Growth amid uncertainty – how companies are seeking growth in today's global economy

The global economy is in recovery mode after the shock of the covid-19 pandemic in 2020. According to the International Monetary Fund (IMF), the global economy contracted by 3.1% in 2020.[1] Global trade, meanwhile, fell by 5.3% during the same year according to the World Trade Organisation (WTO).[2] A recovery began in 2021, as global growth rebounded by 5.9% and trade grew by 10.1%. However, the outlook for global growth has become increasingly uncertain. The impact of the pandemic still lingers as new outbreaks lead to further disruptions in supply chains, and the war in Ukraine has added another major shock to the global economy. In this context, the opportunities for growth are likely to shift and companies are revising their strategies related to new markets. In the first article of this series, Economist Impact, supported by Google, examines how companies are approaching their growth strategies in today's global economy.

Sustained risks are creating a new growth calculus for companies

Uncertainty has dominated the global economy in the past two years. The global uncertainty index, a measure of uncertainty in the global economy, reached its highest level during the peak of the global pandemic in 2020.[3] It has since fallen back to a more moderate level but many risks remain in the global system, whether they are driven by geopolitical events, climate change or domestic policy uncertainty in key markets. Recent research by Economist Impact has revealed how these growing risks have become central to decisions about trade and investing in foreign markets.[4] When asked about their main concerns related to global trade, companies noted that two issues stood out: the US–China trade dispute and higher inflation.[5] In a separate survey conducted in 2021, Economist Impact assessed the main factors that determined companies' foreign direct investment (FDI) decisions.[6] Political stability, along with the quality of infrastructure and the tax and regulatory regime, was the most important factor cited by respondents. In light of the war in Ukraine, it is likely that political stability and other geopolitical factors will rise in importance as companies contemplate the new global economy.

> **"I do think all the risks related to geopolitical conflicts, market volatility and unfriendly trade and regulatory environments are impacting the calculus of how companies approach international expansion. For the most part, these exogenous factors don't affect the absolute size of the opportunity, but they do affect the ease of capturing that opportunity"**
>
> Phil Carter, Senior director of growth at Quizlet

The ongoing risks in the global economy are changing how companies assess new growth markets. It is possible that these risk factors will soften the strategic plans for some companies, implying that growth assumptions are being downgraded where uncertainty is high.

The biggest multinational companies (MNCs) were expanding their international operations as the global economy opened up in the 1990s. As a measure of how international the world's biggest companies had become, the United Nations Conference on Trade and Development (UNCTAD) developed a transnationality index (TNI) which compares the world's top 100 companies in terms of their domestic to foreign assets, revenues and employment. According to this measure, the internationalisation of global companies peaked in the middle of the last decade and has since plateaued. While it is likely that foreign markets will remain important for companies, when we combine this with a greater presence of risk in the global economy, it is prudent to ask how companies examine growth opportunities in this new chapter for globalisation.

What's driving companies' FDI and exports plans?

As of late 2021, forecasters were relatively optimistic about global growth conditions in 2022. The IMF had forecast global growth of 4.9% for 2022, with emerging markets in Asia, the Middle East and Sub-Saharan Africa expected to be the fastest growing.[7] Amid a broad recovery in global trade, the WTO had forecast especially strong trade growth in North America and the Middle East. The optimism for global trade growth was also evident in research conducted by Economist Impact.[8] In a survey of 3,000 business leaders across the world, companies expected exports to grow by 19% in 2022 while imports would grow by 14%. The use of new technologies, via their ability to monitor supply chains and adapt to risks, was cited by 43% of respondents as the top reason to be optimistic about international trade. Clearly, companies were expecting a strengthening recovery following the shock of covid-19. Survey respondents were expecting to see the strongest trade growth in South America, the Middle East and the Asia-Pacific region.

The companies surveyed by Economist Impact saw two main drivers of export growth: demand in key markets and expansion into new markets. In light of events in Europe, it is likely that some of this optimism for new markets will be curtailed. It is also possible that the war in Ukraine not only pauses any planned expansion into European markets but shifts those plans to other regions. It may also lead companies to redouble efforts in existing markets as their preferred export growth strategy in the short term.

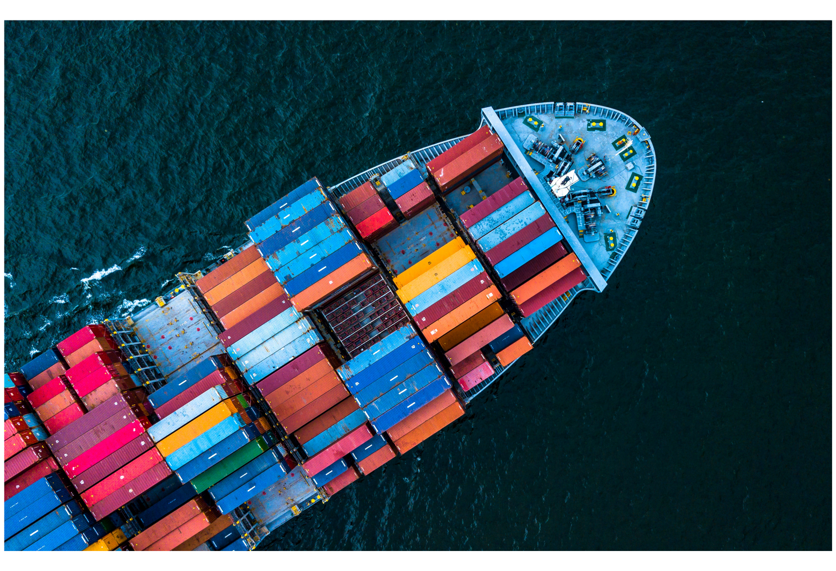
MNCs also use FDI to enter new markets. Globally, FDI rebounded strongly in 2021. According to UNCTAD, it grew by 77% to an estimated US$1.65trn, from US$929bn in 2020.9 Crucially, the level reached in 2021 surpassed the pre-covid-19 level of FDI, signalling a return to confidence in the global market. However, with the onset of the war in Ukraine, we are likely to see another difficult period for FDI flows.

> **"Companies start to move into other regions of the world to bring a different perspective to the initiatives that they're driving." -Paul Bresnahan**

Notwithstanding the uncertainties in the current environment, companies are still likely to lean on FDI as part of their growth strategies. Often referred to as knowledge-seeking FDI, companies use this approach to accelerate innovation plans as they learn from a new market. "We made a conscious decision to move a major portion of our R&D out of our domestic Japanese market so we had access to different economies, different cultures, different environments to see what is driving change there and to drive innovation."

Trade agreements will create opportunities over the medium term and should help to lessen certain risks

The WTO recently announced the first agreement on services trade in almost 25 years.10 Focused on reducing the administrative burden on trading services, the agreement is expected to provide a timely boost for the global economy. Research from the WTO and the Organisation for Economic Cooperation and Development suggests that the implementation of this initiative could amount to US$150bn annually globally, with the largest gains for financial, business, communications and transport services.11 While this is encouraging, we are unlikely to see a global agreement on goods trade any time soon. Rather, the opportunities for companies lie in the implementation of a growing number of bilateral and regional trade agreements. For companies worried about the threat of trade disputes, trade agreements should lessen this risk as countries covered by an agreement are less likely to engage in a damaging trade dispute.



The Asia-Pacific region is central to this discussion. In recent years, it has seen the development of two major trade agreements: the Comprehensive and Progressive Agreement for Trans-Pacific Partnership and the Regional Comprehensive Economic Partnership. By construction, this will incentivise supply chains to gravitate towards member countries in these agreements and provide opportunities for businesses to find new markets.

The Africa Continental Free Trade Agreement (AfCFTA) is another regional agreement that should create opportunities over the medium term. Primarily, AfCFTA will bring gradual benefits to companies within the region. However, companies outside of the region will need to place a greater focus on cultural factors and localising their products to each specific market. "Africa is sometimes seen as a continent rather than 54 countries", notes Bisila Bokoko, former executive director at the Spain–US Chamber of Commerce. This points to the importance of market research and understanding the need to localise a product to a new market.

> **"We sometimes believe that because a product works in our local market, we can replicate the same model overseas,"**
>
> Bisila Bokoko, Former executive director at the Spain–US Chamber of Commerce.

Bilateral agreements will also create opportunities for businesses in select markets. The recently signed UAE–India free trade agreement is expected to add approximately US$9bn to the UAE economy, with an increase of exports to India of 1.5%, or US$7.6bn, by the end of the decade.[12] India, for its part, could see an additional US$14.3bn of exports to the UAE over the same period.[13] Meanwhile, the UK and Australia reached an agreement to facilitate trade between the two countries. The economic impact is likely to be limited, given the distance between them, but it will provide new opportunities for companies in both markets. Finally, digital trade agreements are growing in some countries that will support the ease of doing business in these markets. Singapore is a leader in this regard, having finalised agreements with Chile, New Zealand, Australia, South Korea and the UK.[14]

Key takeaways

The global economy has entered a new chapter and, accordingly, companies are looking at it in a new way.

Assessing growth in today's global economy, key action points to consider:

• An uncertain global outlook places a premium on understanding not only the potential growth of new markets but also the potential impacts of any emerging risks in those markets. New markets should be considered through the lens of risk-adjusted returns.

• Growth is likely to be strongest in Asia but MNCs are also expecting trade growth to be significant in the Middle East and South America. Export growth in key markets is the main factor driving companies' optimism related to trade opportunities.

• FDI has recovered from the shock of covid-19 but uncertainties will lead to a challenging period for companies looking to invest abroad. Knowledge seeking and innovation plans will remain important drivers of companies' FDI strategies.

• New trade and digital agreements will create opportunities for companies over time and lessen some of the risks associated with trade disputes among countries. As companies make use of new technologies to monitor risks, understanding the implementation of these agreements will be important for assessing new markets.

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