.2 Evaluation objectives

The objectives of the evaluation are to clarify the rationale for supporting inward and outward investment and to review the intervention logic and activities. The evaluation should provide insight into the effectiveness of the current approach toward attracting foreign direct investment (FDI) and promoting outward direct investment (ODI). It focuses on and assesses major activities, expected intermediate and final outcomes in more detail, and whether activities have generated any additionality.

2.3 Scope of the evaluation

This evaluation is focused on the impact of the "client engagement" component of NZTE's investment team on overall FDI/ODI. The activities within the "industry development" (market and research studies) and the broader "investment promotion" components are briefly described and considered as necessary activities in promoting New Zealand as an investment destination. However, a direct (or even

indirect) link between investment promotion and actual investment decisions is difficult to assess.

While the evaluation is principally aimed at assessing the performance of NZTE activities directed at facilitating inward and outward investment, the evaluation also examined investment issues and barriers experienced by firms using investment as an internationalisation strategy. This is an important element of the evaluation as it helps establish whether NZTE services are addressing the needs of firms, and these findings may challenge or confirm the policy rationale for government intervention.

2.4 Methodology

The evaluation approach incorporates different streams of work and questions for inward and outward investment.

Stakeholder review of approach
Key stakeholders (MED policy staff, NZTE, MFAT and the Treasury) were included to ensure they are in a position to provide support for the project stages. Treasury is the Government's lead policy advisor on FDI.

Problem rationale and literature review
This work involves reviewing literature on the process of internationalisation and the benefits and risks associated with inward and outward direct investment, and importantly the rationale for the current government programme.

Baseline Data Analysis
Some of the baseline data to be collected is framed up from the literature review. The baseline data would include but not be limited to key descriptive base data time series on inward and outward direct investment, key NZTE data.

Review of effectiveness of NZTE investment team
This stage involves interviews with firms to assess their views of the effectiveness of NZTE investment team, and provide insights into the quality of the investment facilitated and issues and barriers faced by firms.

This phase includes a 'counterfactual' survey through interviewing firms who chose not to contact NZTE. The survey format also allows us to look at other features, such as issues, barriers and spillover benefits. The counterfactual survey would then provide an indication of whether NZTE has successfully targeted high quality FDI relative to that investment which is occurring without their support.

Impact and Additionality Assessment
The final phase of the evaluation considers the direct economic impact of NZTE activity and how much of this could truly be considered additional, i.e. would not have happened without NZTE activity.

The initial evaluation plan foresaw the option to complement the counterfactual with data from Statistics NZ's prototype Longitudinal Business Database (LBD). Due to resource constraints quantitative evaluation techniques were not applied.

3. Foreign Direct Investment policies

3.1 Policy framework

Foreign direct investment in New Zealand is generally welcomed and encouraged. The main features of the FDI regime are:

- Approval is required for business assets worth more than $100 million;
- Purchases of sensitive land[14] and fishing quota are also subject to approval
- There are specific ownership limitations in a few industries.

Under the Overseas Investment Act 2005 and the Overseas Investment Regulations 2005, the Overseas Investment Office has the authority to approve the investments and to monitor them to ensure they comply with the approval conditions[15]. The screening regime is based on the view that in general, foreign investment is in New Zealand's national interest, because of the benefits it provides. However, in a subset of cases where investments concern sensitive assets, the concerns of welfare losses could be sufficiently high so as to outweigh these benefits. The approval requirements are criticized by OECD (2011a, 2011b) as discouraging direct investment and potential investors.[16] There are no foreign exchange controls. Capital inflows and repatriation are allowed freely subject to reporting requirements. Profits, royalties and fees and other investment related payments are freely transferable.[17]

Countries continue to conclude new international investment agreements (IIAs), bilateral investment treaties (BITs), and double taxation treaties (DTTs), see UNCTAD (2010, 2011) and OECD/UNCTAD (2011). Parallel to the steady growth of FDI, the number of IIAs has continued to increase (Figure 5-14 in Annex). New Zealand recently signed a Closer Economic Partnership Agreement with Hong Kong and China (March 2010), a double taxation treaty with Turkey and Saint Kitts and Nevis, and an Income Tax Treaty with Hong Kong (December 2010). The Protocol on Investment (February 2011) to the Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA or CER) ensures that New Zealand investors receive

[14] The definition of sensitive land is complex with the legislation defining sensitive land by several different types of land, each with an area threshold.

[15] For further details see Treasury's "Review of Overseas Investment 2009/10".

[16] Only 2-4 applications per year are declined and the involved proposed purchase price is often confidential. One of the biggest declined applications occurred in 2008. The government stopped a Canadian Investment fund from purchasing a 40% stake in Auckland International Airport Limited. The government claimed it intervened to prevent foreign ownership of 'strategically important' infrastructure. It has been suggested that this case could act as a barrier for international investors interested in investing in facilities like electricity and gas distribution, telecommunications, ports and airports.

[17] This evaluation report does not investigate other potential barriers to investment like limits on foreign nationals working in affiliates, or nationality and residence requirements for the members of the board of directors or immigration policy in general.

the most advantageous treatment offered to any foreign investors in Australia, and vice versa[18].

In addition to international investment agreements, New Zealand has also been engaged in investment-specific policy measures. These include further improving the entry conditions for foreign investors and further promoting foreign investment, e.g. consolidation, clarification or simplification of existing foreign investment regulations. New Zealand government proposed to further focus and enhance NZTE's inward investment activity, and a framework to guide outward investment activity. It was recommended that NZTE investment team should "*further target its promotion and facilitation activities on high-quality inward investment … (and) … support outward investment by NZ firms on a case-by-case basis where the investment is of high-quality and generates productivity improvements amongst domestic firms*" (EDC (07) 123, EDC Min (07) 14/1 and EDC Min (08) 13/3).[19]

3.2 Policy rationale and intervention logic

Objectives

The ultimate reason for re-assessing New Zealand's FDI and ODI policies is to further the government's economic growth agenda (EGA) and in particular the identified need for deeper international connections and smarter capital.

Problem Definition

New Zealand is an open economy but due to remoteness encounters special challenges in connecting to the rest of the world. Economic integration is desirable because it:

- provides access to resources that facilitate high productivity;
- enables the better use of resources for production;
- allows specialisation in areas of comparative advantage and benefit from economies of scale;
- provides access to international knowledge and its adaptation to domestic circumstances; and
- stimulates competition to spur innovation and move resources to areas of comparative advantage.

[18] For a list of all agreements in force and under negotiations consult the Ministry of Foreign Affairs and Trade homepage.

[19] Further details, see Annex "Outward Investment: Role of New Zealand Trade and Enterprise" and "Guidelines for Supporting Outward Investment activities"

The underlying reasons for New Zealand's difficulties with international connectedness include:

- New Zealand's geographical distance from large markets means that it is costly to engage in international trade. New Zealand is 'off the radar' for many international companies and investors and it is difficult to build and maintain relationships.

- New Zealand has a small domestic market. This means that it may not be a very desirable location for (especially market seeking) FDI. A small domestic market also results in a lower level of domestic competition, lower levels of expertise in some areas (such as management), fewer economies of scale and fewer agglomeration benefits compared to other less remote and small developed countries. Together, these factors mean that many domestic firms are below the productivity threshold required for successful ODI and so do not engage in it.

- Market failures in the formation of networks and provision of information by the private sector. There is considerable duplication of efforts when private firms seek the same information regarding FDI. This is inefficient and raises the cost of information to MNEs relative to if it were provided by a single intermediary, meaning that they may not consider FDI in New Zealand as a potential location (see Box 4 for a typical decision process of international investment). Much of this information is publicly available and cannot be 'sold' by private firms, meaning that they are unwilling to act as intermediaries in its provision.

- The rationale for investment promotion is based on information asymmetries that may prevent the efficient allocation of investments across countries. International investors do not have "perfect" information about all countries or investment opportunities and face large costs with gathering the necessary information. Insufficient (or incorrect) information can lead to inefficient markets. This means that companies may be better off if these information gaps can be filled. An investment promotion agency can act as an information provider to foreign investors in several situations, including :

    - Smaller firms rarely have resources to acquire knowledge about location decisions;
    - International perceptions of a country may not reflect business realities;
    - The business sector rarely has sufficient knowledge of the public sector to find its way around. Especially for foreigners, an investment promotion agency providing a "road map" or guidance may be very useful;
    - There is a role for a "trusted intermediary" to introduce the foreigner to the domestic business and private sector networks.

- Other reasons for investment promotion relate to public good characteristics. It may be impossible to exclude non-clients from investment promotion. If, for example, an investment promotion agency carries out an advertising campaign that improves the country's image abroad, all companies may

benefit as a result. But if it were left up to the clients to pay for the services, the funding would only reflect their benefit from the investment promotion agency. The benefit of its services to others would not be taken into account. In such a case, the investment promotion agency may become underfunded. If, on the other hand, the investment promotion agency is publicly funded, non-clients benefiting from the investment promotion agency's work would also be paying for the services (through taxes). In theory at least, the greater supply of investment promotion services would then better reflect the total benefit to society.

- International networks may be underdeveloped too – in part due to the lack of information and therefore lack of awareness and in part due to the fact that New Zealand's geographical isolation makes it difficult to foster relationships.

Box 4 Deciding about the location for future investment(s)

The decision process of companies choosing a location for future investment(s) usually starts with drawing up a long list of possible locations; this is often done in close co-operation with consultants hired for the selection process. A long list typically includes 8 to 20 countries belonging to 3 groups: 1) most popular MNE locations in the world, 2) countries in the proximity of existing activities abroad of the investing company, and 3) emerging MNE locations (often included on the basis of marketing campaigns, or personal contacts with, countries' investment agencies).

The long list is then narrowed down to a short list of around five possible locations taking into account different factors (cost, quality, etc.). This is usually done without visiting the potential locations, but merely on the basis of investment information and data provided by the countries in question.

In a next stage, the locations on the short list are visited in situ, mostly by the company executives and hired consultants. The visits, often of multiple sites in the country, are organised in close co-operation with the investment agencies of the countries.

The actual choice for a specific location/site happens in the final stage bringing all information together, including the availability of potential sites and the incentives offered by the different governments.

Source: OECD (2010b)

Other relevant problems are:

- New Zealand's ability to absorb spillover benefits appears to be lower than desirable due to, e.g. inadequate absorptive capacity determined by things such as human capital, infrastructure, financial markets and distribution

networks[20]. Distance from the technological frontier is also relevant here. Technologically advanced FDI is desirable because it encourages domestic firms to 'catch up' to their competitors, but if the gap is too big, domestic firms may stagnate or be driven out of business.

- Private firms focus on direct (private) benefits from overseas market entry. MNEs are unlikely to take into account the benefits that accrue to other firms (spill-over benefits) due to their FDI to New Zealand. This means that the level of FDI determined by the market is likely to result in lower levels of international investment than are optimal for society as a whole.

- While most of the work on FDI spillovers has focused on inward FDI, researchers have also studied whether multinationals go abroad to acquire technological knowledge from other firms. The leading example of this may be a foreign firm locating an affiliate in the United States Silicon Valley in order to ´source´ technology from the firms in its environment.

- New Zealand has a low level of 'high quality' FDI. High quality FDI is that which enhances innovation and productivity and has potential spillover benefits. Much of the FDI that does occur in New Zealand (for example market seeking FDI) does not create economic benefits to New Zealand to the same extent that high quality FDI might.

- The global market for FDI is highly competitive. Many other countries offer strong financial incentives for MNEs to invest in them and New Zealand is not able to match these (Van Biesebroeck, 2008, 2010). This means that a successful promotion and attraction strategy needs to be in place for New Zealand to 'win' that sort of high-quality FDI that will make a worthwhile contribution to achieving EGA goals.

- Other kinds of foreign investments such as portfolio investment and bank lending are highly liquid and volatile. Such investments can increase a country's vulnerability to capital flight in financial crises, meaning that they are less desirable than FDI, which is by nature more stable and less liquid.

- New Zealand has a low savings rate and underdeveloped capital markets. This means that firms are restricted in their ability to obtain the domestic capital that would enable them to grow both domestically and internationally, see e.g. Treasury (2010) or the work of the independent Savings Working Group (2011) recommending a much more strategic and integrated approach (remove distortions in the tax system, encourage more diversified investment in New Zealand and offshore shares, bonds, portfolio investment entities (PIEs) etc.).

[20] New Zealand scores low on indicators that measure absorptive capacity like R&D expenditure, number of patents, capital access index or number of engineering graduates, MED (2011).

Activities

As the intervention logic diagram (Figure 3-1) shows, the kind of FDI that is desirable to attract is still the subject of debate. "Upstream" FDI[21] appears to have greater potential for spillover benefits, while "high quality" FDI in general has greater potential to enhance New Zealand's access to smart capital. These different categories of FDI overlap but may not always do so. Improving New Zealand's capacity to absorb positive spillovers is critical if the government is to justify attracting FDI on the grounds of it creating productivity enhancing spillovers.

At a broad level, the suggested activities involve:

- Identifying and attracting FDI with high spillover potential ('upstream' FDI)
- And/or attracting FDI in general
- And/or identifying and attracting high quality FDI in a niche sector
- Addressing information gaps
- Removing regulatory barriers
- Improving the underlying productivity fundamentals of the economy
- Increasing the quality and quantity of New Zealand firms that are exporting and conducting R&D
- Increasing supply chain linkages

Outcomes

The policy rationale articulated here focuses on FDI and ODI's contribution to the Government's Economic Growth Agenda (EGA).

Intermediate outcomes include:

- A higher level of innovation and productivity enhancing FDI
- A higher level of ODI
- More competition
- Greater absorptive capacity

These intermediate outcomes are expected to lead to:

- Productivity enhancing spillovers and an increased ability to absorb them
- Greater capacity and greater utilisation of existing capacity
- The embedding of New Zealand into the international supply chain
- Improved access to foreign markets
- Reduced intra-firm costs
- More scope for growth
- Opportunities for specialisation and economies of scale

[21] Companies selling intermediate inputs to domestic buyers.

These are then expected to lead to:

- Increased international economic integration and
- More smarter capital

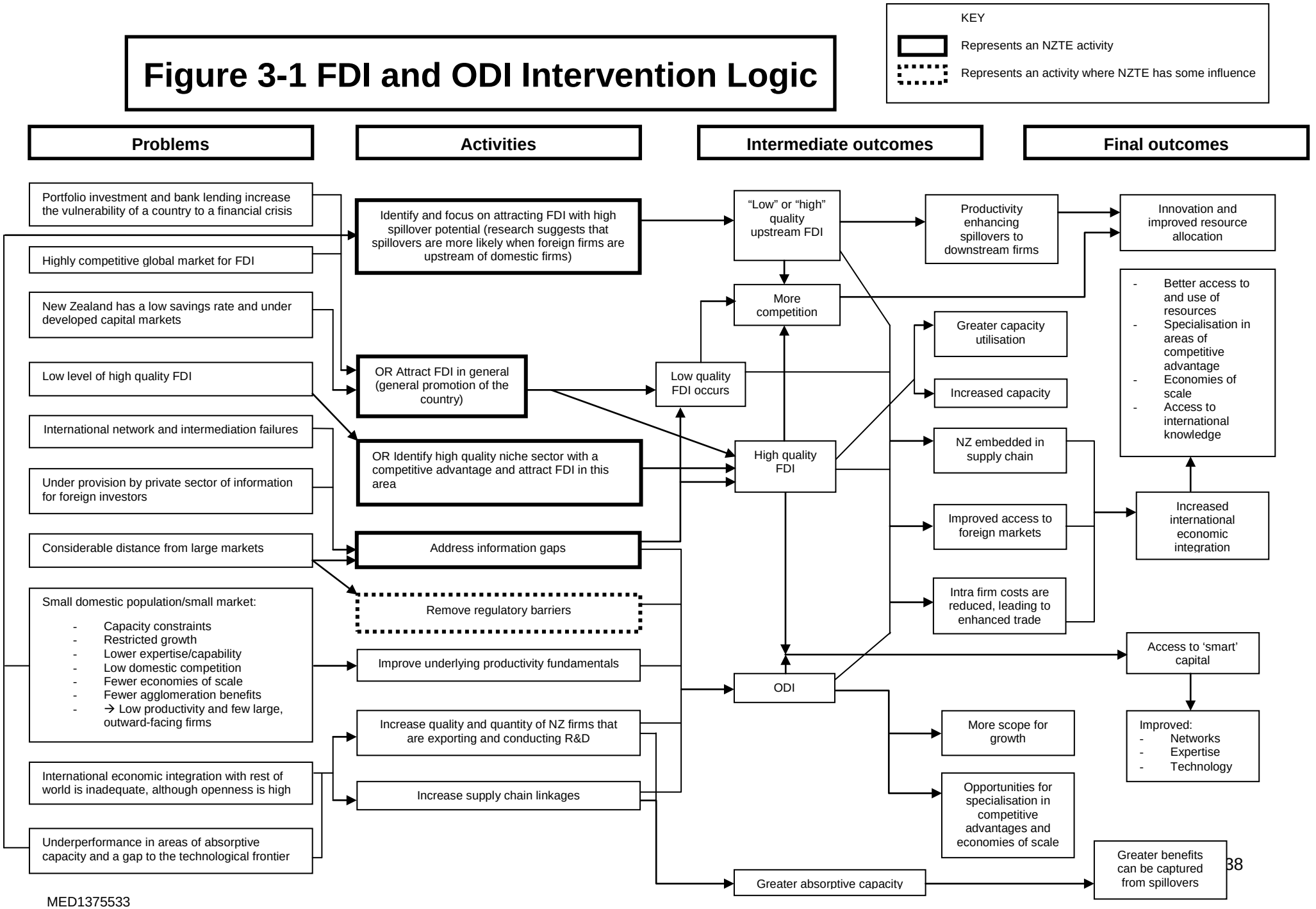
And ultimately, to

- Higher growth,
- Higher exports and
- Higher GDP per capita.

This intervention logic reflects the latest findings from both the theoretical and empirical literature surrounding FDI and ODI and is somewhat different to the intervention rationale proposed earlier.[22] The intervention logic reflects a more detailed knowledge of the implications of different kinds of FDI and ODI and their role in achieving the EGA's objectives. It shifts the focus away from the specific activities of NZTE's investment team and onto the primary drivers and objectives of the policy.

[22] See MED (2007), Review of Investment New Zealand, available from: http://www.med.govt.nz/upload/42028/review-investment-nz.pdf

Figure 3-1 FDI and ODI Intervention Logic



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3.3 Activities of NZTE investment team

NZTE runs a number of programmes designed to encourage and enable domestic firms to engage in competitive exporting. “NZTE Investment team” is New Zealand’s investment promotion agency with the aim to attract investment in targeted industries where New Zealand has a competitive advantage. Annual total budget “International investment facilitation services” amounts to almost $15 million (including overhead) with 16 staff located offshore and 19 in New Zealand. The following description is based on a review of relevant documents (business plan, annual reports, website etc.) and interviews with staff from NZTE’s investment team. The activities of the investment team focus on:

- Industry development
- Investment promotion and facilitation
- Client engagement

The activities are described briefly below. This evaluation focuses on client engagement and tries to establish whether NZTE services are addressing the needs of firms. It may confirm the policy rationale for government intervention in this specific area. The activities in the area “industry development” and “promotion and facilitation” are considered as precursor to any client engagement and this evaluation does not specifically assess these activities.

3.3.1 Industry development

The NZTE investment team undertakes market and research studies to identify markets for investments and investment opportunities. These studies can clarify whether attracting FDI to a sector can create wealth for New Zealand and results in “value proposals”, e.g. the analysis of how dairy colostrum could be taken up the value chain and using FDI to commercialise the concept (see another example in Box 5). These studies also identify potential investors in overseas markets and their emerging investor requirements, and analyse investor needs and profiles.

Box 5 Premium Tourism

Following discussions with industry commentators, NZTE Investment formed the hypothesis that New Zealand was missing-out on a growing premium tourism market because it lacked the required tourism infrastructure. This hypothesis was tested via a comprehensive study to examine the potential market for premium tourism, the offering, and possible delivery solutions.

The study concluded that New Zealand did indeed have the potential to grow its premium market and that unique features of the New Zealand culture, landscape and environment could be formulated to create a compelling tourism offer. The findings suggested that premium hotel spa resorts would be a good fit for this emerging market – much of which would come from Asia.

The study findings were promoted to interested parties and this attracted a small number of prospective investors and operators. One consortium is now evaluating a substantial investment to construct and then operate a chain of spa resorts in key locations across New Zealand.

Using its knowledge of expert analysis and market information NZTE investment team can help foreign firms identify potential investors and sustainable business prospects and tailor investment solutions to fit.

The intention is that the market and research studies will be used as widely as possible to a) encourage interest in investor communities, b) promote NZ, c) provide quality information to investors and others that could not be obtained (easily) elsewhere, and d) promulgate deal flow. Almost all market and research studies and related work are published. The studies that have a broader use or appeal to the public or companies are published on the New Zealand Business portal[23].

The market studies are used by NZTE investment team internally to identify areas for focused promotion activities. External feedback on the market studies occurs occasionally where an investor makes a specific enquiry or looks at an opportunity as in the case of premium tourism (Box 5). Therefore, it is difficult to assess the direct impact of NZTE's market and research studies. Immediate use is made internally, however the ultimate outcome of these reports can only be evaluated over a longer time period. Long term impact could be identified since most reports are quite focussed and have a limited market and may lead to only one single but significant deal.

3.3.2 Investment promotion and facilitation

The role of the NZTE investment team is to promote New Zealand as an investment destination and to build New Zealand's international investment profile through investor attraction events, like the New Zealand-Australia Investment Forum, promotional literature, websites[24], and networking.

Box 6 Promotion – North Asia Capital Markets

The majority of New Zealand's Venture Capital and Private Equity funds have been fund-raising for their second, or third, round funds for the past 12 months. This has proved difficult in the traditional fund-raising markets of North America and Europe due to the financial crisis and other factors. This has forced some of the fund managers to look towards North Asia (China, Hong Kong, Japan and South Korea) as a potential source of investment capital. However, due to cultural and regional investment preferences this market is much more difficult to enter than Europe and the US. The North Asia market is well aware of New Zealand's trade reputation, but when it comes to investment we are typically either seen as a resource option (Farm land, minerals etc.) or are overlooked in favour of our larger cousin, Australia.

Against this backdrop, NZTE Investment decided to undertake a targeted promotional programme to raise the awareness of New Zealand as an investment destination within North Asia's growing high net worth individuals and Family Wealth managers.

[23] http://business.newzealand.com/auspac/en/invest-in-new-zealand/

[24] http://www.investnewzealand.govt.nz

This programme culminated in an invitation-only investment conference held in Hong Kong and hosted by the Hon. Bill English. Minister's English's mana was used to help attract the high-calibre audience required to make the event a success. Four New Zealand fund managers ranging from early stage VC through to private equity presented at the event to give the 40 attendees a well-rounded picture of the New Zealand investment opportunity. These presentations were followed-up by an overview of the New Zealand investment landscape and tax situation.

Following the event seven investors have sought follow up meetings with the New Zealand fund managers, and two (with investment capital of US$90b and US$8trillion respectively) are interested in visiting New Zealand to explore specific fund and portfolio investment opportunities.

3.3.3 Client engagement

The NZTE investment team aims to facilitate investment deals and assists international corporate investors to relocate their businesses to New Zealand, to establish greenfield operations, and to invest in and work with New Zealand companies in global ventures. The objective of the intervention is to facilitate deals that would not otherwise occur, or occur "better" and "faster". FDI comes from three main sources: multinational enterprises (MNE), offshore funds (sovereign wealth funds, institutional funds, private equity), and high net worth individuals. The NZTE investment team can seek to help New Zealand businesses raise offshore capital, often through joint ventures and international partnerships.

NZTE's offshore investment specialists promote the country's competitiveness and establish relationships with overseas investors interested in New Zealand's most promising sectors and where New Zealand has a competitive advantage that is attractive to investors, e.g. food and beverage, biotechnology, and ICT.

Investment specialists in offshore offices are a first and single contact point if the firm is located in its home country and interested in New Zealand opportunities. The activities include facilitating communication between foreign firms and their prospective partners and government agencies; helping foreign firms manage regulatory requirements; and helping to grow existing investments in New Zealand

NZTE's onshore sector specialists provide offshore intelligence to local companies to help them take advantage of international investment opportunities.

3.4 Data set provided by NZTE investment team

As part of the evaluation NZTE provided a list containing information regarding companies that contacted the investment team and where there is an on-going relationship. This section describes the data set from the customer relationship management system.

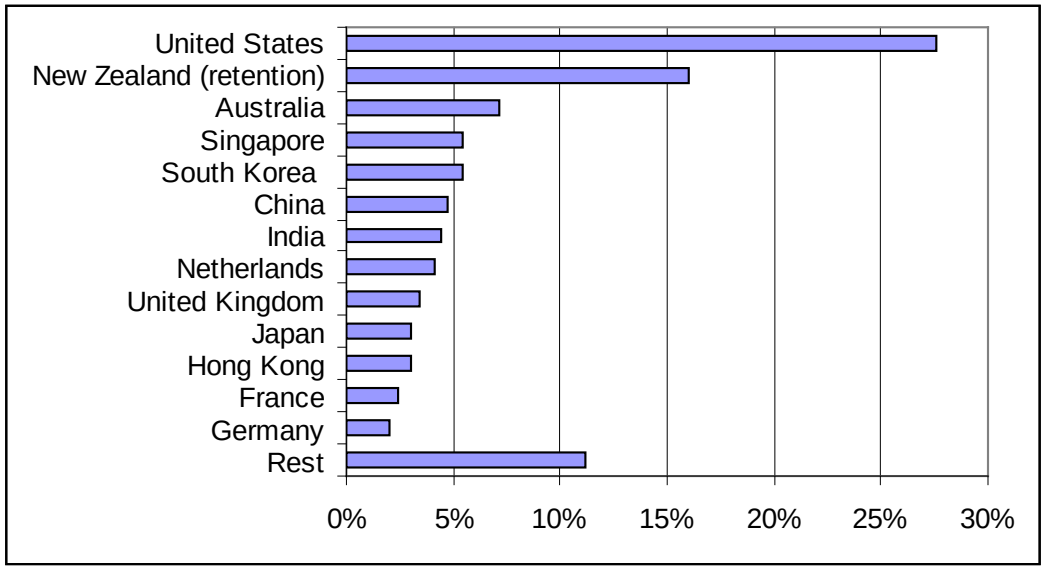
The data set contains 418 companies or funds (400 FDI, 18 ODI) as active clients, i.e. where NZTE investment team is actively working with companies showing an investment interest. Table 3-1 provides the distribution of companies by sector.

Table 3-1 Companies by sector

Investment Sector	Number	% of total
Biotech	52	12.7%
Resources & Manufacturing	95	23.2%
Food & Beverage	102	24.9%
Capital markets	31	7.6%
Cleantech	63	15.4%
ICT	27	6.6%
Infrastructure	39	9.5%

Analysis of the NZTE portfolio in Figure 3-2 shows that the US is the most important source country, followed by retention of FDI in New Zealand[25].

Figure 3-2 Distribution of investors by country



[25] Balance of payments figures highlight Australia as being the major source (Figure 1-8, p.15).

Companies that had contact with NZTE investment team are divided into different engagement stages summarised in Table 3-2.

Table 3-2 NZTE engagement stages

Definition	Description of progress	Probability of success	% of companies
PROSPECT	• Prospect identified and first contact made • Likely to warrant further investigation • Rough economic benefit calculation completed	0 – 10%	67.7%
LEAD	• Information gathered from a decision-maker, need has been determined • Comprehensive due diligence. • Initial identification of investment 'solution'. • Rationale for investment is substantiated with facts/numbers specific to this opportunity and client	10 – 40%	22.2%
CASE	• Refinement of investment 'solution'. • Client confirms the strength of the business case based on completed analysis of collected information. • Additional information is supplied to client to address concerns/strengthen case to ensure investment.	40 – 80%	8.4%
COMMITMENT	• Confirmation of key stakeholder engagement. • Client makes investment decision, which goes to the Board for approval. • Board approves investment decision. • Public announcement made / share market notified	80%	1.2%
IMPLEMENTED	• Investment completed • Sign-off received.	100%	0.5%

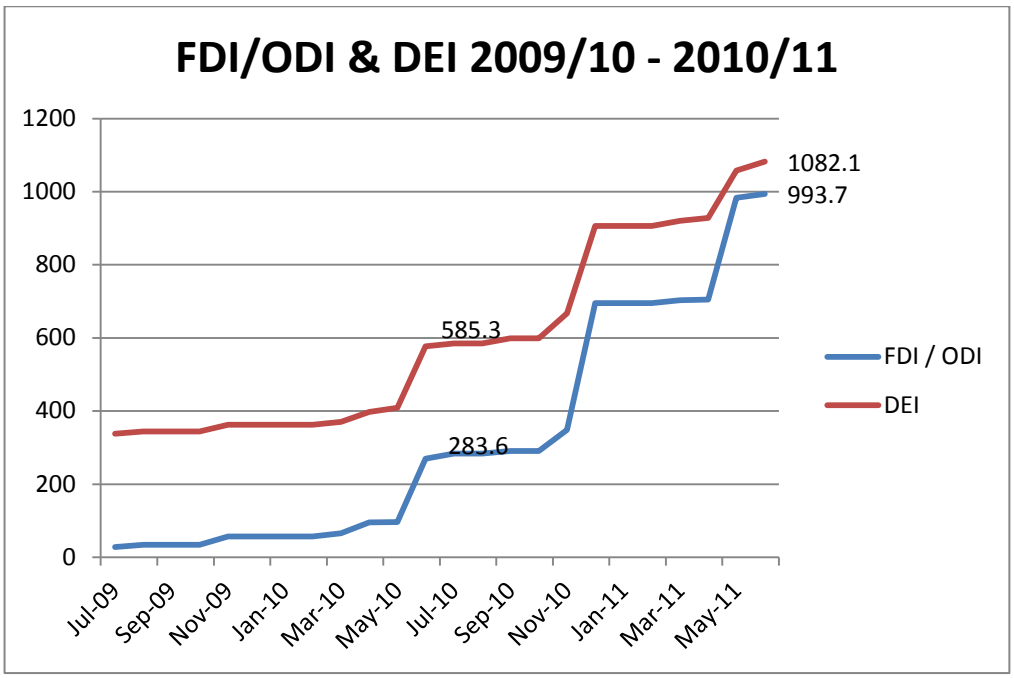
NZTE investment team activities involve starting a dialogue with the purpose of having a well-defined investment opportunity (case) and a clear potential outcome for New Zealand. The investment team has built up a pipeline of investment opportunities (last column of Table 3-2). The gestation time of these investment opportunities can be up to several years. The number of cases per year is low (usually less than 10), however, the value per project investment can be considerable ($25-100 million p.a.).

NZTE investment team uses a Direct Economic Impact (DEI) measure to decide which projects and businesses to invest in. DEI analysis is limited to direct benefits into participating businesses and direct suppliers and employees. The DEI calculation is a straight forward analysis of future value streams discounted to NPV. The DEI figures are based on judgements and assumptions. However, NZTE tend to be quite conservative when undertaking the DEI analyses. The best way for NZTE to measure the quality of a deal is to look at its DEI. If it produces a net positive DEI then it will have a positive beneficial impact and some FDI projects will deliver higher volumes of DEI than others.

In addition, the NZTE investment team estimates an attributable DEI, which is the additional value created as a result of investment team involvement. However, DEI is not systematically available and attributable DEI is based on assessment by the NZTE investment manager[26].

NZTE started systematically measuring investment projects and their DEI only two years ago. The volumes and flow of FDI projects fluctuate considerably and one major successful deal can make the difference for a given year.

Figure 3-3 Direct Economic Impact (DEI) measure by NZTE



In addition, it turned out that the relationship between FDI projects and the related DEI is not as consistent. A recent deal with an asset management fund involved $300m but the DEI estimates are low as the fund has not yet been fully committed and the exact nature of the investments is unknown until they occur. Other reasons for a low DEI could be that FDI projects include the acquisition of real estate.

NZTE investment team reports regularly on key performance measures, e.g., on the level of client satisfaction with the services provided. The investment team usually scores high on these performance measures and client firms confirm that they "*play a part in the investment decision*" (average score 6.1/8 for last two financial years) or "*are important in raising awareness of NZ as an investment destination*" (5.8/8).

[26] . NZTE was involved in $724m of FDI deals in 2010/11 with an estimated direct economic impact of $505m to occur over a number of years. NZTE estimated that the net economic impact attributable to NZTE in 2010/2011 was $77m.

4. Additionality achieved from the NZTE programme

This evaluation tries to consider the impact of the NZTE investment team and how much of this could truly be considered additional, i.e. would not have happened without the intervention through the NZTE investment team. This includes a 'counterfactual'.

To achieve this the evaluation team conducted an online survey among and structured interviews with two groups of companies both engaged in international activities: The first group was assisted by the NZTE investment team[27], the second group decided to internationalise without contacting the NZTE investment team.

The results of the interviews are summarised as case studies. Although discussed in more detail in the next sections, companies the identified NZTE investment team to be useful:

- If sector expertise is available, i.e. if NZTE investment managers are up to date with the market.
- To find contacts in New Zealand, especially within government.

4.1 Case study evidence

During interviews the evaluation team was interested in establishing what firms consider to be the most significant determining factors associated with foreign ownership in their business or with international expansion.

Case study: FDI to complete a skill set in energy sector

Quest Integrity Group is an American company focussed on asset integrity and reliability management. It offers services in specialty non-destructive testing (NDT), engineering assessments, software for modelling lifetime reliability and fitness for service, to a range of industries including the refining and chemical process, pipeline, syngas and power industries. Quest's alliance partner Qi2 is an incubator company for developing and applying NDT instrumentation and structural health monitoring technologies in a broad range of industries including energy, aviation/aerospace and civil infrastructure sustainment.

New Zealand Investment

Quest purchased Materials Performance Technology, MPT, Solutions from Industrial Research Limited in 2006 allowing them to add materials science and further risk-based inspection expertise to their value-proposition of delivering asset integrity and

[27] NZTE investment team also provided qualitative written feedback from clients through the NZTE key performance measures (see section 4.3). However, the case study interviews allowed a more in-depth investigation into the underlying investment decision making process.

reliability management solutions. MPT had been a regional operator serving clients in NZ, Australia, and Asia. Quest Integrity have developed MPT's services into a global operation and business activity of the unit has tripled since the acquisition.

Quest are continuing to invest in the company and refine its knowledge. MPT was an attractive investment to Quest because it had a critical mass of knowledge, a core group of talent, and also had good support from local universities. Collaboration and joint investment with New Zealand universities continues. Quest Integrity is working in a knowledge industry and so distance is not a factor. Having the business group in New Zealand means they can offer lifestyle choice when recruiting for the company. New Zealand offers a great lifestyle.

Information for Investment

For acquisition of the business unit from IRL due diligence was all done internally to Quest Integrity. A New Zealand law firm – Izard Weston - was contracted to finalise the deal. Materials Science & Engineering is a very specialised field. Quest Integrity had worked with MPT prior to the acquisition and were confident in MPTs knowledge and values.

NZTE involvement

NZTE weren't involved in the purchase of MPT. One of Quest's NZ managers suggested contacting NZTE and they have provided some input into projects currently in development.

Milton Altenberg, Chairman and CEO of Quest Integrity, said, "*NZTE is very engaging. Quest are looking at joint investments in a number of projects in New Zealand. New Zealand is open to doing business. There is funding support for R&D. New Zealand is a compelling place to be and Quest like that environment. We are looking for ways to do more business in NZ.*"

Policy Comment

"*Government needs to back the knowledge economy by investing in education, particularly in science, technology, engineering and mathematics. Quest targets involvement in countries producing a lot of engineering graduates.*"

Case Study: Early stage internationalisation

Pacific Edge Limited is a Dunedin based biomedical company developing and commercialising simple-to-use, highly accurate, diagnostic and monitoring tools for cancer detection. The company was formed in 2001 with intellectual property acquired from the University of Otago. Pacific Edge was publicly listed in 2002 and now has about 850 shareholders. It employs 16 full-time staff equivalents. The company is focussing on five products, one of which (Cx***bladder***) is in the market and has global market potential. A second product is close to market, two others are at late-stage development and one early-stage.

International growth is essential to realising the potential of the business. Pacific Edge Limited is developing its business internationally through both planned overseas investments and license agreements, i.e. owned or licensed central service laboratories in key geographic locations. The strategy for revenue generation is to

license out to commercialisation partners who have the capability to obtain regulatory approval, manufacture, market and distribute within the area for which their license is granted. Pacific Edge has recently established a distribution and service agreement for Cx***bladder*** in Australia with market leader Healthscope Pathology and Spain and Portugal with Oryzon a molecular diagnostic company in Spain. Overseas investment possibilities are currently being explored in Singapore and USA.

Pacific Edge used merchant banks, consultancies and accounting firms to investigate foreign markets. The company has found information from NZTE, particularly key contacts, introductions and some specialist advice, to be invaluable to its international growth strategy. It used a Strategic Investment Fund (SIF) grant and has developed a close working relationship with NZTE. The company believes that access to capital is a critical constraint to growth.

Case Study: Government assistance for industry feasibility studies into the production of Bio-Oil

A New Zealand Pulp & Paper Company and an Australian technology development company have recently been investigating an opportunity to convert Bio-mass into Bio-oil. The Australian company has significant intellectual knowledge having converted Biomass to Bio-Oil at their pilot plant located near Sydney. If the project is successful, the jointly developed technology and conversion processes will be able to transform Bio-mass and mill residual wastes into Bio-Oil products. The targeted end products for New Zealand are Diesel and or Jet fuel.

NZTE Investment Services have supported this project to investigate production of bio-diesel firstly by introducing the two companies and then providing a grant to help fund feasibility studies. The Strategic Investment Fund provides dollar for dollar funding to feasibility studies which attract and support foreign direct investment.

This opportunity being investigated may lead to a full scale production facility built in New Zealand. The jointly developed manufacturing process could be in operation in approximately five years. Capital investment estimates are still to be finalised, and once fully operational could see the Bio-Oil plant in New Zealand producing 600,000 barrels of oil a year. This will reduce New Zealand's dependence on imported oil and or diesel.

Having the support of the New Zealand government provides leverage for the company to convince investors to provide capital for such projects. The technical background and understanding of individuals in the NZTE Investment Services Team were found to be very useful and their services are recommended to others.

Case Study: Dulux NZ received $30 million investment to upgrade and expand water-based manufacturing facilities and distribution centre

Dulux is the largest paint manufacturer in New Zealand with 35% of the New Zealand paint market. It has had a manufacturing plant at Gracefield, Lower Hutt for over 70 years. Dulux wanted to modernise the plant to meet stringent company safety and environmental requirements while setting it up for the longer term requirements of the New Zealand market. Paint manufactured at Gracefield is for the New Zealand market and is not typically exported. Dulux was part of Orica Group (an Australian

company in ASX top 20) but were de-merged from Orica in July 2010 and are now a separate company listed on the ASX as DuluxGroup.

Decision-making process

Dulux decided to continue manufacturing paint for the New Zealand market in New Zealand. It could have supplied the NZ market from their Brisbane factory or a factory in China both of which were cost-neutral options. The Brisbane factory has five times the capacity of the NZ factory. The decision to stay in NZ was made to retain a simple supply structure and in recognition of the importance of being a New Zealand based manufacturing company to the brand.

Having decided to stay in NZ options included a greenfield site or redevelopment of the Gracefield site. Dulux considered sites in Auckland, Palmerston North and multiple options in the greater Wellington region. A decision was made to progress further with an Upper Hutt site requiring a more in-depth feasibility study. Redevelopment of the current Lower Hutt site was chosen as the most cost effective option. Retention of corporate knowledge in the labour force also contributed to the decision.

As many Wellington manufacturers have moved to Auckland, Dulux is now one of the larger manufacturers in the Wellington region. Dulux are investing $30m in the redevelopment project. It is their largest one-off investment to date, signalling a commitment to an ongoing manufacturing presence in New Zealand. The existing plant is the first Australasian decorative paint plant to manufacture under the international standard for environmental manufacturing standards, ISO 14001.

NZTE involvement in the process.

The majority of the information on which the investment was based came from in-house sources. The Dulux Group and its Orica parent are large companies. Some specific advice was sourced from consultants e.g. risk profiling accountants. NZTE Investment Team engagement started about 4 years ago and they provided contacts into central and local government. While NZTE contributed and what they did certainly helped, they were not a critical part of the investment decision making process.

Case Study: ODI to gain market access

Rocket Lab is a New Zealand-based rapid technological development company with a focus on the US market. The company employs eight staff and delivers pioneering technology and specialised components to the international space industry.

Rocket Lab has engaged in ODI through a joint venture with an American company, as well as working directly with the American government. The key reason for engagement in the United States was to enable distribution of Rocket Lab's technology into a very large market. These projects have largely been funded by the company's clients along with some research grants from MSI.

Contact with NZTE was initiated by Rocket Lab. Rocket Lab is currently working with a Los Angeles based NZTE representative who has relevant industry experience and is supporting the company's initiatives. NZTE had no involvement in the ODI

decision-making process and current NZTE funding programs do not cover businesses such as Rocket Lab.

Case study: Foreign Direct Investment by biopharmaceutical, CoDa Therapeutics Inc.

CoDa Therapeutics Inc. is a biopharmaceutical company with business headquarters in San Diego California and with an operations office and research facilities in Auckland. The company is focused on the development and commercialization of therapeutics for wound care and tissue repair, and inflammation, based on a new platform technology known as "Gap Junction Modulation". Patented inventions and data generated in the laboratories of Professor Colin Green (University of Auckland) and Professor David Becker (University College London) underpin the company's business.

CoDa Therapeutics Inc. was formed in 2006. Now, in 2011, it employs 14 people of whom 9 are based in Auckland, New Zealand.

Brad Duft, co-founder and CEO of CoDa Therapeutics Inc. said, 'Our New Zealand investment provides us with: access to a skilled labour force; reduced costs including for Phase 1 and 2 clinical trials; and allows us to develop and test new products and technologies more efficiently and economically. New Zealand is a good place to do clinical work. It has access to new technologies and has world-class research and development capabilities.' To date, CoDa has designed and executed two Phase 1 safety trials (eye and skin) and a 98-patient Phase 2 efficacy trial (chronic venous leg ulcers) in New Zealand, and sponsors an Investigator-Initiated study at the University of Auckland focused on evaluation of its lead clinical product for the treatment of acute ocular burns. CoDa has also initiated a 300-patient multi-centre Phase 2b venous leg ulcer trial that includes a number of sites in New Zealand. All manufacturing and other preclinical activities, including toxicology, although carried out elsewhere (in the US and Canada) for functional reasons, are run out of CoDa's New Zealand office by its COO, Tracey Sunderland, the company's second employee. Regulatory affairs are also managed by Ms Sunderland and her team in New Zealand.

NZTE engagement

The decision for CoDa Therapeutics Inc. to invest in operations in New Zealand was based on existing relationships between founding directors. Other possible locations were not seriously considered. While the company directors have had some interaction with NZTE from time to time, NZTE have not influenced or informed company investment decisions.

Case study: Potential FDI into New Zealand

Deutsche Werkstätten is a German interior design and woodwork company around 110 years' old and employing approximately 250 people. They specialise in super yacht interiors although they also perform interior work in buildings. Deutsche Werkstätten started internationalising about 10 years ago and has engaged in Russia, France and the United Kingdom.

Decision-making process

The company became interested in New Zealand through a coincidental meeting with a New Zealander who had worked in Europe. This individual organised meetings with contacts in the New Zealand yacht and private plane industry, as well as with NZTE. Any investment is still in the decision-phase, but if it goes ahead it is likely to be a joint venture with production in New Zealand and will be with the objective of bringing specialised know-how to New Zealand firms in the super yacht industry.

Information sought

To date, the company has not sought much information from external sources such as consultancies. The field that they are in is highly specialised and they believe that they already have the necessary knowledge.

NZTE involvement

Contact was made with NZTE before any location (within New Zealand) or project decisions were made. Further contact may be made with government agencies later in the investment process, once the precise location within New Zealand has been decided. NZTE have been actively involved in facilitating the FDI process for Deutsche Werkstätten, including visiting the company in Europe, establishing direct contacts in New Zealand and organising meetings in New Zealand with NZTE and others. Fritz Straub, Managing Director of Deutsche Werkstätten said, “I have some experience internationally and have never seen a country with such active people.”

No other countries have been considered for this particular investment and the initial idea sprung from a chance meeting with a New Zealander.

Case study: Potential FDI into New Zealand

MBC Global is an Australian-based business process service provider specialising in large scale customer service – particularly in the energy sector. This involves dealing with billing, transactions and problem solving in a way which delivers the client a fixed-cost solution per customer.

MBC Global does not currently have any investment in New Zealand, but is looking to expand its operations into other English-speaking markets through FDI. New Zealand is being considered above expansion into Melbourne or the UK due to its cost-effectiveness, closeness to Australia and currently favourable exchange rate.

Information sought

Regulatory compliance is of particular importance in the energy sector and this is one of the main areas where MBC Global has sought information. This was gained by attendance at a large energy conference in New Zealand and through speaking directly to New Zealand’s energy regulators about potential barriers and difficulties.

NZTE Involvement

MBC Global knew that countries tend to provide FDI assistance and incentives and so after narrowing down to New Zealand as an attractive investment option, the company searched for and contacted NZTE with regard to conducting a feasibility study. This is now being done with an external, New Zealand-based consultancy. MBC Global has found NZTE to be proactive in helping to navigate through the New

Zealand bureaucracy with a relatively light touch. Value was particularly added through introductions to the right forums and contacts.

MBC Global has been impressed with NZTE's engagement with them in a role that could be described as facilitating rather than initiating the FDI process.

Case study: Venture Capital Investment in New Zealand

The Trans-Tasman Commercialisation Fund (TTCF), which was established three years ago, is a collaboration between the University of Auckland, The University of Adelaide, Monash University (Melbourne), The University of South Australia, Flinders University (Adelaide), and an Australian based superannuation fund. Other members of the collaboration include the governments of South Australia and Victoria and the New Zealand Government through NZTE. TTCF provides capital to assist in the commercialisation of technology-based research projects within the universities in the collaboration. It actively solicits co-investment from other venture capitalists both in NZ and offshore and is accredited to the New Zealand Venture Investment Fund's SCIF program. TTCF has three current and three pending investments associated with Auckland University.

Decision-making process

Auckland University was a prime mover in getting the fund up and running and had projects ready for commercialisation when the fund commenced operations. Auckland University's commercialisation team, UniServices, has a global reputation for commercialisation and is very active in this field. NZTE Involvement

TTCF has appreciated the NZTE Investment team's involvement and found them to be of considerable value from an operational perspective. For example NZTE's US based staff assisted the fund access to high profile venture capital funds in the USA. The success of this assistance was based on the individuals involved and the extent of their networks, specific expertise and experience.

Spillovers

Due to the high-tech nature of the projects involved, there may be limited opportunities for spillover benefits to firms other than those directly involved in the investment. The type of investments being made and the stage at which they are made means that much of the initial involvement is with the university through contracted R&D. As products are developed or proof of concept is obtained then business development activities ramp up. TTCF's relationship with Auckland University facilitates other investment to projects within that university. The impact on employment by investments in Auckland University based spin-out companies is that there are at least 100 personnel affected either directly or indirectly by the commercialization strategy both within and outside the university. Another impact of TTCF is that co-funding alongside TTCF is over NZ$30 million over the past three years.

Case study: ODI and FDI by financial services company

HiFX Ltd provides foreign exchange transactions and payment services and physically delivers foreign exchange for both corporate and private clients. It is purely

a foreign exchange conduit and clients are not involved in any currency speculation. HiFX started in the UK in 1997. The company decided to expand to New Zealand in 2001 as the market was deemed similar to that in the UK. In 2004 HiFX obtained an Australian Financial Services license and futures-dealers license, allowing them to expand their client base and provide their services to the Australian market place. The company is regulated by the Australian Securities and Investment Commission (ASIC). Australia currently accounts for approximately 60% of the New Zealand company's returns. The NZ office currently generates the largest profit of the HiFX group. Last year the global HiFX group advised on and transacted over $18.5 billion in foreign exchange requirements.

In 2008 HiFX acquired two Christchurch firms Eldridge Lynch and Associates Ltd (now known as Currency Online Ltd), a minor FX brokerage competitor, and Lakros Technologies Ltd, a software development house. These acquisitions were made in order to acquire the online dealing software Lakros had developed, and that Currency Online Ltd was using to deliver its service and still does. A further $7m has been invested in the software and it is now used by all HiFX globally.

No NZTE engagement

Jonathan Ewens, of HiFX NZ said, '*HiFX really do not have any need for NZTE services. The company has good profitability so will invest as opportunities arise. Also, HiFX does not meet the criteria for a NZTE grant due to their profitability.*'

Possible policy improvements

New Zealand is seen as a potentially easy target for money launderers as it is still developing regulations and is behind the rest of the world at present. Regulatory compliance requirements would need to improve considerably if NZ wants to set itself up as an international financial service provider.

Case Study: International expansion of financial services company

Debitsuccess is a full service payment processing company leading the market in both Australia and New Zealand. The company was established in New Zealand in 1994 and is still a wholly-owned NZ firm. The firm started out managing the financial relationships between gyms and their customers. Debitsuccess collects recurring payments from its client's customers and makes weekly payments to their clients. The firm expanded from the health and fitness sector into insurance, child care, school fees, golfing memberships, sports clubs, charities and a variety of other sectors. People prefer to pay small weekly, fortnightly or monthly amounts rather than single large annual amounts. The company now works across a wide range of sectors the common thread being clients who want to offer their customers the ability to pay for goods and services over time without having to incur interest penalties or having to factor debts. Debitsuccess's clients outsource the full financial relationship with their customers to Debitsuccess which frees up valuable resources for them.

Expansion overseas

The business concept was successful in New Zealand and so the company expanded into the Australian market in 2002. Australia now generates 83% of the company's business. Australian and New Zealand business is serviced by a call centre, with 120 employees, in New Zealand. The company has 2500 clients,

processes over 18 million transactions per year, with a value of approximately A$700m.

Having become the market leader in the Australian market Debitsuccess identified an acquisition target in the United States, however during due diligence it was found that the company had more problems than they had revealed and so the acquisition hasn't gone ahead. In the US Debitsuccess has worked with a private equity firm, consultants with expertise in banking, and consultants with expertise in management software for the health and fitness sector.

Debitsuccess has looked at other opportunities in the US but as it hasn't identified a suitable company will probably undertake a Greenfields approach.

No NZTE engagement

While the company has known about NZTE they did not think that NZTE would have the specialised services Debitsuccess required. Debitsuccess consider that NZTE would be good for general advice but don't expect individual services in their sector of business.

Case study: Success in oil and gas industry involves internationalisation

Contract Resources is a New Zealand firm providing specialised industrial and mechanical services to the oil and gas, chemical, mining, cement, utilities and dairy industries. The company was established in 1989. Work on expansion of Marsden Point oil refinery and Methanex NZ synthetic fuels projects established a track record in a competitive industry. Contract Resources use 'state of the art' technology for loading and reloading catalysts from reactors and also commissioning, repairing and modifying reactors. Their operation is mobile with containerised equipment which can be easily relocated. Catalytic technology has increased as catalysts are increasingly used in green processing technology.

Contract Resources is a service company based on equipment not labour. They build most of their own equipment. In New Zealand their business is more broadly based and clients in NZ include Fonterra's milk powder plants where Contract Resources have facilitated in reducing plant maintenance down time significantly. Other New Zealand clients include Carter Holt Harvey pulp and paper mills and continuing work with Marsden Point and Methanex.

Outward direct investment

Contract Resources sold its part in an Asian arm of the business in 2001. Since then it has redirected offshore activities into the Australian market. It entered the US market four years ago. The US market is difficult and to gain traction Contract Resources have purchased 80% of an American company. The original owner retained the other 20%. Contract Resources work in South America on a project by project basis. In the last year Contract Resources have established 2 offices in the Middle East, Abu Dhabi and Qatar, with an operation in Oman also planned. Company turnover is around ~$125m; 90% of this business is outside of NZ.

Contract Resources learnt from their first Asian experience and think they can now enter new markets independently. They have had 20 years experience in their

industry. Contract Resources have developed a reputation for exceptional service, technical innovation and experienced staff. Bill Stretton, a director of Contract Resources, said "*Processes now are very different to what they were 20 years ago. 'Pre-Qualification' for industry in different countries can be onerous and very time consuming. Without a background of working with the large oil companies we would have no chance.*"

Contract Resources have not engaged with NZTE Investment team as they didn't think they would be able to add value.

Case study: Internationalisation of traditional products

Southern Cross Forest Products is a large processor and remanufacturer of clear wood pine products in NZ. They sell and export finely finished wood packaged with a barcode for the DIY market. The product is ready to sell to the customer. The aim is to keep the supply chain as short as possible. The company has invested in the US for three and a half years, and in the last year in Australia to provide distribution in those markets. Southern Cross Forest Products are also looking to expand their activities into Asia.

Southern Cross Forest Products did not find management consultancies and law firms particularly useful. They needed information on things like wages, tax scales, paye structure, legalities of foreign ownership, and banking. Australia is very different to NZ. In the US they had some support from a distribution company. In Australia they are starting out small and have worked things out for themselves as they didn't want the expense of consultants. Southern Cross Forest Products have not used NZTE services.

4.2 Survey of firms engaging in FDI and ODI

As part of the evaluation a survey was conducted of firms that had engaged in FDI and/or ODI in the past five years. 51 responses were obtained from the 130 firms who were sent survey invitations, giving a 39% response rate. However, quite a few of those firms who did respond only partially completed the survey.

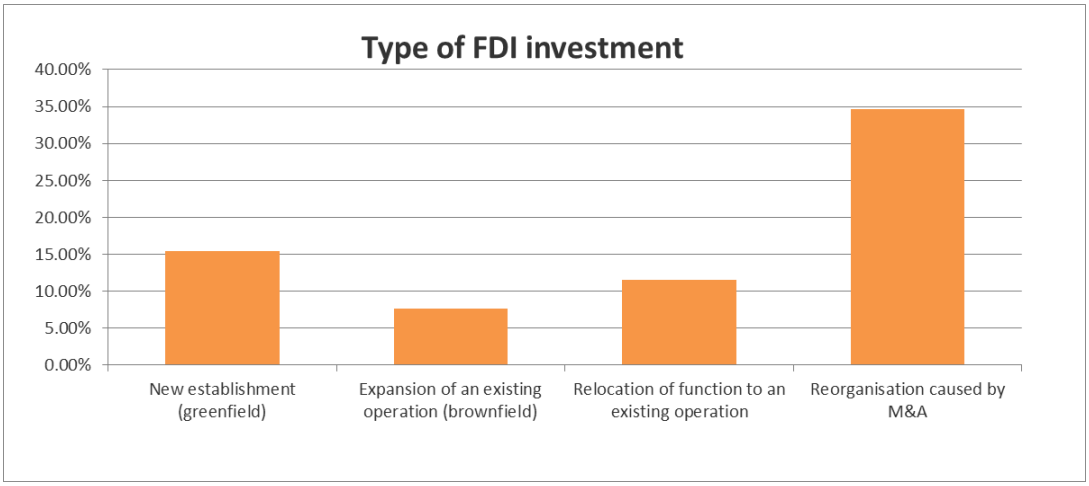
4.2.1 FDI results from the online survey

The answers regarding FDI into New Zealand companies need to be considered with care. Each survey was sent to a New Zealand company and not to the international head office that might be behind it. The New Zealand companies may not have been involved in the FDI decision making process and so may be unaware of all the reasons and research behind the FDI decision. There is also a fairly low response rate: 31 firms (62%) stated that they had received FDI in the last five years but not all of these went on to complete all of the FDI questions – for example, one question had only 16 respondents.

Bearing this in mind, the FDI results from the online survey are as follows:

The main types of FDI recorded were mergers and acquisitions, greenfields investment and the relocation of a function to an existing operation (see below).

Figure 4-1 Type of FDI investment

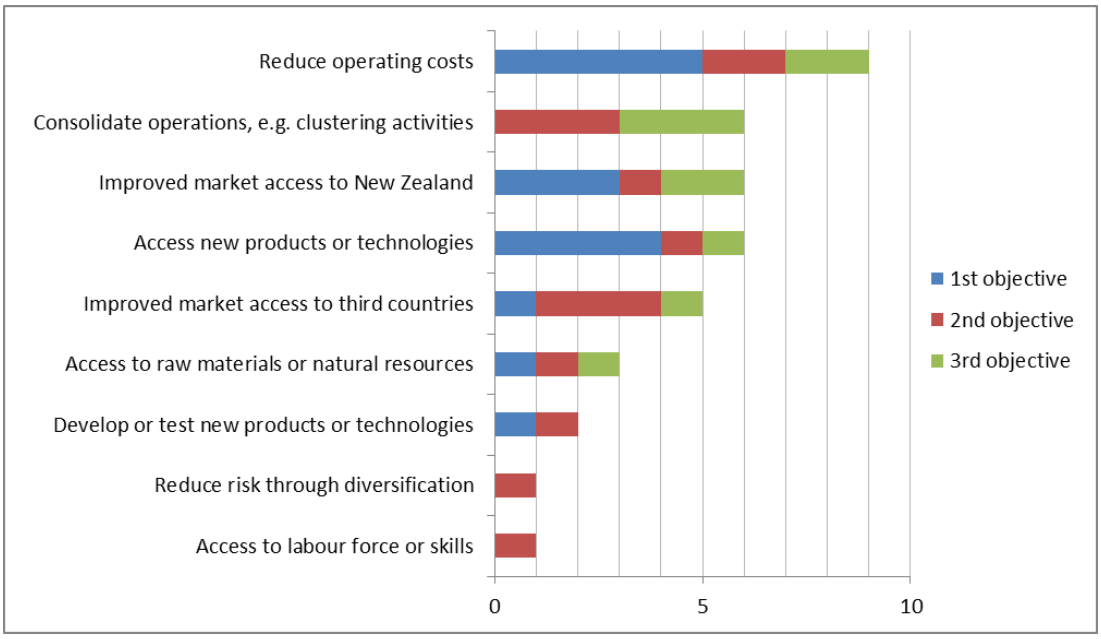


Respondents stated that the main objectives of FDI were to: reduce costs, access new products/technologies, improve market access to New Zealand and consolidate operations. These results are consistent with academic literature and other surveys. Different factors are at play in deciding where to locate foreign investment and market related factors (e.g. market size and growth) are the most frequently cited location factors. Government incentives seem to be less important for respondents (see also UNCTAD, 2009).

FDI for the reduction of costs suggests that the FDI may be occurring because New Zealand has a comparative advantage in the area that the FDI is occurring in. FDI to

access new products/technologies suggests that FDI may be occurring in sectors that are close to the technological frontier.

Figure 4-2 Objectives of FDI



A considerable majority of respondents (over 70%) stated that no other countries had been considered when the FDI decision was made. About 10% said that they had considered one to two other locations and the remainder didn't know or refused to answer. This stands in contrasts to the typical investment decision process of MNEs (long list to short list of potential countries, see Box 4) and indicates that in the New Zealand case, market seeking reasons seem to be prevailing in the investment choice.

The most frequently used sources of information when the FDI decision into New Zealand was made were international accountants and law firms, followed by international management consultancies, investment or merchant banks and business associates or other firms. None of the respondents stated that they had used either a national or regional investment promotion agency (IPA) as a source of information.

4.2.2 ODI results from the online survey

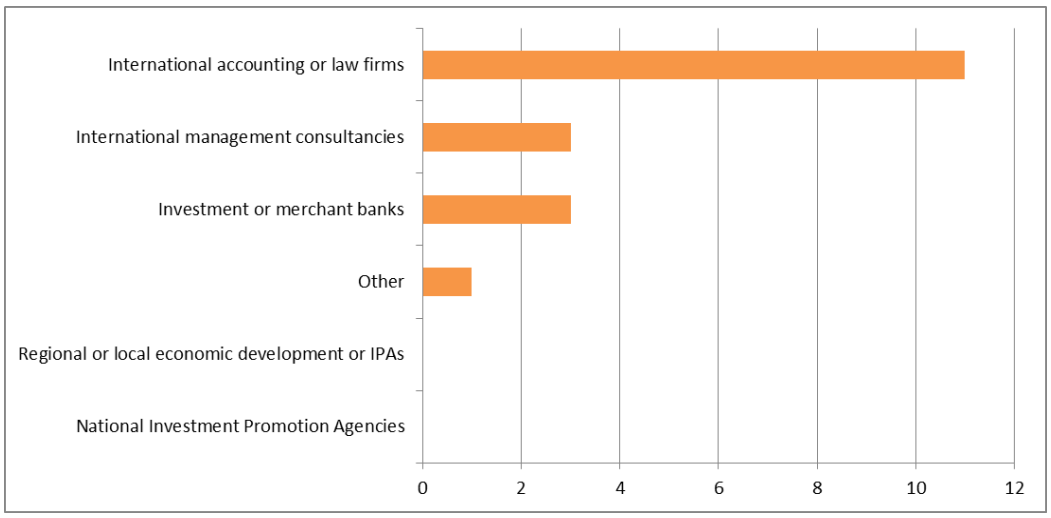
The ODI part of the survey can be considered to be more robust than the FDI part since managers are likely to have a detailed knowledge of their own firms' ODI decisions. However, this part of the survey had an even lower response rate than the FDI part and so similar caution needs to be taken regarding the results. 23 firms (51% of respondents to this question) stated that they had engaged in ODI in the last five years but not all these went on to complete all of the ODI questions. Some questions had only 17 respondents.

The ODI results from the online survey are as follows:

The ODI decisions were mainly greenfields (43% of responses to this question) and brownfields investments (38%). One respondent stated the ODI was a reorganisation caused by a merger and acquisition and the rest of the responses were in the 'other' category.

The dominant objective for ODI was to improve market access to other countries, followed by to reduce risk through diversification and to access new products markets.

Figure 4-3 External Information sources used in ODI decision



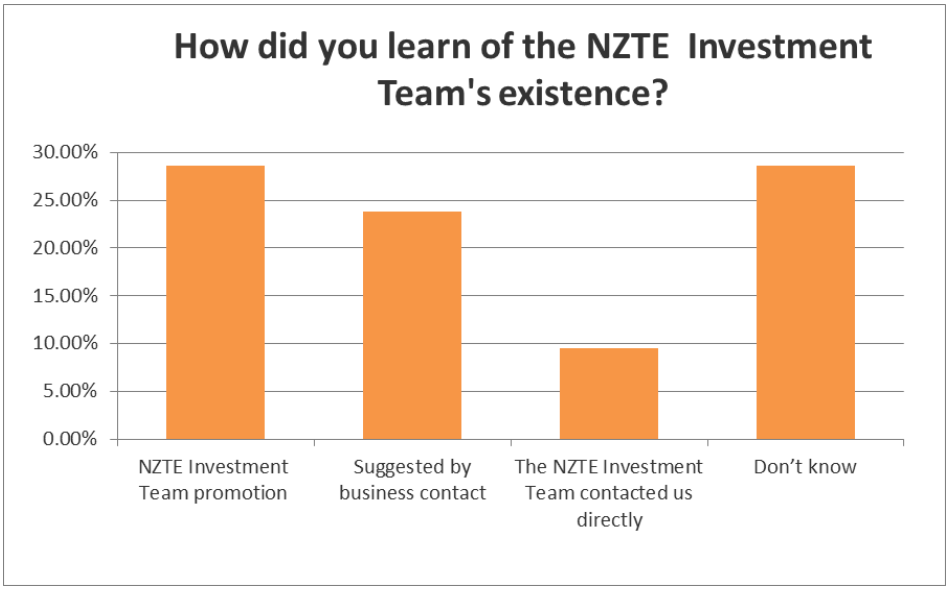
As was the case with FDI, the dominant sources of information were international accounting or law firms, followed by management consultancies and investment/merchant banks. No firms stated that they had used IPAs as an information source in their ODI decision.

4.3 Evidence of the benefits associated with support from the NZTE Investment team

The online survey also contained questions on NZTE's investment team. 21 respondents (50% of this question) stated that they were aware of NZTE's investment team.

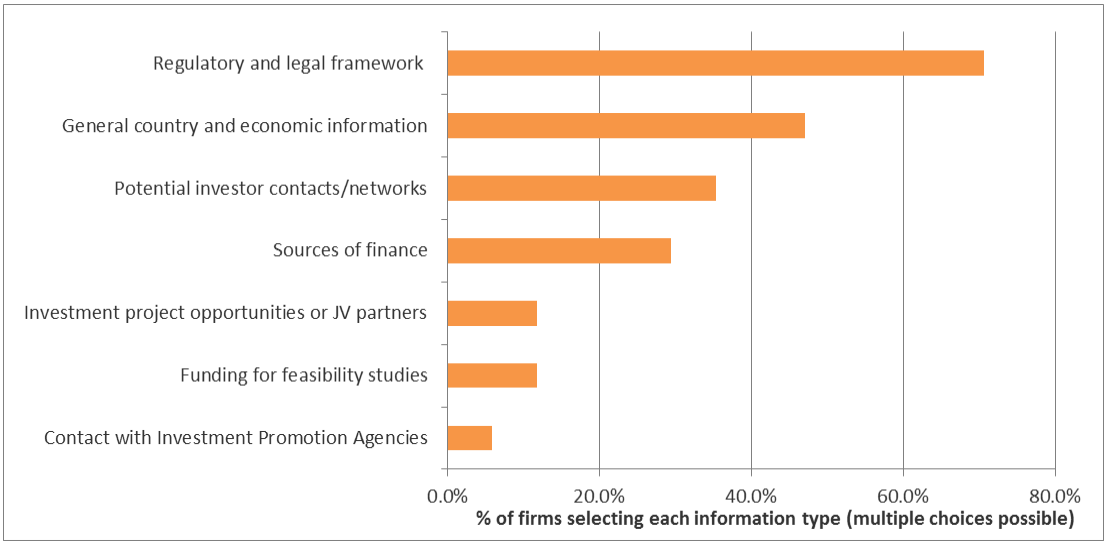
For those who knew how they had learnt of NZTE's investment team's existence, the main ways that they became aware of it were through NZTE's promotion activities (six respondents, which was 29% of those who responded to the question) followed by suggestions by business contacts (24%). A considerable proportion (29%) didn't know how they became aware of the team.

Figure 4-4 NZTE awareness



In keeping with the fact that law firms, accountants and consultancies were recorded as the most frequently used sources of information for both FDI and ODI, information on regulatory and legal frameworks was the most sought for investment decisions by those who were aware of the NZTE Investment Team's existence. This was followed by general country and economic information and then potential investors/networks and sources of finance.

Figure 4-5 Information sought during Investment decision process



Questions were also asked regarding when contact was made with NZTE, what information was obtained from them and the role that they played in the investment process. These questions received only two responses each, meaning that we cannot draw conclusions from them.

The main reason for not contacting NZTE was that firms thought that they had sufficient internal resources (9/13 of respondents to this question). This was followed

by firms thinking that NZTE couldn't add any value (5/13 of respondents to this question) which is similar to the view that they had sufficient internal resources. (Note that some firms selected both categories).

Those firms who weren't aware of NZTE generally indicated that the information that they were looking for was relatively hard to find. Similar to those who were aware of NZTE's investment team, the information sought for was predominantly regarding regulatory and legal frameworks and general country and economic information.

During the investment decision-making process, which of the following information or services were your company looking for? If this information/service was sought, was it easy to find (regardless of source)? Please score with 1 being very difficult to find and 5 being very easy to find.								
Answer Options	**Information not sought**	**1**	**2**	**3**	**4**	**5**	**Response Count**	**Sum of responses for info sought**
General country and economic information	8	2	1	1	1	0	13	5
Regulatory and legal framework e.g. trade, labour,	7	0	3	0	3	0	13	6
Investment project opportunities or joint venture	12	1	0	0	0	0	13	1
Sources of finance	13	0	0	0	0	0	13	0
Potential investor visits	12	1	0	0	0	0	13	1
Contact with Investment Promotion Agencies	13	0	0	0	0	0	13	0
Funding for feasibility studies	13	0	0	0	0	0	13	0
Other	8	0	0	0	0	0	8	0

NZTE Investment Customer Experience survey

NZTE simultaneously conducted a pilot survey of their investment customers in March/April 2011. This allowed us to: (1) check that MED's survey results were similar to NZTE's for similar questions and (2) obtain information for NZTE specific questions for which MED's survey had a low response rate.
Due to the low number (12) of respondents completing the survey results should be considered indicative only.

The NZTE survey confirms that most firms either didn't consider other countries when making their investment decision or else considered only one or two others. The most frequently considered alternative locations were Australia, and the United States. The NZTE survey also confirms that the most used sources of information were international accounting and law firms, as well as business associates/other firms, investment/merchant banks and international management consultancies. National or regional Investment Promotion Agencies were least used.

NZTE's survey obtained information on when contact was made with the NZTE Investment team during the decision making process. This was a question that MED's survey asked but for which they had a very low response rate. The most frequent point of contact was before making a location/project decision. This was followed by contact during the decision making process and then by contact after the location/project was determined, seeking more information.

5. Conclusions and recommendations

This report has brought together the existing knowledge on attracting foreign direct investment (especially high-quality investment) and on supporting outward direct investment. More specifically it has highlighted the importance of different location factors and relevant policies[28].

Findings

The evaluation has found that:

1. New Zealand is very dependent on FDI as a key source of investment, skills and trade development, and opportunities.

2. International evidence and studies on New Zealand show that direct investment (inward and outward) is linked to economic growth, but the magnitude of the effect is small. The role of foreign ownership has been overstated compared to the influence of other (structural) factors. Improvements in technology, efficiency and productivity at the firm level tend to have a considerably greater effect on stimulating growth. Additional benefits (spillovers) of direct investment do not occur automatically, but depend on the characteristics of individual firms and the wider economy.

3. A key finding of the study is that benefits of "high quality" investment are highly dependent on compatible company and country characteristics. The level of absorptive capacity[29] in New Zealand seems to be a bottleneck in the investment climate in order to make the country more attractive for "high-quality" FDI.

    - The New Zealand evidence on wider benefits (knowledge or productivity spillovers) from FDI to the local economy suggests that such benefits are more likely for exporting firms and are small elsewhere.

    - FDI can enhance competitive pressure to innovate and up-skill, thus indirectly enhancing economic growth.

4. New Zealand is highly successful in attracting FDI, with the largest share continuing to come from the Australia. Foreign-owned firms now account for over 50% of business revenues, almost 60% of value added and 45% of employment.

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[28] The recent UK policy review "International Trade and Investment- the Economic Rationale for Government Support" looks into the vital role of foreign investment in driving forward growth in the UK economy and comes to similar findings, see BIS (2011). It concludes that "the potential benefits of inward investment depend crucially on the characteristics of the project. High quality projects, capable of contributing positively to productivity, UK R&D and skilled jobs, are likely to be mainly technology exploiting, greenfield investment, most of which is likely to come from technological leaders."

[29] Absorptive capacity is a firm's ability to use new information and knowledge to commercial ends. Absorptive capacity can be developed through more R&D, better knowledge management and human resources, or increased supplier and client integration.

5. Foreign companies identified a) reduced costs (efficiency seeking), b) access to new products and/or technologies, and c) improved market access to New Zealand (market seeking) as the main sources of value. Equally, New Zealand companies, contemplating ODI, identified a) improved market access to other countries, b) reduced risk through diversification and c) access to new products or markets as the main direct sources of value to them.

6. Additional evidence showed that foreign businesses investing in New Zealand benefited from the existing leading-edge knowledge of purchased New Zealand companies and that acquired businesses benefited from distribution channels of MNEs that otherwise would not have been accessible.

7. The economic rationale for government support in attracting quality investment and supporting outward investment is based on market failure (e.g. barriers to obtaining critical information) and the generation of positive externalities (e.g. knowledge spill-overs to a firm that is not directly involved in the transaction).

8. Barriers to FDI include limited knowledge about the characteristics of New Zealand as a place to invest. Other barriers faced by foreign investors are access to the right contacts and networks, access to information not otherwise available, and guidance in navigating the legal and regulatory framework in New Zealand.

9. There is evidence of productivity enhancing spillovers for some types of inward investment. As these benefits cannot be fully internalised by the foreign investing firm, the inference is that markets unaided would not deliver optimal levels of FDI.

10. Governments in most countries have put policy measures in place to encourage multinationals to establish local affiliates in the hope of generating benefits from international direct investment. It is less clear if these policies are effective.

11. Overseas evidence suggests that the most effective strategies are those which are very well integrated with government priorities. This requires a close co-ordination of foreign investment policy with other policies such as innovation policy.

12. Most firms contemplating FDI or ODI projects have sufficient internal resources to manage their international investment decision and see no need to use NZTE services for investment purposes. Accountants and law firms are used if external information or expertise is sought. Almost 40% of surveyed firms were not aware of NZTE investment services. Some firms will seek NZTE help with government contacts and essential information about New Zealand. NZTE influence on FDI decisions is mainly due to helping inward investors to facilitate access to contacts and information that is not otherwise accessible.

13. For those potential FDI interests that substantially engage with NZTE, the investment team contributes to and closely supports the process by facilitating engagement with key contacts and other leads in New Zealand. They also provide significant sector knowledge, market insights and other information that can increase New Zealand’s competitive edge in attracting investment.

14. For FDI, benefits of NZTE involvement cannot be quantified and it is unclear whether government is able to intervene effectively. However, there is some evidence, e.g. premium tourism market, of the ability of NZTE investment team to contribute to high quality investment in ways likely to benefit the New Zealand economy.

15. International evidence show that less productive companies choose exporting over direct investment in their internationalisation strategy because high fixed costs and risks are associated with such investment. The evidence of a clear ranking between New Zealand firms that export and those that conduct ODI is, however, weaker. The number of New Zealand companies engaged in ODI is low and accordingly the number of ODI companies assisted by the NZTE investment team is very low.

Conclusions

- The overall level of direct investment (FDI and ODI) does not pose a problem for New Zealand; but certain aspects, particularly the absorptive capacity of domestic companies, are less developed and New Zealand does not fully benefit from spillover effects.

- A higher level of absorptive capacity would also strengthen the effectiveness of activities carried out by NZTE investment team, in particular FDI promotion and client engagement.

Recommendations

The evaluation has identified the following issues for further consideration:

- There is a role for NZTE in assisting firms to attract quality investment and to internationalise through outward investment. Necessary FDI promotion activities are “investor servicing” that involves assisting potential or committed investors by providing information, acting as a point of enquiry and helping analyse business opportunities. However, the impact of such work is often limited, and expected outcomes should be clarified in the light of what can realistically be achieved. Important factors for international investment (e.g. market size and growth) are to a large extent outside the scope of government policy.

- The current FDI approach is focused on attracting “high quality” investment that results in a targeted FDI strategy. Identifying and measuring “high quality” investment has become more complicated due to the fragmentation of the global production process. The challenge for this approach is to design a coherent and efficient strategy that is in relation to other characteristics of New Zealand. A more differentiated approach including prioritising in terms of sectors and/or functions with clear cost advantage, e.g. R&D activities seems to be warranted.

- The magnitude of positive knowledge spillovers through FDI depends on the absorptive capacity of domestic companies for advanced technology and/or knowledge of international investors or MNEs. We should aim for integrated direct investment and innovation initiatives that foster the innovation performance and absorptive capacity of domestic companies. More insights are also needed on how FDI work can better respond to the growing importance of innovation and global innovation networks.

- FDI attraction and policies for ODI strategies should not be used in isolation of other work to support New Zealand business growth. An integrated approach should cover different policy instruments, including support for private R&D, skill development and immigration, access to public research, and innovation networking. This requires a closer co-operation between NZTE and e.g. the Department of Labour, Ministry of Environment, and Ministry of Science and Innovation.

- Exporting is still the preferred way of internationalisation for New Zealand companies and outward direct investment is perceived as too risky for most New Zealand firms, given their size and capabilities. Given the low number of ODI cases and the close link between international investment and international trade, the evaluation calls for a better understanding of how New Zealand and its companies can enhance their connectedness in global networks, e.g. explore how New Zealand positions itself within international networks of companies and how the local economy can benefit from these networks.

- The evidence showed that ODI support should be set into a new framework that focuses on firms which are seeking to grow and have the appropriate productivity and innovation characteristics to achieve for spill over benefits to other New Zealand firms. Evidence also cautions against encouraging firms to engage in international investment that lack the qualities necessary for sustainable business success.

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Annex

Outward Investment: Role of New Zealand Trade and Enterprise

Outward investment is an internationalisation strategy that can enable New Zealand firms to better market opportunities and overcome New Zealand's geographic isolation and small domestic market.

NZTE is already responsible for a range of activities that support business internationalisation, strengthen New Zealand's international linkages and promote investment. Initiatives to assist outward investment by New Zealand firms should be viewed as a complementary extension to existing activity.

To ensure that NZTE generates a net economic benefit, initiatives to assist firms' outward investment must lead to benefits additional to those that would flow on from firms undertaking the investment without assistance. This may require alignment and co-ordination of complementary activity, rather than directly assisting the firm making the investment.

Guidelines for Supporting Outward Investment activities

When seeking to support projects that involve outward investment activities by New Zealand firms NZTE should adhere to the following principles:

- Support must be for new outward investments with good prospects of generating significant net economic benefits for New Zealand, in particular those that involve productivity-enhancing spillover benefits because these;
    - Introduce new technology, research and development activities, ability to commercialise innovations or management know-how into the New Zealand economy;
    - Establish new, or enhanced, linkages and networks between the host country and New Zealand that other New Zealand firms can directly leverage and create value from;
    - Create opportunities for other New Zealand firms to improve their position in international supply chains, distribution networks and markets in ways that contribute to improved productivity, sales and competitiveness; and
- Support must be consistent with New Zealand's reputation as a good international citizen, including adherence to international rules.

Additional tables and graphs

Figure 5-1 Foreign ownership of domestic inventions
2005-07

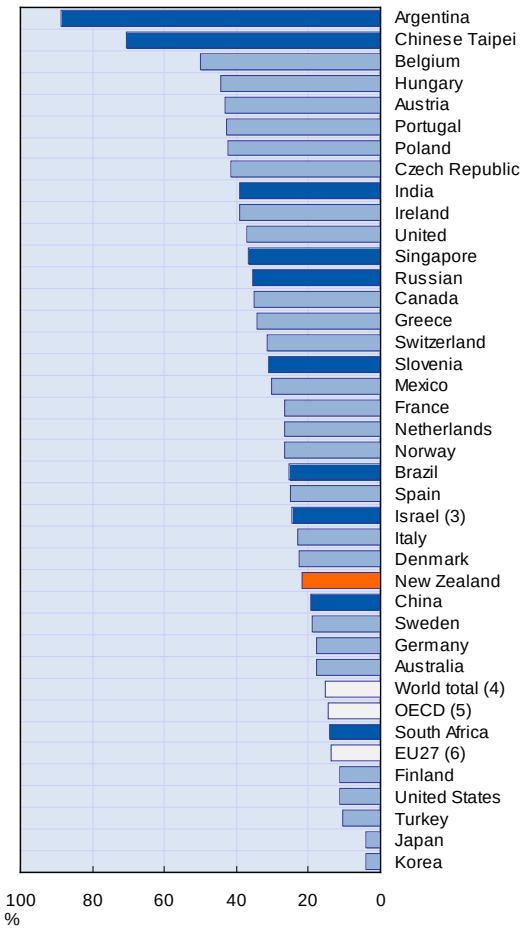


Figure 5-2 Domestic ownership of inventions made abroad
2005-07

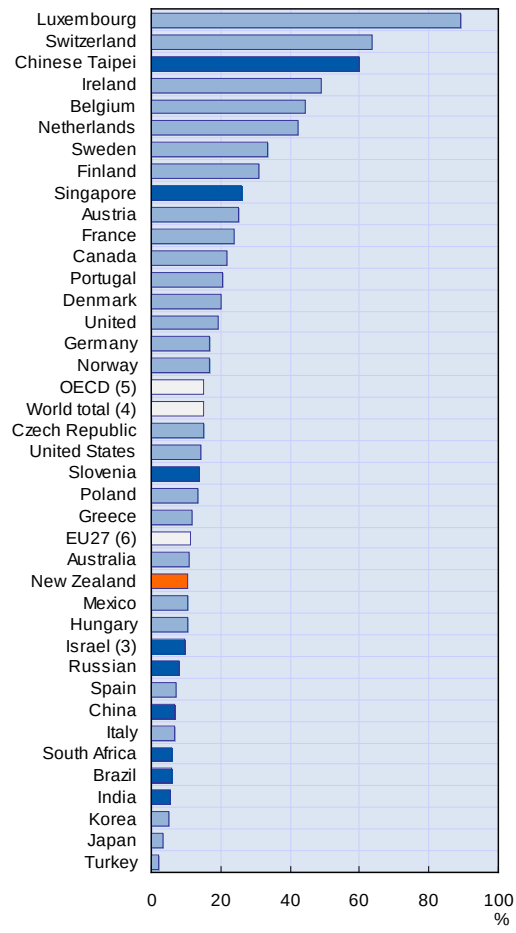
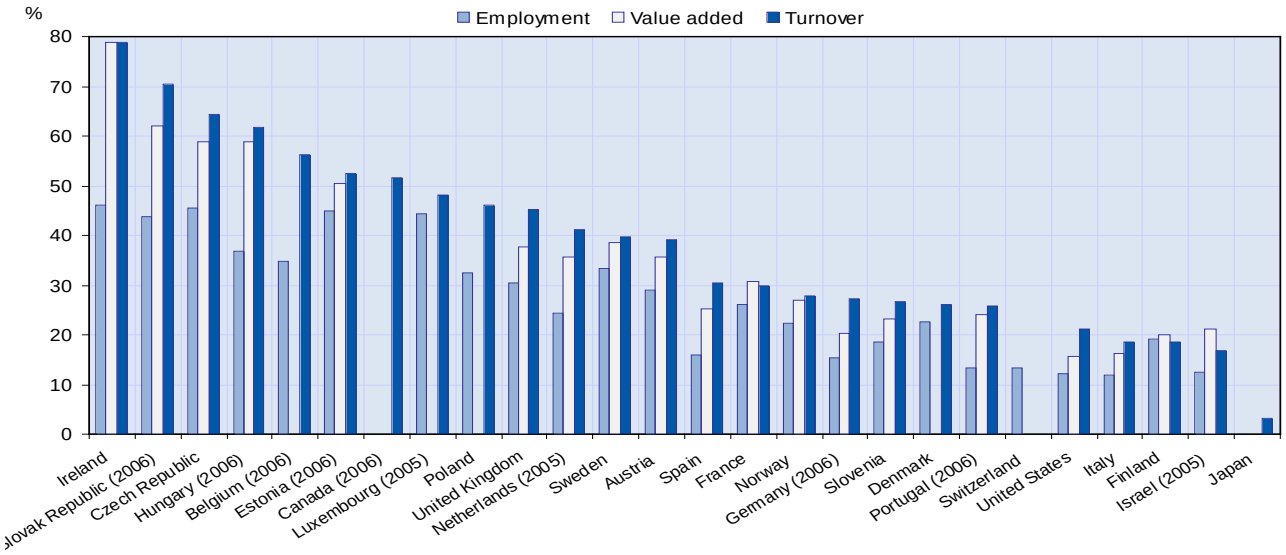
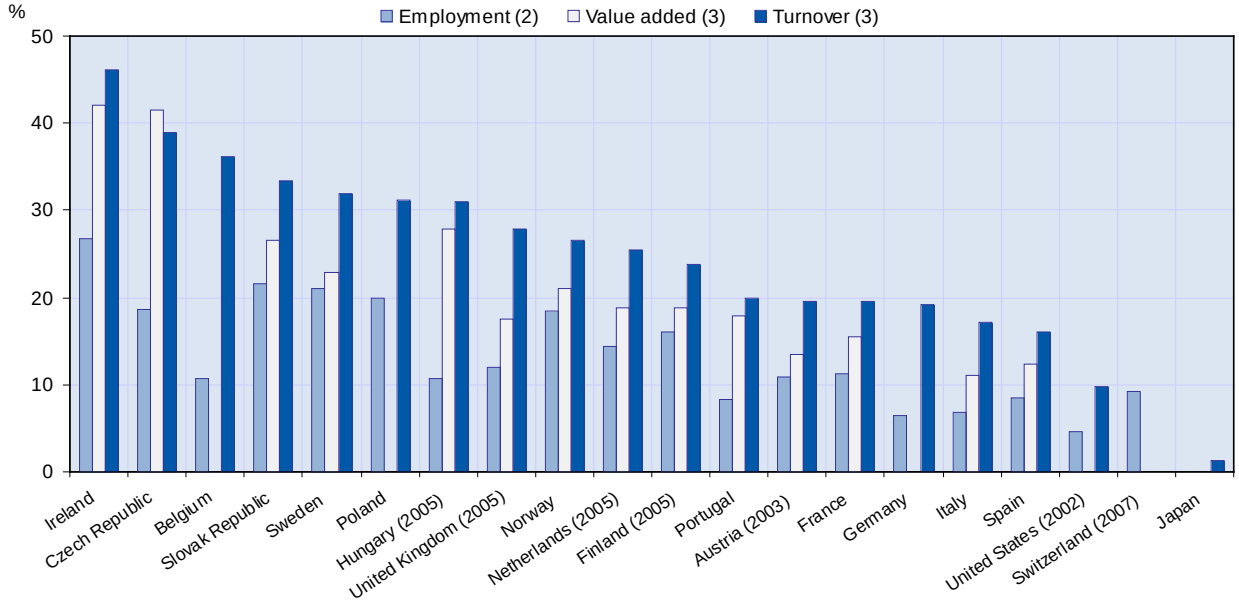


Figure 5-3 Share of foreign-controlled affiliates in manufacturing employment, turnover & value added, 2007



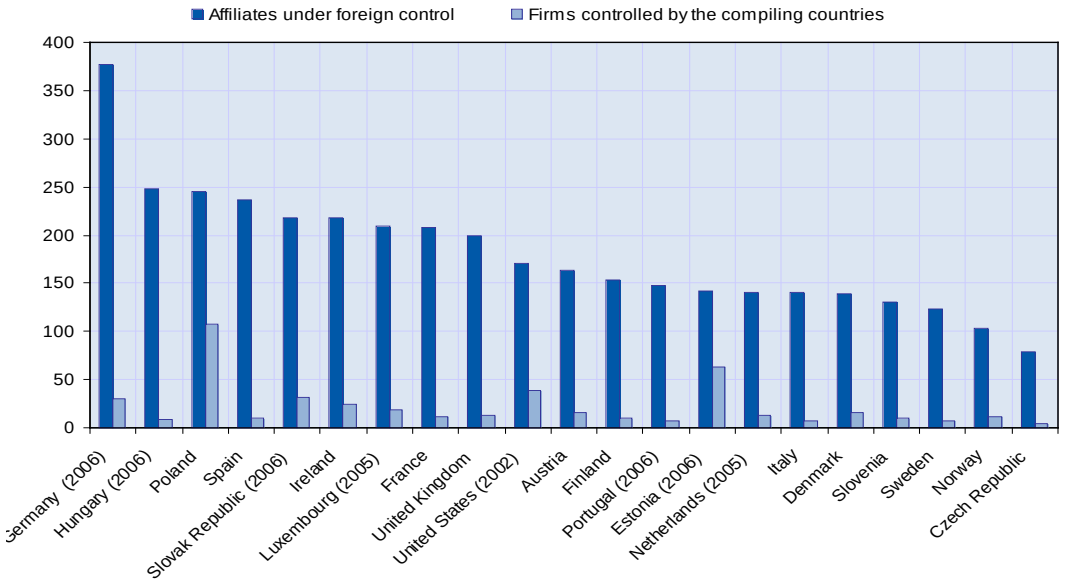
Source: OECD Economic Globalisation Indicators 2010

Figure 5-4 Share of foreign-controlled affiliates in services employment, turnover & value added, 2006



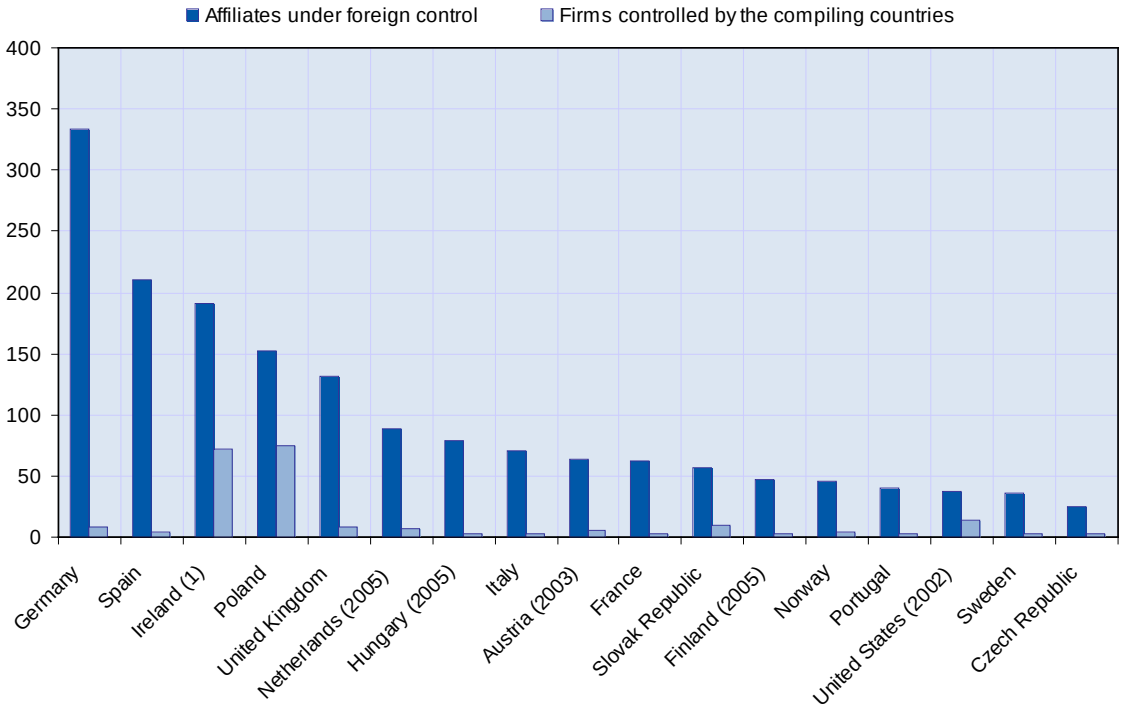
Source: OECD Economic Globalisation Indicators 2010

Figure 5-5 Number of employees by enterprise of foreign affiliates and national firms manufacturing, 2007



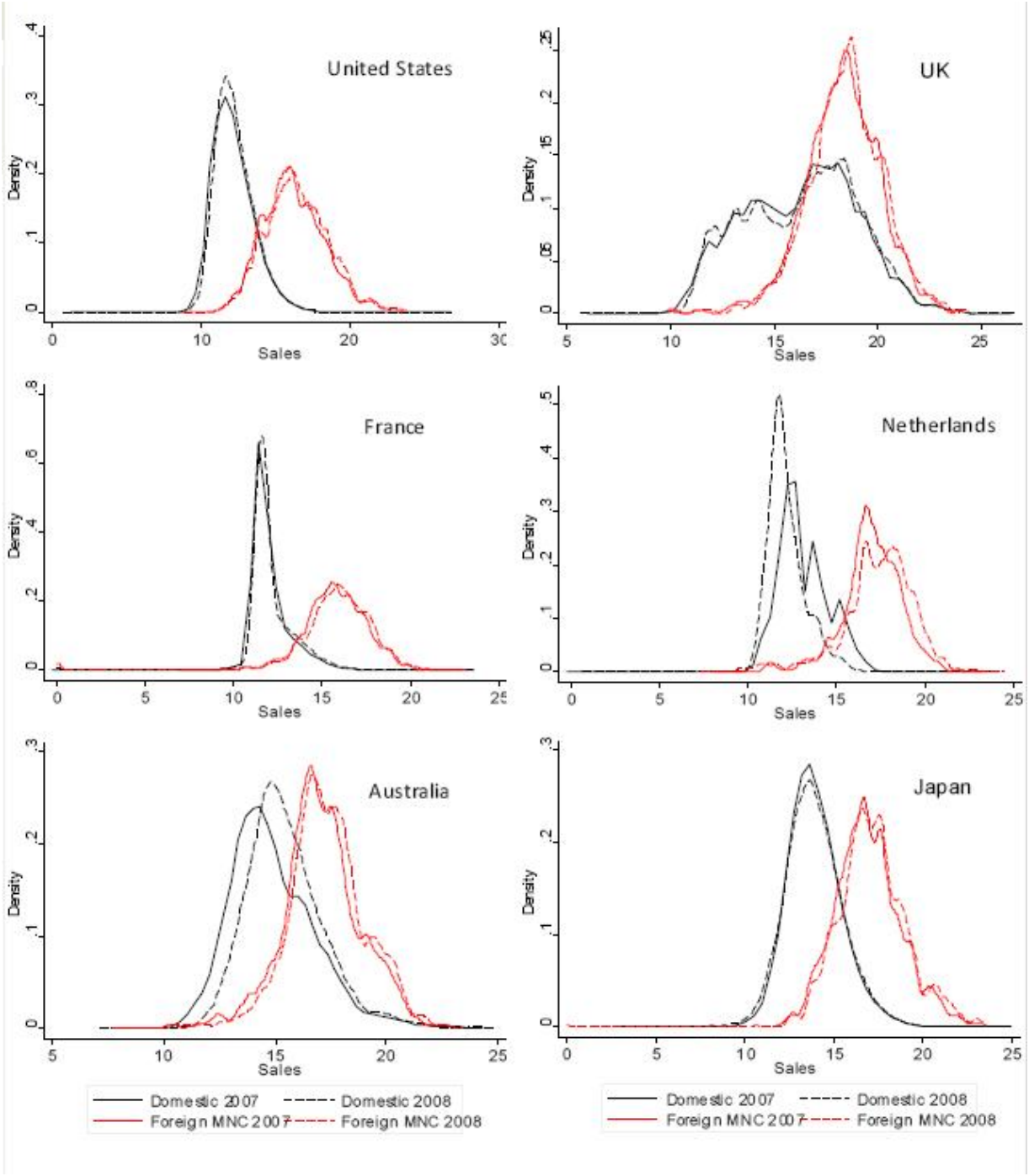
Source: OECD Economic Globalisation Indicators 2010

Figure 5-6 Number of employees by enterprise of foreign affiliates and national firms in services, 2006



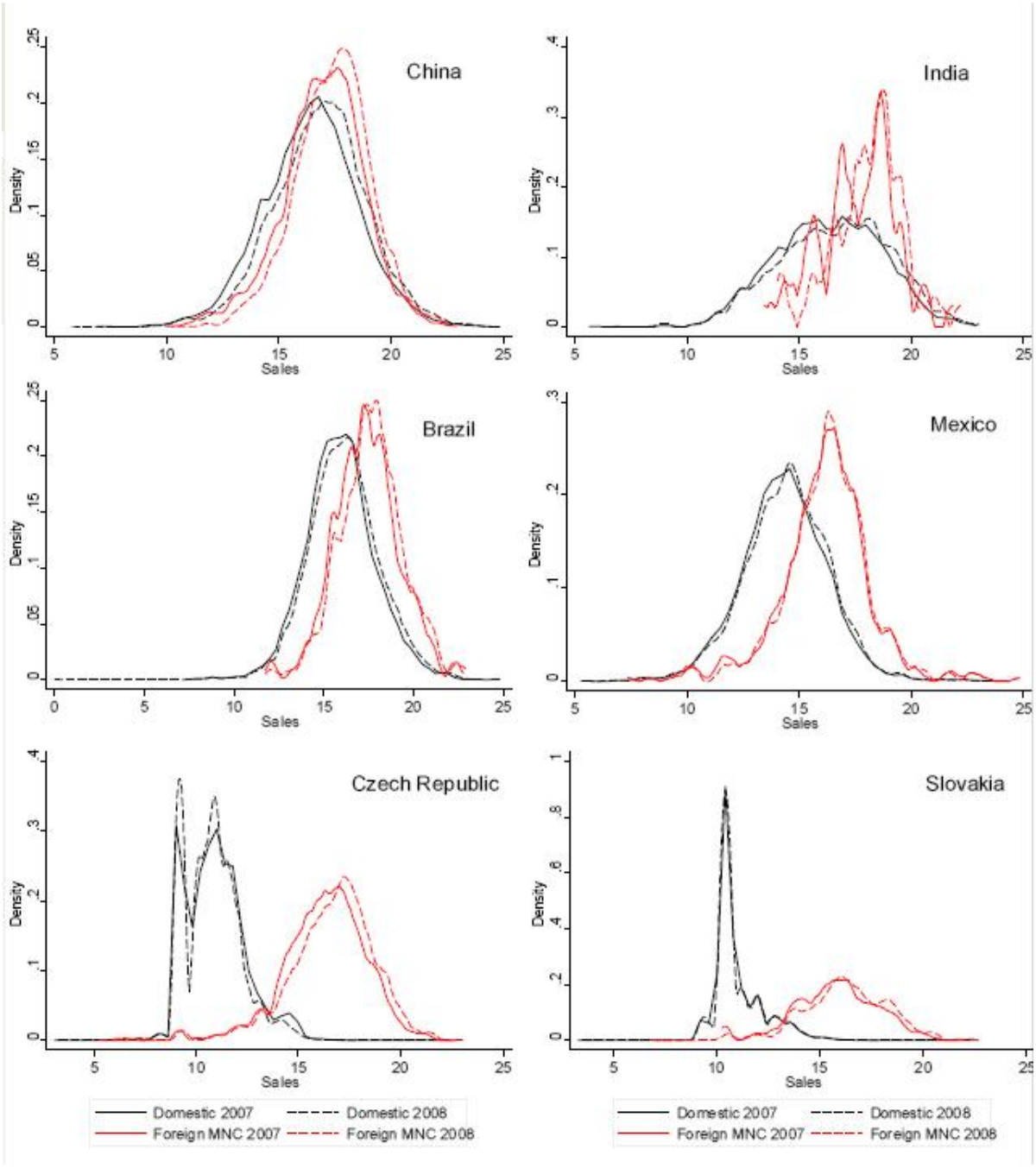
Source: OECD Economic Globalisation Indicators 2010

Figure 5-7 Distribution of domestic and multinational establishments: developed countries



Source: Alfaro/Chen (2010)

Figure 5-8 Distribution of domestic and multinational establishments: developing countries



Source: Alfaro/Chen (2010)

Figure 5-9 Relative annual growth of exports of goods

Growth over the period 1998-2008, OECD total = 1.0

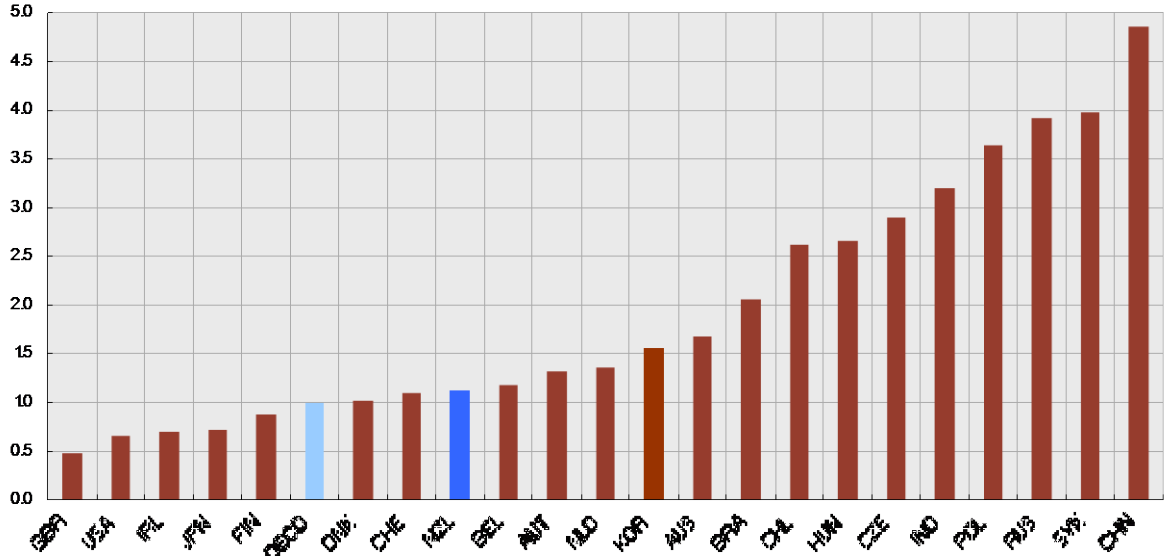


Figure 5-10 Services trade balance: exports minus imports of services

Billion US dollars, average 2006-2008

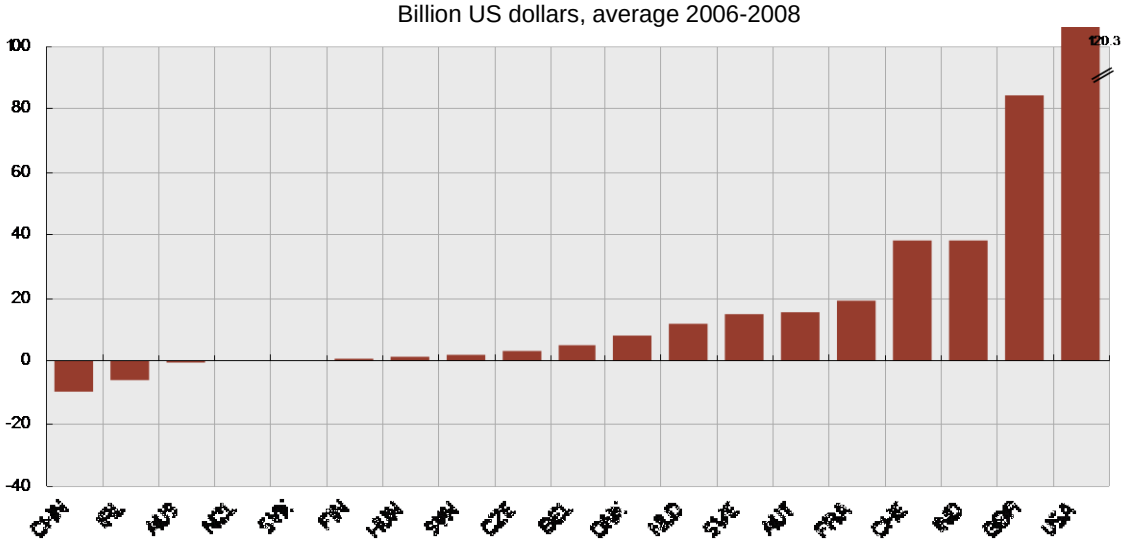


Figure 5-11 FDI stocks

As a percentage of GDP, 2007 or latest available year

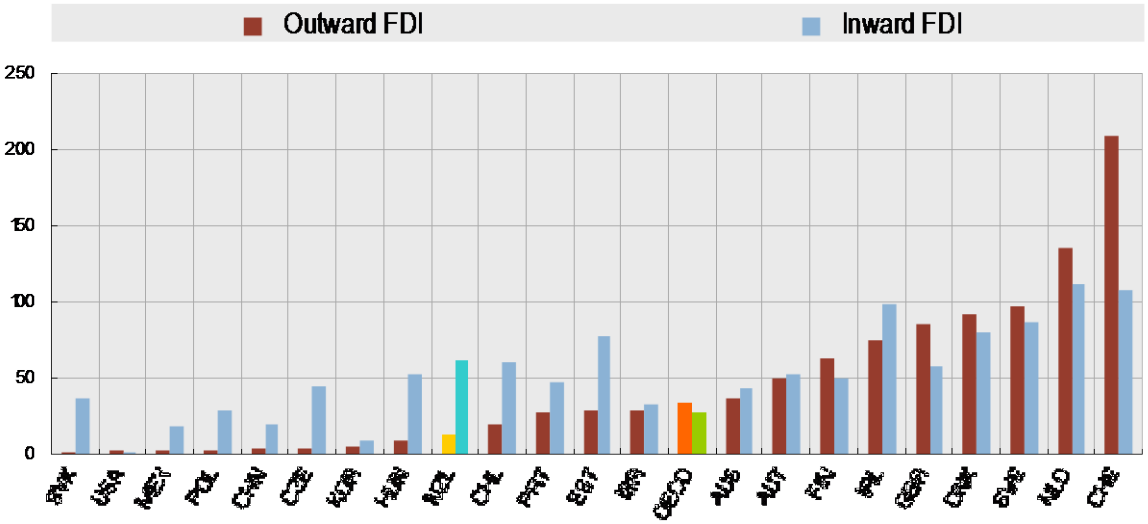


Figure 5-12 FDI outflows from OECD countries as a % of GDP

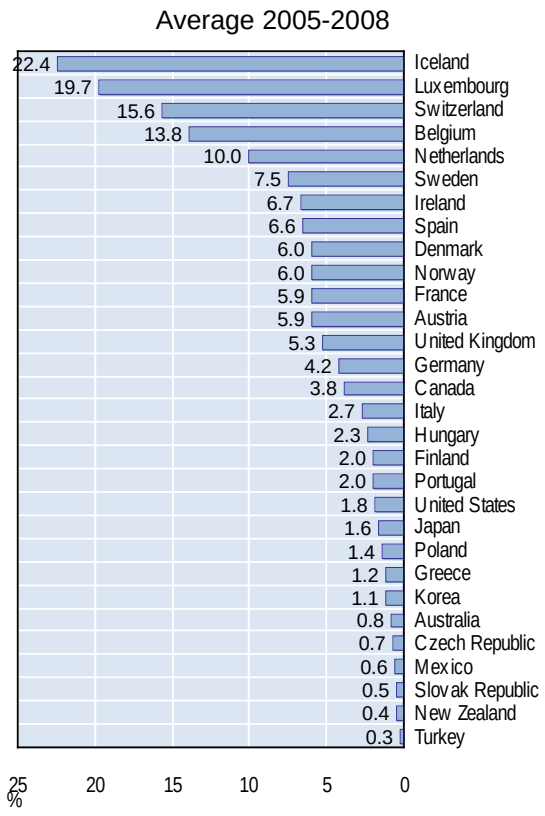


Figure 5-13 FDI inflows to OECD countries as a % of GDP

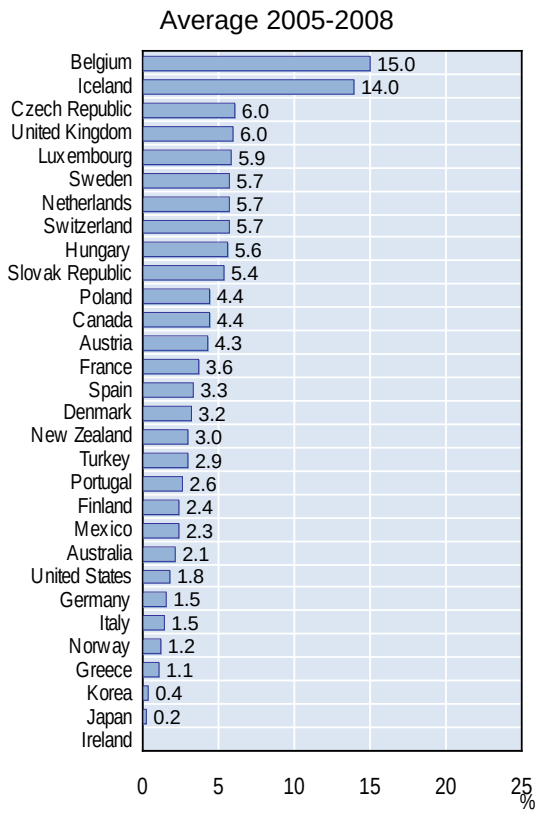
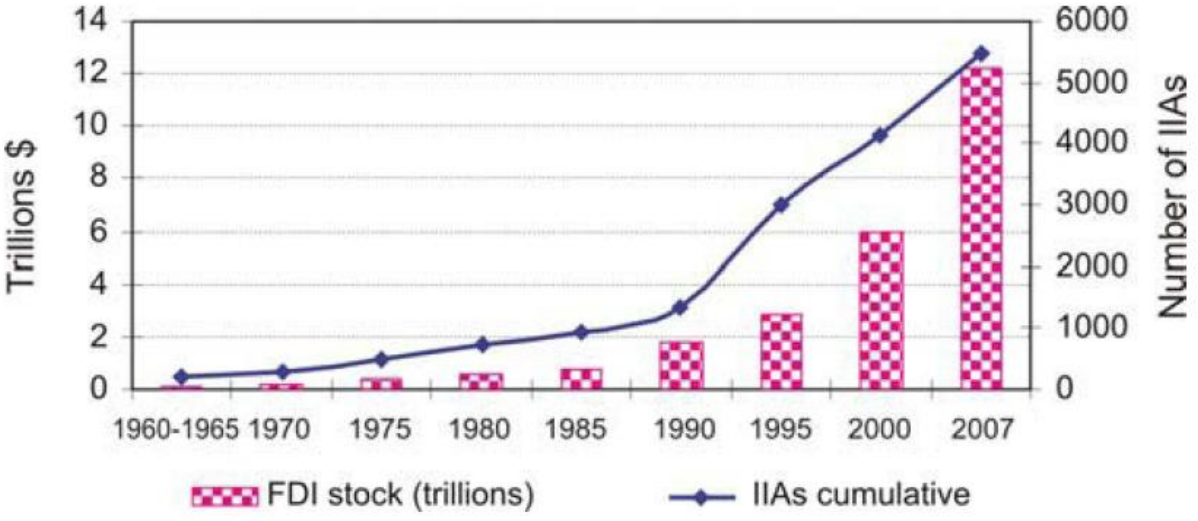


Figure 5-14 Increase in International Investment Agreements (IIA) and FDI stock
(1960-2007)



Source: UNCTAD (2008)