

Digital FDI

Policies, regulations and
measures to attract FDI
in the digital economy

WHITE PAPER

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Executive Summary

Policy-makers and firms realize they must grow their national and corporate digital competitiveness or risk being left behind. But how? One way is through attracting foreign direct investment (FDI) in the digital economy, or “digital FDI”. The evidence shows that FDI brings not only capital but also knowledge and technology and attracting digital FDI can help economies and companies boost digital capabilities. Yet as this is a new area, there are information gaps and coordination challenges to connecting capital to digital investment opportunities, especially in developing economies.

To help unlock these opportunities, the World Economic Forum has launched a Digital FDI initiative. The initiative is designed to support public and private actors in their digital investment goals through three steps: a supply step; a demand step; and a step to connect the two and catalyse win-win investment flows for policy-makers and firms.

On the supply side, the initiative aims to identify policies, regulations and measures that governments can adopt to create digital-friendly investment climates, “supplying” investors with ecosystems that will attract such investment. On the demand side, the initiative aims to understand the digital investment needs and priorities of firms and how these can be facilitated; in other words, the “demand” for digital investment opportunities. Connecting supply and demand can take place through economy-level projects that identify and address country-specific digital investment challenges and goals.

This white paper helps support the supply step by presenting the results of a global survey on the most important policies, regulations and measures to firms’ decision to invest in the digital economy. The premise is that attracting digital FDI may require specific policies, regulations and measures vis-à-vis traditional FDI because digital firms operate different business models. Just like traditional firms, digital firms invest abroad to be close to customers, access

local knowledge, open new markets and more. They often find a physical presence necessary for their operations, including to manage logistics and assets for delivery, run data centres, tailor services to local contexts and preferences, and deal with regulatory complexity. At the same time, digital firms have business models that vary in important ways from traditional bricks-and-mortar businesses. Digital firms rely heavily on data and technology, often involve platform economies and leverage non-traditional assets. Different policies, regulations and measures may, therefore, rise to the top as the ones digital firms care about most.

Policies, regulations and measures to attract digital FDI can be thought as falling into three pillars: (a) those that enable investment in new digital activities (e.g. ridesharing apps); (b) those that enable investment in the adoption of digital services by existing firms (e.g. telemedicine or mobile banking); and those that enable investment in digital infrastructure.¹ Regarding the last, investing in digital infrastructure will not only be driven by the policy and regulatory framework but also by physical considerations. For simplicity, the white paper uses the term “elements” to capture the policies, regulations and measures that will impact a potential investor’s decision to commit capital and other resources.

To identify the most important elements in each pillar, the Forum carried out a survey of 310 investment decision-makers in technology and digital firms around the world. The survey revealed that:

The top three elements that investors care about when investing in new digital activities are:

- Data security regulations
- Copyright laws to protect intellectual property
- Data privacy regulations

The top three elements that investors care about in deciding to adopt digital technologies are:

- Availability of e-payment services
- Support for starting digital businesses
- Support for local digital skills development

The top three regulatory elements that investors care about when investing in digital infrastructure are:

- Ease of receiving licences for digital infrastructure
- Availability of skilled local engineers and other workers
- Use of international standards (tied for 3rd)
- Regional coordination for infrastructure investment (tied for 3rd)

The top three physical elements that investors care about when investing in digital infrastructure are:

- International connectivity
- National connectivity
- Urban connectivity

These results can provide a roadmap for policy-makers to create digital-friendly investment climates. Given finite time and resources, they may wish to start with those elements that are most likely to make a difference to attracting such investment.

At the same time, each economy will be at a different starting point in terms of its regulatory framework and may also have different digital development goals that it wishes to further through investment. In addition, firms may be interested in investing in different digital economies for different reasons.

As a result, while the global survey provides broad guidance, in a second phase of the Digital FDI initiative the Forum aims to launch country-level projects. This would allow for tailored analysis to specific national conditions and thus targeted reform recommendations.

If policy-makers or firms are interested in launching such projects, the Forum's Platform for Shaping the Future of Trade and Global Economic Interdependence looks forward to hearing from them.



Introduction

In so doing, digitalization is creating new economic activities while also expanding the scale, scope and efficiency of existing economic activities. It will thus underpin future growth and is key to COVID-19 economic recovery.²

One way to grow the digital economy and increase digital competitiveness is through attracting foreign direct investment (FDI).³ There is significant evidence that FDI can bring technology, know-how, jobs and growth.⁴ Just like traditional firms, digital firms invest abroad to be close to customers, access local knowledge, open new markets and more. While some digital service suppliers are relatively “asset-lite”, meaning they do not require significant FDI to service a market, other digital service suppliers display a similar international asset footprint to non-digital multinational enterprises (MNEs). For instance, the evidence shows that e-commerce firms (e.g. internet retailers), digital content providers (e.g. those providing digital media, games, information and data) and telecoms firms have virtually an equivalent ratio of foreign assets to foreign revenue when compared to traditional, non-digital MNEs, indicating that FDI is essential to their business models.⁵

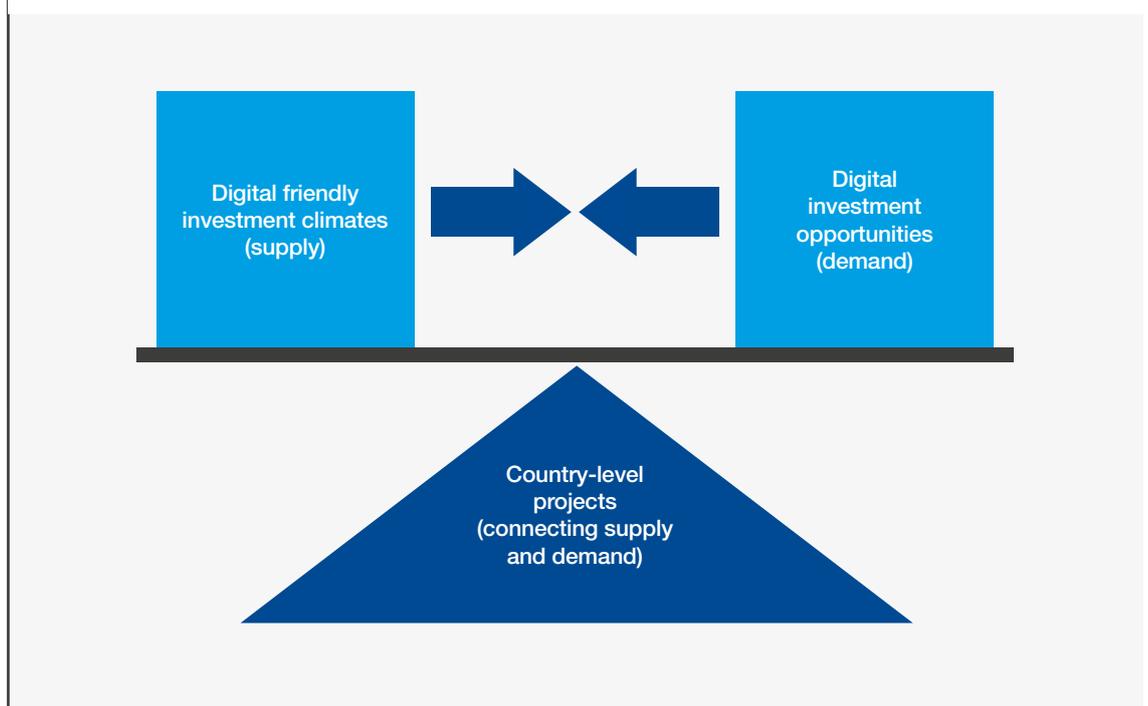
Yet attracting FDI in the digital economy may require specific policies, regulations and measures because digital firms have business models that vary from traditional brick-and-mortar businesses.

Digital firms rely heavily on data and know-how, often involve platform economies and leverage non-traditional assets (it is worth noting this white paper does not dive into the important issue of taxation which, given its complexity, needs to be dealt with separately).⁶ At the same time, some of the fastest growing and most highly valued firms in the world are in the technology sectors, creating huge opportunities for investment that is win-win between firms and recipient economies.⁷

The World Economic Forum’s Digital FDI initiative, part of the Platform for Shaping the Future of Trade and Global Economic Interdependence, thus aims to catalyse these opportunities in three steps: unlocking supply; understanding demand; and helping to connect the two through country-level projects.

On the supply side, the initiative aims to identify policies, regulations and measures that governments can adopt to create digital-friendly investment climates “supplying” investors with ecosystems that will attract such investment. On the demand side, the initiative aims to understand the digital investment needs and priorities of firms and how these can be facilitated; in other words, the “demand” for digital investment opportunities. The supply and demand can then be balanced and connected through country-level projects that identify and address country-specific digital investment challenges and goals (see Figure 1).

FIGURE 1 Digital FDI Initiative – balancing and connecting digital investment supply and demand



This white paper provides a starting point for unlocking the supply side by suggesting how governments may be able to create digital-friendly investment climates. Understanding the “secret sauce” to digital-friendly investment climates will become even more important in the current economic downturn, with fewer resources for investment and thus more competition to attract scarce capital. It will also be essential for economies to increase digital capacity and competitiveness post COVID-19, both to support immediate recovery and promote long-term resilience.

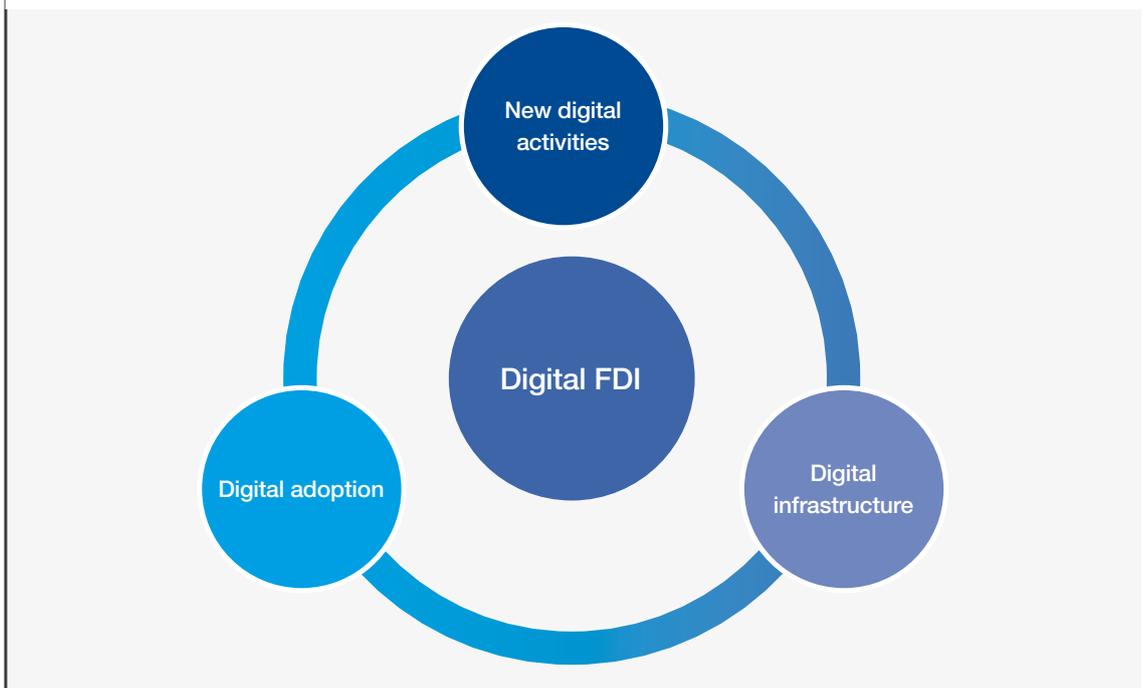
Finally, digital FDI can serve as an additional vector to drive sustainable development in both host and home economies.⁸ Efforts to increase FDI’s contribution to sustainable development, such as the OECD’s FDI Qualities Indicators and planned Toolkit⁹, or the future investment policy research agenda¹⁰, may therefore wish to integrate digital FDI into their work programmes.



Framework

The Forum built on a framework laid out by the United Nations Conference on Trade and Development (UNCTAD) in its *World Investment Report 2017: Investment and the Digital Economy*, which suggests that policies, regulations and measures to attract digital FDI can be thought of in three pillars:¹¹ (1) new digital activities; (2) digital adoption by traditionally non-digital firms; and (3) digital infrastructure. Within each of these three pillars, there are specific elements that impact and enable a potential investor's decision to commit capital and other resources (see Figure 2).

FIGURE 2 Digital FDI framework



Source: Elaborated from UNCTAD (2017)

Pillar 1: Elements that enable investment in new digital activities. The digital economy has generated a host of new business models. From social media and digital platforms to cloud computing and data centres, without the internet such businesses would not exist. Governments can embrace such new business models and actively support them to attract investments. To illustrate, policies, regulations and measures that encourage investment in ridesharing apps, such as the billions being invested in Gojek and Grab as they compete for the ridesharing and delivery market in South-East Asia.¹²

Pillar 2: Elements that enable digital adoption by traditionally non-digital firms. Beyond new business models, the digital economy has the potential to change traditional ways of conducting business. Local enterprises can adopt various digital services to reduce obstacles caused by physical barriers, simplify supply and value chains and provide speedy delivery of goods and services. Certain policies, regulations and measures can enable the adoption of new digital approaches; for instance, through telemedicine,

mobile banking and online sales. To illustrate, Polish telemedicine firm MedApp invested in the Baltic states, allowing cardiovascular diagnostics to be provided via telemedicine.¹³

Pillar 3: Elements that enable investment in digital infrastructure, which includes both a physical dimension and a regulatory dimension. Robust and reliable physical infrastructure is key for the development and growth of the digital economy. Attracting investment in digital infrastructure requires a conducive regulatory framework; for instance, policies and regulations that encourage investment in payment processors. Success in attracting foreign investment in digital infrastructure will also depend on the presence or absence of extant infrastructure. To illustrate, Visa invested in Nigeria's Interswitch, a payment switch and processing company, making Interswitch a unicorn overnight.¹⁴

So what are the policies, regulations and measures that need to be considered in each of the three pillars and which are most important to investors' decision-making?

3

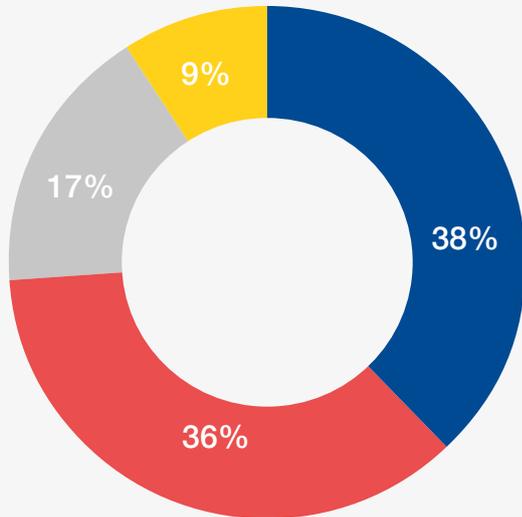
Survey

To answer these questions, the Forum carried out a global survey guided by an advisory committee of experts (see Contributors below for a list of advisory committee members). The committee helped to ensure the Digital FDI initiative was considering the right policies, regulations and measures and asking questions in the right way. A global survey allowed the Forum to ask investment decision-makers in firms from different jurisdictions what policies, regulations and measures were most important when they decided to invest in a market (for an example survey question, see Appendix). The survey was peer-reviewed both in-house and with our advisory committee. The Digital FDI initiative also sought the input and support of digital industry groups in key economies.

Firms were surveyed in the United States (170), United Kingdom (50), India (30), Japan (20), Canada (20), and China (20), or a total of 310 survey responses. Additional responses were later received from Estonia, in line with the overall findings.¹⁵ The reason for a larger number of firms being surveyed in the United States is that most digital MNEs have their parent in the US and therefore are the key group to understand. In 2017, 63 of the top 100 digital MNEs were from the US.¹⁶ Nevertheless, future work will seek to broaden the geographic coverage by including economies in Africa and other emerging markets.

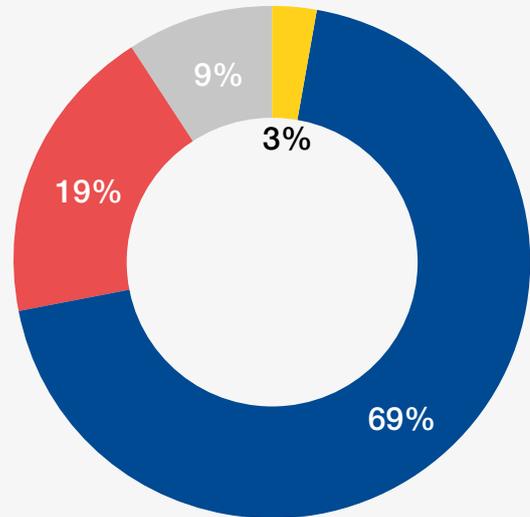
Below are key characteristics of the individuals surveyed.

Job title, level, or responsibility



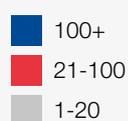
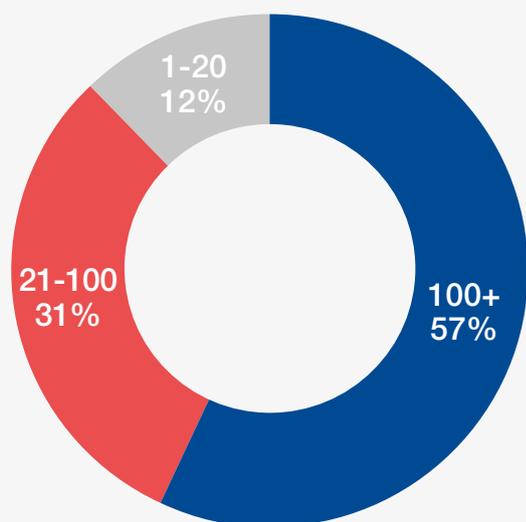
- Manager
- C-suite, owner, president
- Director
- Vice president

Age of respondent

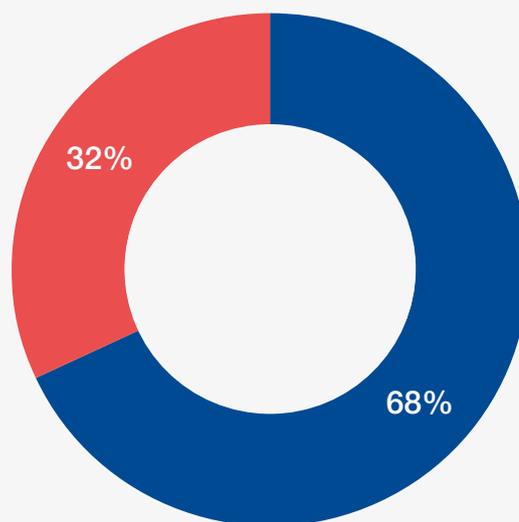


- 35-50
- 18-34
- 51-64
- 65+

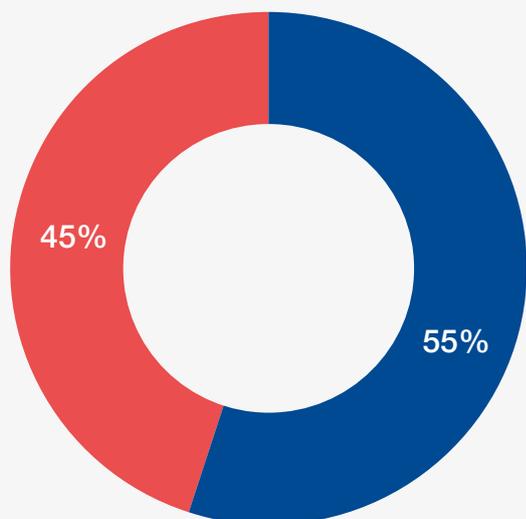
Number of employees in firm



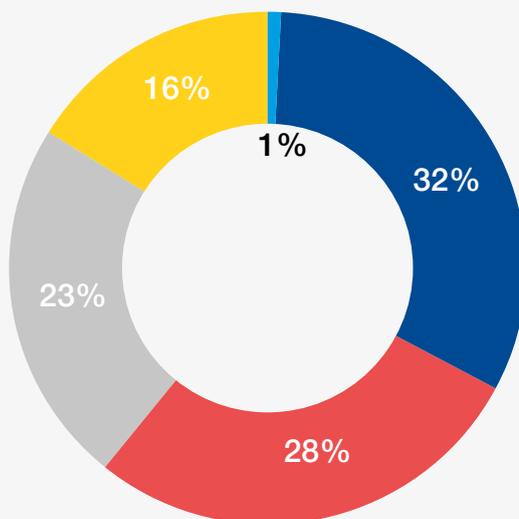
Has your firm already invested abroad?



If so, has this been occasional or frequent?



What was the motivation or reason?

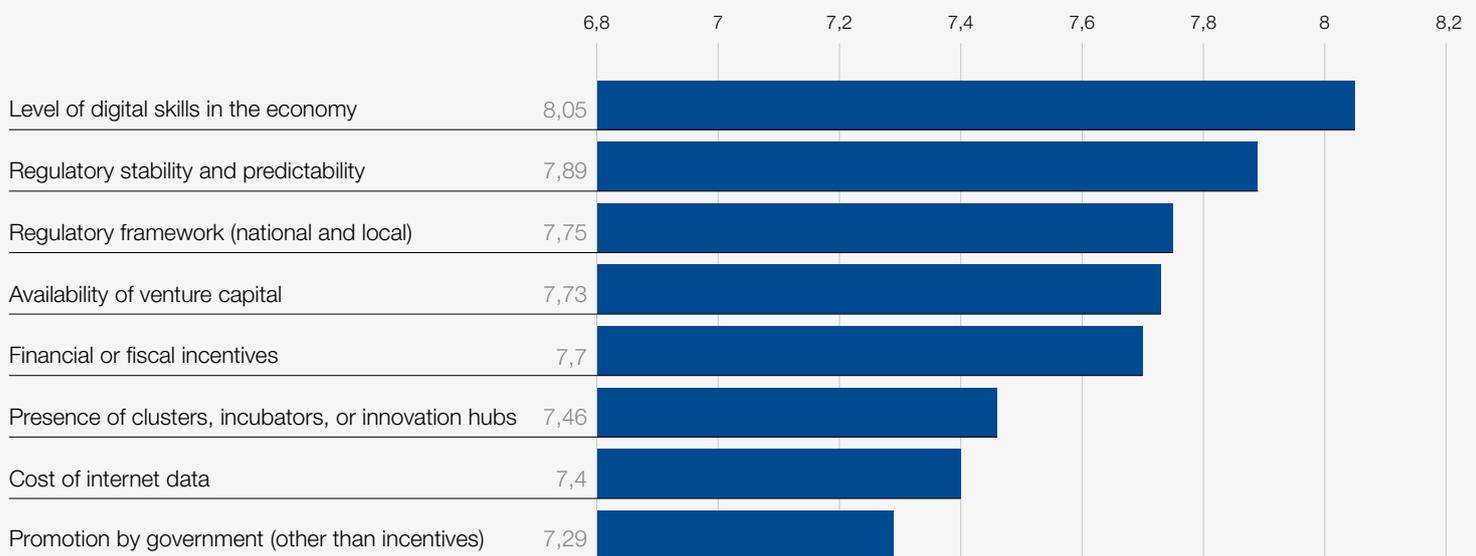


4

Findings

The Digital FDI initiative asked five principal questions and this section relays the findings: (1) a big-picture question to understand the relative importance of different elements at the highest level; (2) a question on new digital activities; (3) a question on digital adoption; (4) a question on the physical dimension of digital infrastructure; and (5) a question on the regulatory dimension of digital infrastructure. For each question, the top three responses are highlighted and discussed.

4.1 How important are the following for investing abroad in the digital economy?

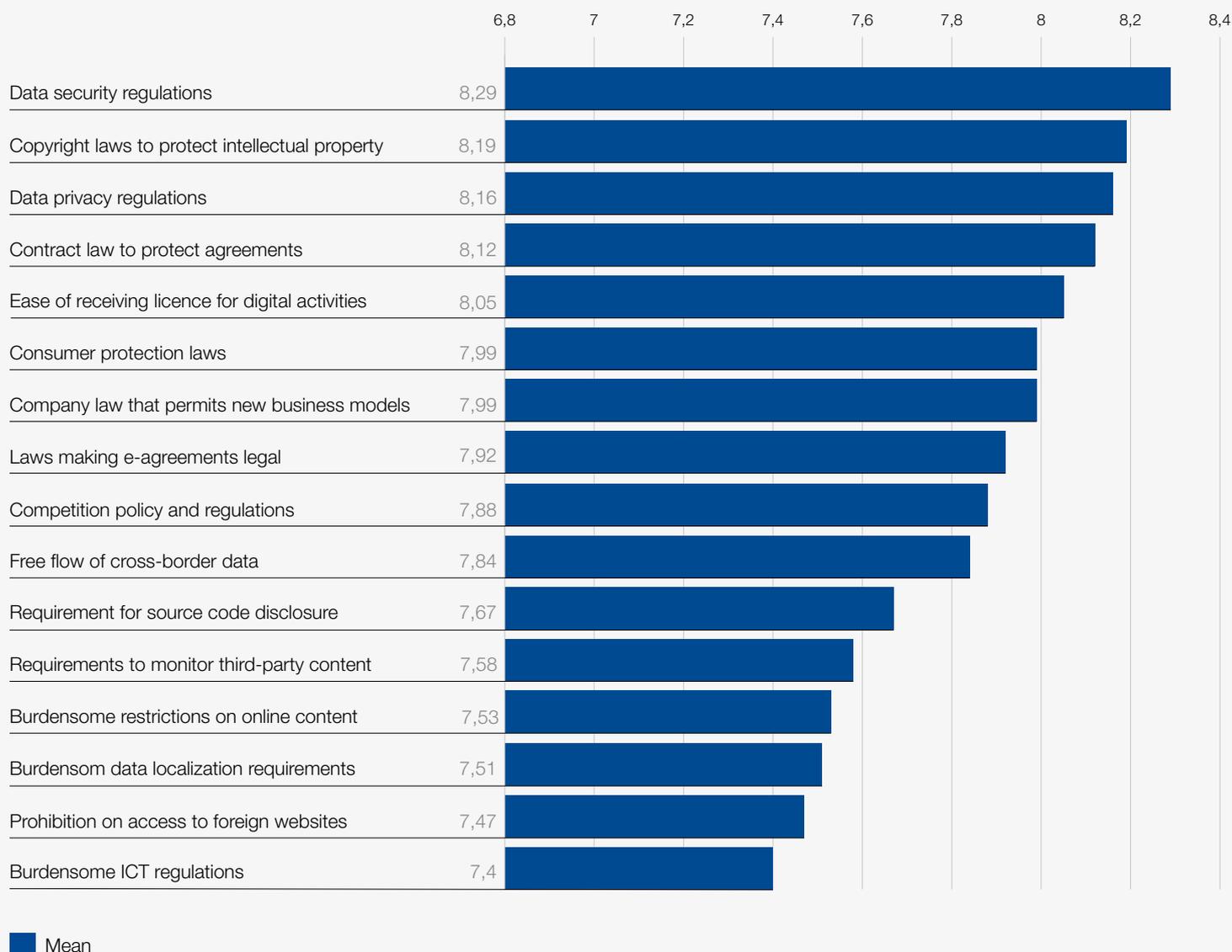


■ Mean

In terms of the big picture, the top three elements that investors care about when making decisions to invest in the digital economy are: (1) the level of digital skills in the economy; (2) regulatory stability and predictability; and (3) the regulatory framework. This is good news for two reasons. First, it provides evidence of the importance of this effort; getting the regulatory framework right is one of the most important elements that will affect an investor's decision-making. Second, regulatory stability and predictability can potentially be shaped

by a government, so this is something policy-makers may be able to control. The importance of the regulatory environment, as well as stability and predictability as a determinant for investors' decision-making, is a finding shared by other work, providing additional support to this point.¹⁷ Finally, it is worth noting that the single most important element is the level of digital skills in an economy, a clarion call to ensuring that public and private actors prioritize the development of such skills.

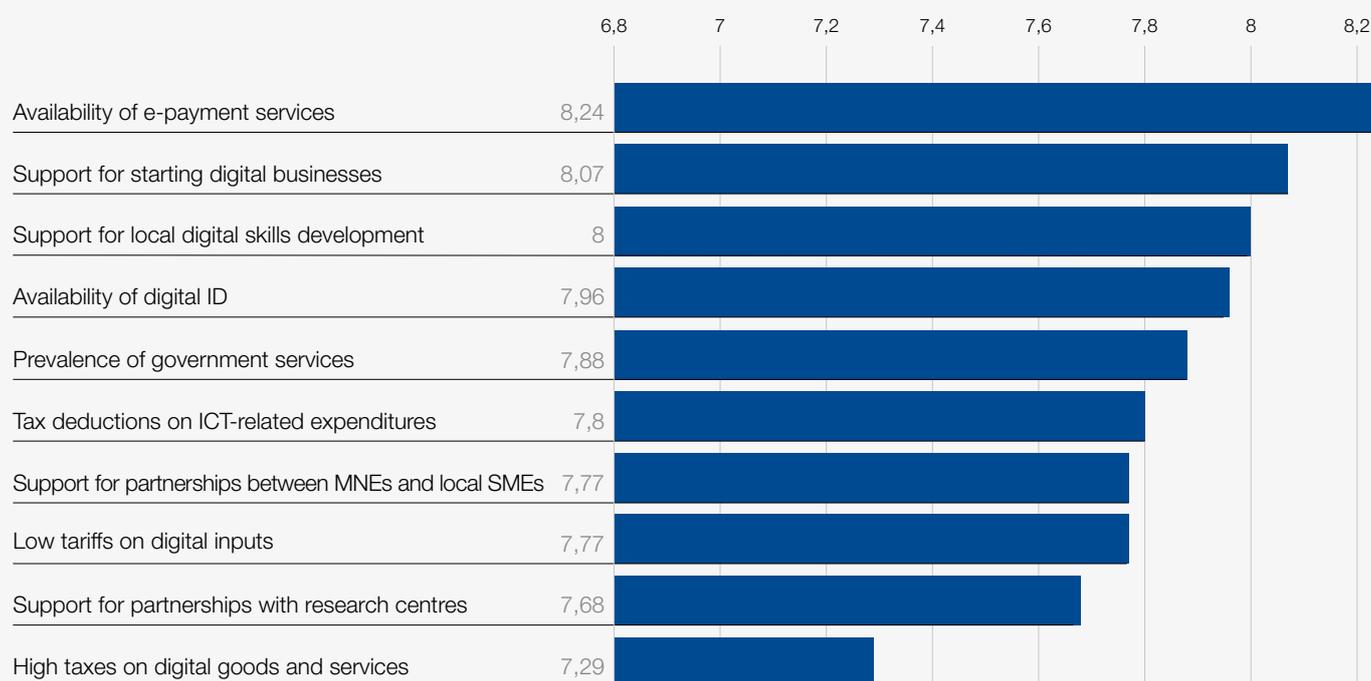
4.2 How important are the following for investing abroad in digital activities?



The survey reveals that the top three elements investors care about when investing in new digital activities are: (1) data security regulations; (2) copyright laws to protect intellectual property; and (3) data privacy regulations. This provides evidence of how important it is to get data policy right. The finding is intuitive. Firms that have invented and own a new digital service want to ensure their idea can flourish and is protected by the legal system from being copied or stolen.

The Forum has recently published two white papers on data flows, which can serve as resources on how to consider adopting policies and measures to facilitate the free flow of data securely and in a manner respecting intellectual property and data privacy.¹⁸

4.3 How important are the following for adoption of digital technology?



■ Mean

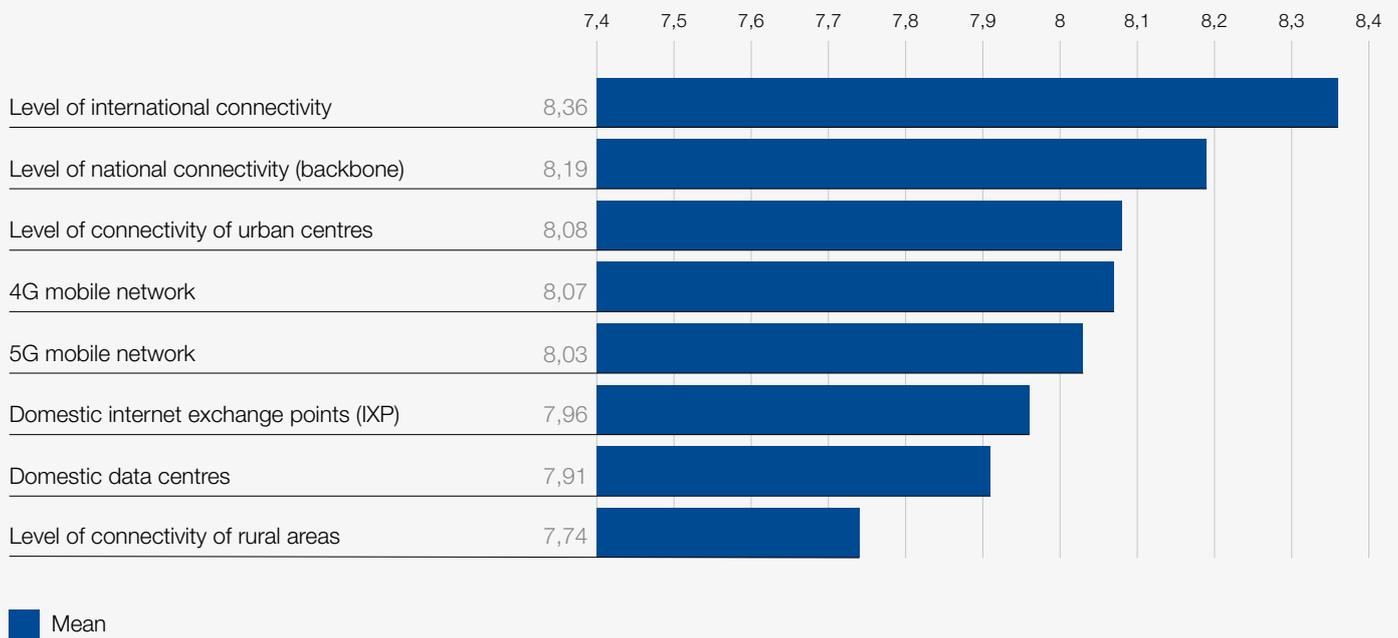
The top three elements firms care about in deciding to adopt new digital technologies are: (1) availability of e-payment services; (2) support for starting digital businesses; and (3) support for local digital skills development. The issue of digital adoption by existing firms is one that may warrant close attention, as this is the way current firms will increase competitiveness and therefore be able to thrive in the digital age, with commensurate implications for jobs, revenue and economic growth.

The most important element is the availability of e-payment services, an intuitive finding. If a firm cannot readily get paid, it is not likely to start providing a new service. The Forum recently published policy recommendations to facilitate such cross-border payments, which can help orient efforts in this area.¹⁹

In second place is support for starting digital businesses, which may be relevant to orienting the work of the investment promotion agencies (IPAs) in attracting digital FDI. For instance, IPA may wish to consider targeted facilitation measures to help firms start new digital businesses. Concretely, this could entail tailored investor services, expedited approvals, red carpet treatment, or higher levels of incentives for digital investments. On this last, however, it is worth noting the evidence indicates that incentives generally do not compensate for the lack of a welcoming investment climate, including through the regulatory framework and its implementation.²⁰ The optimal approach would then be a friendly regulatory approach coupled with incentives.

Finally, in third place are local digital skills, which came in first in the big-picture question and will be discussed in more detail below.

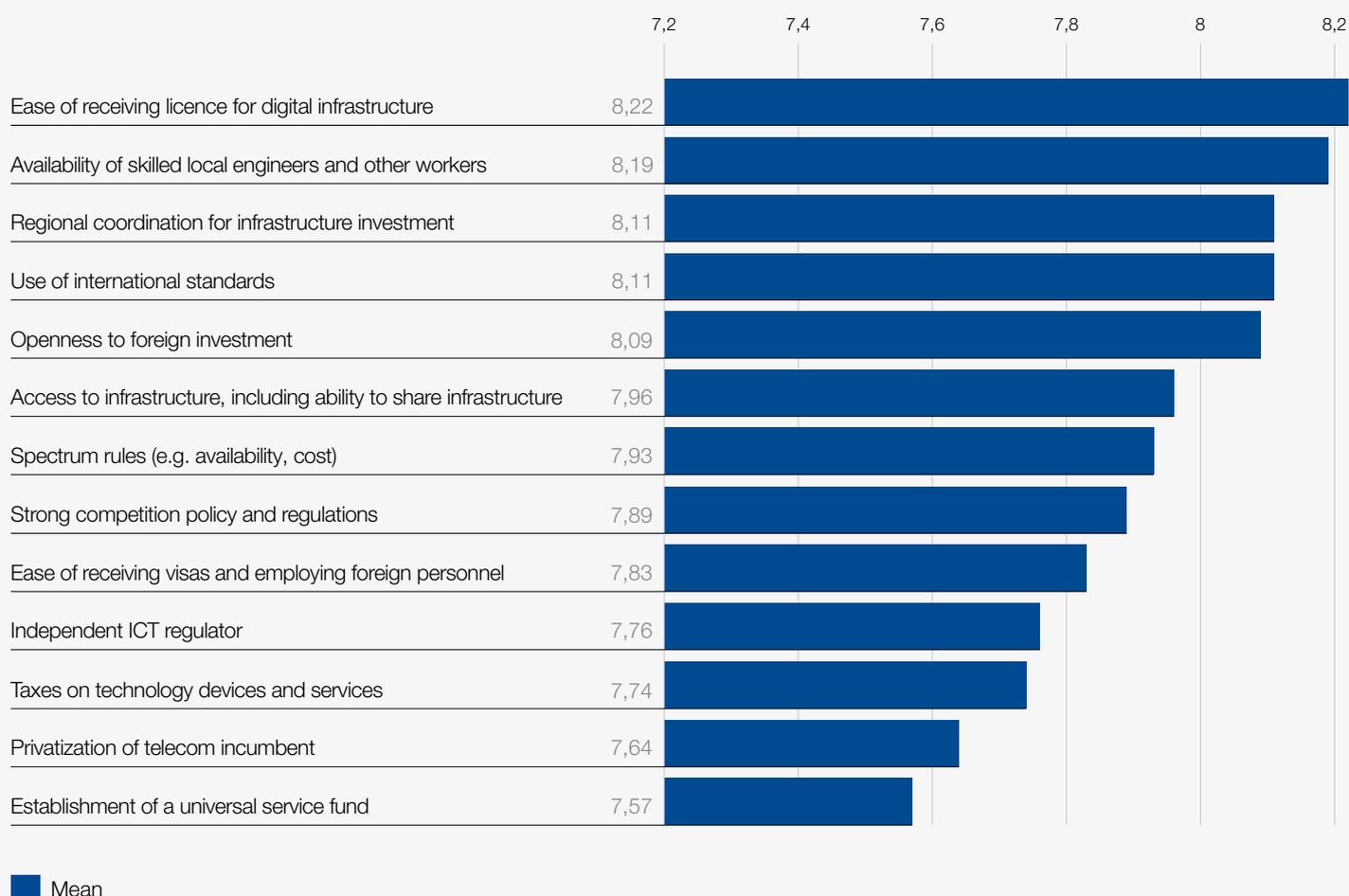
4.4 How important are the following physical elements for investing abroad in digital infrastructure?



The top three physical infrastructure elements for attracting digital FDI all have to do with connectivity: international connectivity, national connectivity (also known as the national “backbone”) and urban connectivity. Connectivity in rural areas, in contrast, comes in last, perhaps because rural areas are not seen as the locus of economic activity that investors

seek. This finding is again intuitive. Investors want to enter larger markets because these offer more potential for revenue-generating activities. If an economy is connected internationally – or if different parts of the national economy are connected to one another – it will make that economy relatively more attractive for investment.

4.5 How important are the following regulatory elements for investing abroad in digital infrastructure?



The final question identifies the most important regulatory elements for FDI to flow into digital infrastructure: (1) ease of receiving licences for digital infrastructure; (2) availability of skilled local engineers and other workers; and two elements tied for third place, (3) use of international standards and (3) regional coordination for infrastructure investment.

These results suggest an agenda to help attract digital FDI, including ensuring that licences are easily acquired and international standards adopted, as well as coordinating with regional neighbours on infrastructure investment. As seen above, international connectivity is an important determinant of investor interest in an economy. It is worth noting that skills again come into the picture as a priority for investors and so a public-

private collaboration towards supporting digital skills development would seem very welcome to help attract investment in digital activities, digital adoption and digital infrastructure. Countries may wish to create such a mechanism to coordinate and accelerate digital skills development efforts.

One resource to help support some of the activities identified above is a recently published playbook on *Accelerating Digital Inclusion in the New Normal*.²¹ This provides concrete examples of programmes in different countries, including in adopting standards, improving connectivity and providing digital skills training, among others.

Conclusion

In conclusion, creating a digital-friendly investment climate may require specific policies, regulations and measures. Given limited time and resources, policy-makers may wish to start with those that firms have identified as most important to their investment decision-making. This white paper has suggested starting with the top three policies, regulations and measures in each of the dimensions that help shape digital FDI decisions.

At the same time, each individual economy will be at a different starting point in terms of policies, regulations and measures, as well as priority areas for digital development. In addition, investors may be interested in different markets for different reasons, whether because of size, income level, skills, resources, geographic location, etc.

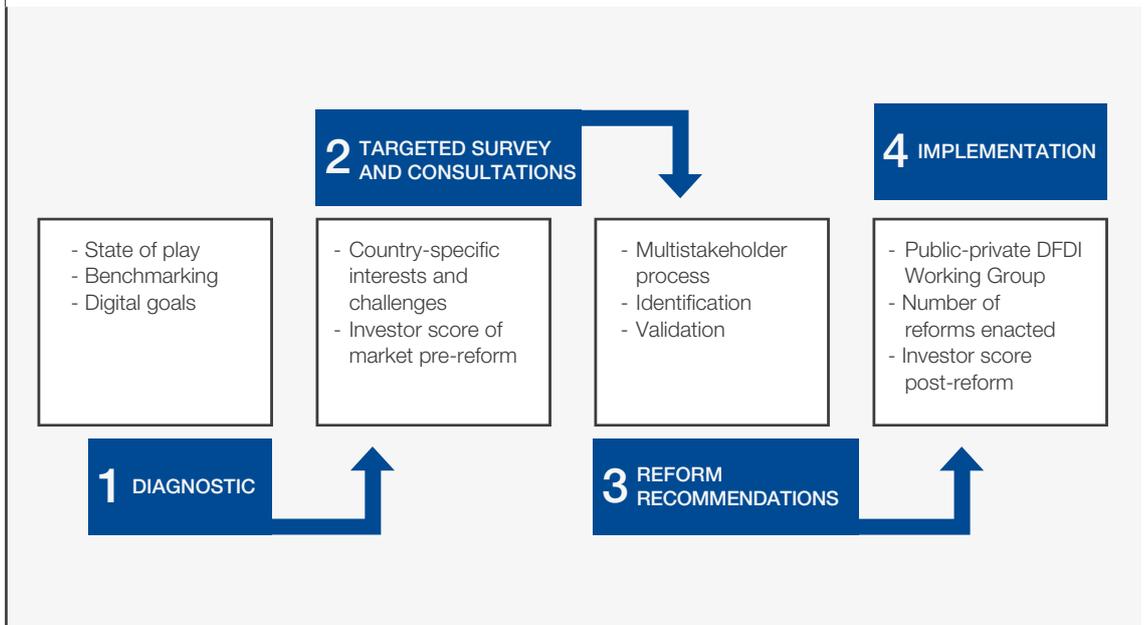
As a result, there is a need to tailor the Digital FDI initiative to individual economies through country-specific analysis and reforms. This can take place in four steps. First, a diagnostic step to understand (a) the state of play of relevant policies, regulations and measures, (b) how these are benchmarked against the elements identified as important in the global survey, and (c) the specific digital development goals of the economy.

Second, a targeted survey of and consultations with investors interested in that market, asking them, “What do you need to see in this country to invest in its digital economy?” Third, developing reform recommendations through a multistakeholder process to help connect the supply of a digital-friendly investment climate by policy-makers to the demand for such an investment climate by firms. Fourth, implementing these reforms and tracking impact both through the number of reforms carried out and the improvement in investor perception of the attractiveness of the digital investment climate (see Figure 3).

Regions or trading groups that seek to boost economic integration may also wish to foster two-way digital FDI.

Critically, all of these efforts should be framed within the context of driving sustainable development.²² Future work will examine digital FDI flows at the sector level and how to target FDI in sectors that are digital enablers, as well as specific actions policy-makers can take to increase digital FDI's contribution to sustainable development.²³

FIGURE 3 Economy-level Digital FDI initiative



The Forum is seeking partners to launch such country-level projects. Please get in touch if there might be interest from your government or firm.

Appendix

Methodology

In each of the questions, respondents were asked to rank the importance of different elements, with 0 the lowest possible score, denoting no importance to an investor's decision-making, and 10 the highest possible score, denoting the greatest possible importance.

An example question is shown below for illustrative purposes.



Q12 Any comment to add? _____

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Endnotes

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5. The relative importance of FDI for a firm can be calculated through the ratio of the share of foreign sales to the share of foreign assets. In other words, does a firm need to undertake significant FDI to generate foreign sales or can it do so without the need for FDI? Traditional MNEs have on average a ratio of 1 between foreign sales and foreign assets. If the ratio is lower than 1, then this indicates that FDI is even more important to that type of firm than an average MNE; if more than 1, that FDI is relatively less important. According to UNCTAD’s research, internet platforms (e.g. search engines, social networks) have a ratio of 2.6; digital solutions providers (e.g. electronic payments) have a ratio of 1.9; IT firms (e.g. software and services, devices and components) have a ratio of 1.8; digital content providers (e.g. digital media, games, info and data) have a ratio of 1.1; e-commerce firms (e.g. internet retailers) have a ratio of 1.1; and telecom firms have a ratio of 0.9, which reflects the significant investment they must undertake in physical infrastructure. However, it is worth underlining that this ratio captures relative importance: a digital firm that has very significant foreign sales and thus a high ratio could still have undertaken significant FDI in absolute terms. For detailed information, see UNCTAD (2017), p. 171
6. While UNCTAD (2017) differentiates between digital MNEs and ICT MNEs, in this white paper the term “digital firms” is intended to capture all firms that invest in the digital and technology sectors
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15. Estonian firms were surveyed through collaboration with the Estonian Association of Information Technology and Telecommunications (ITL), resulting in four additional survey responses and a dialogue with a group of relevant firms on 27 October 2020. The Estonian results, while too small to be statistically significant, are in line with overall results. See WEF, “Digital FDI Survey Results: Comparing Foreign and Estonian Firms”, 27 October 2020. <https://weforum.box.com/s/zlqwb3pmai21y3ymx8p5w5k002ibma34>
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