Financial Engineering and Risk Management (2023)
Clausius Scientific Press, Canada

DOI: 10.23977/ferm.2023.061015
ISSN 2523-2576 Vol. 6 Num. 10

Country Risk Study on Chinese FDI in African Countries

Chen Xue*

School of Economics, Shanghai University, Shanghai, 201800, China
yjccfljxxc@163.com
**Corresponding author*

Keywords: Trade with Africa, OFDI, Country Risk

Abstract: The year 2020 will mark the 20th anniversary of the founding of the Forum on China-Africa Cooperation (FOCAC). Since the 21st century, with the "the Belt and Road" "going out" strategy deepening, China-Africa economic and trade cooperation has become more and more frequent, the total amount of investment has been increasing, and the investment field has been greatly broadened. With rich natural mineral resources and sustained economic development, Africa has attracted even more foreign investment. However, due to many problems in Africa, such as colonial historical legacy, imperfect laws and regulations, and low infrastructure construction, China's direct investment in Africa has a high degree of uncertainty. In this paper, we firstly check the data of China's outward direct investment statistical bulletin to analyze the current situation of enterprises' investment in Africa. Secondly, we give a brief overview of the concept, classification and rating standard of country risk. Then this paper analyzes in detail the types of risk faced by the investment in Africa, and finally put forward the suggestions and measures on how to recognize and effectively prevent these risks.

1. Introduction

Along with the trend of global economic integration becoming more and more obvious, the competition between the politics and economy of various countries is intensified, facing the various restrictions on China's international investment by the European and American economic republics, the "the Belt and Road" initiative and the Chinese government's "Going Global" call, the development of China-Africa economic and trade relations has become an important issue nowadays. Under the "the Belt and Road" initiative and the Chinese government's call to "Going Global", the development of China-Africa economic and trade relations has become an important issue nowadays [1].

The implementation of the "Going Global" and "the Belt and Road" strategies has greatly improved China's international trade environment and the environment for outward investment by enterprises, and the stock of outward direct investment flows by Chinese enterprises has grown significantly. Africa is an important builder in China's "the Belt and Road" initiative, and the efficient and orderly promotion of direct investment play a key role in the economic and social development of both sides. China's investment in Africa is a key part of the "the Belt and Road" initiative, and China's investment in Africa's industrialization process and infrastructure construction has profoundly changed the development of African society [2].

China-Africa friendship and cooperation has a long history, especially in the past 20 years. The economic and trade cooperation between the two sides have developed rapidly, and the amount of investment in Africa has increased year by year. Africa is characterized by abundant materials, vast territory and rapid economic growth in recent years, which makes the continent a hot spot for foreign direct investment by multinational corporations. However, under the international political and economic situation where the global economy is affected by the epidemic, trade protectionism rises, and the geopolitical situation tends to be tense, the investment of Chinese enterprises in Africa is also facing a high risk of uncertainty. Especially in Africa, because of its reality and history, there exist a lot of unstable political situation, imperfect financial system, and other risk factors that may bring extremely unstable risk to China's investment [3].

By analyzing the current situation of direct investment in Africa and systematically analyzing the main risks faced by Chinese enterprises' direct investment in Africa, it helps to better understand the dilemmas and problems of China's investment in Africa, and is of practical and strategic significance for the effective development of foreign trade and transnational investment [4].

2. Status and Problems of Direct Investment in Africa

2.1. Faster Growth in Investment Size, Low Share of Volume

With the deepening of China-Africa economic and trade cooperation, and Africa as an important strategic region for China's "Belt and Road" and "Going Global", the total scale of China's direct investment in Africa has been growing in recent years [5].

According to the data of China's outward direct investment statistical bulletin in 2021, the scale of China's direct investment stock in Africa has been rising continuously, breaking through to 46.1 billion U.S. dollars in 2018. Affected by the new crown epidemic and huge fluctuations in the price of international raw materials and other factors, there was a slight decline in 2019 and 2020, but as of the end of 2021, it was more than twice as much as that of 2012. The direct investment flow in Africa has shown a fluctuating trend, reaching the peak of investment flow of 5.39 billion U.S. dollars in recent years in 2018. Investment flows showed a fluctuating trend, reaching a peak of 5.39 billion U.S. dollars in 2018, the peak of investment flows in recent years [6].

However, in terms of the scale of China's investment in the major states, its world share of the African market is still very small compared with that of other intercontinental markets. Both investment stock and investment flow, China's total investment in Africa is under 5%.In 2021, the investment stock in Africa was $44.19 billion, accounting for only 1.6% of total outward investment, and the annual investment flow to Africa totaled $4.99 billion, an increase of 18% compared to the previous year, and accounted for 2.8% of the year's outward FDI flow.

2.2. High Country Coverage and Uneven Distribution of Investments

At the end of 2021, Chinese domestic investors had set up a total of 46,000 outward foreign direct investment enterprises (referred to as offshore enterprises) in 190 countries (regions) around the world, an increase of nearly 1,000 from the end of the previous year, covering more than 80% of the world's countries (regions). Among them, the coverage rate of outbound enterprises was 95.7% in Asia, 87.8% in Europe, 86.7% in Africa, 75% in North America, 67.3% in Latin America and 58.3% in Oceania [7].

As a result of the positive dynamics of investment in Africa in recent years, the state of direct investment coverage has stabilized, basically remaining at 85 per cent and above, with coverage at the end of 2021 second only to Asia and Africa [8].

However, for each country and region in Africa, there are great differences in their level of economic and cultural development, natural geographic environment and the degree of opening up of the country to the outside world, resulting in uneven regional distribution of investment in Africa.

China's direct investment in Africa is mainly distributed in the Democratic Republic of the Congo (DRC), Zambia, Guinea, South Africa, Kenya, Niger, Mauritius, Nigeria, Egypt, Tanzania, Congo (Brazzaville) and other countries. These countries have a well-developed economic base and are more stable than other countries, with higher attractiveness of foreign investment, while some other regions have less or even no foreign investment [9].

2.3. Departmental Characteristics of Investment in Africa

From the perspective of industry distribution, China's investment in Africa is constantly broadening the industry, including finance, manufacturing, transportation, power, food and beverage and other industries of the national economy. But there is a high degree of concentration in the investment industry.

In 2021, the five major industries, namely construction, mining, manufacturing, finance and leasing and business services, accounted for 87.1% of the investment, while other industries accounted for less than 15%. In particular, the second industry accounts for the highest proportion, the construction industry accounted for 37.0%, ranked first. The mining industry and the manufacturing industry ranked second and third with 22.6% and 13.4%, respectively, and almost monopolized the majority of the investment amount. The industry investment amount has a significant differentiation [10].

3. Theoretical Foundations of Country Risk

3.1. Definition of Concepts

Country risk originated from the exploration of political risk in the 1960s, and due to the many and varied contents of country risk, different countries have different methods of measuring and constructing systems for country risk, and there is currently no completely unified definition of it. Traditionally, country risk refers to the risk that a borrower or debtor in a particular country or region is unable or refuses to repay its commercial debts due to economic, political, socio-cultural and major events. Thus they expose commercial banks in that region to risks in the business they operate in the region, and thus exposing the commercial banks to other losses [11].

3.2. Classification of Country Risk

The country risk of a country is to a large extent affected by different influencing factors, and the country risk covers a wide range of factors, including the intervention of a country's regime, as well as unofficial factors such as a country's economy, society, culture, and so on. One viewpoint focuses on the fact that the sovereign behavior of a country's government is the only reason for the formation of country risk, which means that cross-border investment activities will be interfered by the host government, and the enterprises coming to invest will suffer great economic losses. Another view is that a country's country risk is influenced by a combination of factors, not purely official behavior.

Therefore, the components of country risk are diversified, resulting in a very complicated country risk system. Specifically, the categorization of country risk includes: political risk, economic risk, and social risk.

3.3. Risk Rating System

In recent years, the uncertainties in the external development environment faced by Chinese enterprises making international direct investment in the international market have been increasing. And a number of enterprises have been repeatedly hampered in their overseas investment because of the risks between countries in terms of politics, economy and culture. Therefore, the establishment of a perfect risk early warning mechanism and the correct identification of risks are necessary measures for Chinese enterprises to effectively improve the safety of overseas investment and reduce the loss of foreign investment.

The United States before World War I was one of the origins of the national credit rating system. After a long period of evolution, three credit rating agencies of American origin, Standard & Poor, Moody's and Fitch, gradually monopolized the credit rating system in the market.

The Chinese Academy of Social Sciences (CASS) has comprehensively selected the political, economic and social aspects mentioned above. It added the factor of relationship with China in light of China's national conditions, so as to comprehensively and quantitatively assess the main risks faced by Chinese enterprises in overseas investment by taking economic foundation, solvency, social resilience, political risk and relationship with China as the main five dimensions. The ratings are categorized into nine grades, from highest to lowest: AAA, AA, A, BBB, BB, B, CCC, CC, C. AAA-AA is low-risk; A-BBB is medium-risk; and BB-C is high-risk. The 2022 China Overseas Investment Risk Assessment includes a total of 114 countries, of which 25 countries in Africa are involved, with Tanzania ranking the 50th in the world and belonging to the medium-risk level. Only 11 of the 25 African countries involved in the rating belong to the medium-risk level, while the rest belong to the high-risk level.

4. Risk Performance of Direct Investment in Africa

4.1. Political Environment Risk

Political risk is the phenomenon of policy issuance and implementation breakdowns due to regime change and political instability in the host country, and social unrest, which triggers the deterioration of the investment environment. Then it creates a political risk problem and triggering more investors to change their investment decisions.

4.1.1. Conflicts within Countries

Conflicts within countries refer to wars, revolutions, civil strife and terrorism within the host country, which cause losses to foreign investment and business enterprises. Due to historical and practical reasons, long-term internal struggles, ethnic conflicts and border disputes, localized conflicts and contradictions in Africa have not disappeared so far. The large-scale riots in South Africa, the continuous military conflicts in Ethiopia, and the regime changes in Niger and Sudan all show that the localized turbulence in Africa is still difficult to be eased.

Coupled with the frequent occurrence of terrorism and ethnic conflicts caused by differences in religious beliefs, it not only seriously threatens the personal safety and capital security of investors and causes instability and discontinuity of Chinese enterprises' investment in African countries, but also the internal conflicts of the country are more prone to cause wars and turmoil and changes in sovereignty, which in turn lead to changes in inward direct policies.

4.1.2. Expropriation and Nationalization Risks

Nationalization risk is an important risk that the host country is unable to bring the possibility of return to the investors of the investing country and the possibility of loss of earnings due to the wave of nationalized economy in solving the domestic and foreign affairs. Nowadays, in the economic reform, the sovereignty of African countries is extremely unstable. Moreover the frequent changes of sovereignty also make the local policy for foreign direct investment enterprises with the personal color of those in power, and the enterprises need to adapt to the new policy and regulatory risks and challenges according to those in power. In Africa, the nationalists in power makes the local residents high national sentiment and passion, so it is easy for foreign investors to generate hostile feelings, seriously hindering direct investment in Africa.

In the 1970s, nearly half of the world's developing countries adopted the strategy of nationalization of inward investment, and of the nearly 2,000 foreign-funded enterprises that were transformed into state-owned enterprises, African enterprises accounted for one third of the total, as many as 826, and most of them were concentrated in the pillar industries of the economy, such as mining, smelting, petroleum, agriculture and so on. Moreover, the nationalized enterprises did not receive equal compensation from the state, which undoubtedly increased the losses of foreign investors in Africa and discouraged their investment in Africa. Further nationalized enterprises do not receive equal compensation from the State, which undoubtedly increases the losses of foreign investors in Africa and discourages investment in Africa.

4.1.3. Anti-corruption

Poverty and corruption feed on each other, and in Africa, which is itself poorer, corruption permeates every political and economic system. Corruption, which concentrates all of Africa's already meagre resources and wealth in the hands of a few.

Local government funds and allocated public services to improve the economic situation of the underclass are more difficult to implement.

Transparency International, an international non-governmental organization (NGO), released a report on 25 January 2021 assessing the state of public sector corruption in countries in 2021, with scores ranging from 0 (the most corrupt) to 100 (the cleanest). The report shows that African countries are generally less corrupt, with 49 countries in sub-Saharan Africa scoring an average of 33 points, all below 50. If there is corruption in the national system, it will disguise the increase in operating costs, affect the efficiency of enterprises, and even lead to the missed opportunities for direct investment in Africa, and national politics and culture will be affected by corrupt behavior.

Customs officials demand bribes, impose strict controls on Chinese goods, and often unilaterally revalue and tax Chinese goods based on European pricing, forcing Chinese firms to pay higher import tariffs and penalties or to pay arbitrary taxes in violation of relevant agreements. Most of these wide-ranging and long-standing forms of corruption in African countries will pose significant and unavoidable risks to Chinese direct investment in Africa.

4.2. Economic Environment Risk

Economic risk refers mainly to the possibility of loss of foreign investors' outward investment returns due to changes in the host country's economic situation or changes in economic policies. This uncertainty stems from the host country's economic development, foreign exchange rates, financial structure.

4.2.1. Inflation Remains High

The problem of inflation is common in Africa. According to the latest data, there are already 24 African countries with double-digit inflation rates, with Zimbabwe having the highest index at 269% and Sudan coming in second at 117%. The government's weak control over currency increases, coupled with frequent regime changes, often puts the local economy under the pressure of high inflation rates, which largely reduces the efficiency of resource allocation and triggers bubble economies.

4.2.2. Backward Infrastructure

Many countries in Africa are backward in infrastructure, large areas of water scarcity, inadequate transportation and power supply, and poor investment in soft and hard environments, monotonous economic structure. Public service provision is difficult, which will greatly increase the operation of China's enterprises in human and material capital. Cheap labor can not solve the lack of resources, such as transportation problems will seriously hinder the supply and sale of goods, affecting the efficiency and stability of our personnel working in Africa. All these infrastructure problems will affect the cost and risk of our products, thus affecting competitiveness, which is not conducive to the sustained and healthy development of our enterprises in Africa.

Africa is located in the tropics and the climate is humid. So it is one of the most widespread epidemic infectious diseases, the most harmful areas, and Africa's economy is relatively backward, the medical level is poor, living equipment is simple, these factors together, make the basic medical risk and health in Africa is a rather difficult problem. How to prevent, how to treat, and how to deal with the aftermath are all issues that need to be addressed by projects investing in Africa, where a large amount of medical costs need to be invested.

4.3. Social Risk

Social risk is a possibility that triggers social conflicts and affects social harmony. Due to colonial rule in Africa, coupled with slow development in the later stages, political instability and the complexity and variability of risks at the social level, Africa is prone to bring risks to China's outward investment enterprises.

4.3.1. Social Security Risk

There are many ethnic groups in Africa, with different cultures, languages and customs among them, and frictions and conflicts among them are extremely easy to arise, posing a serious threat to public security. Due to the generally high unemployment rate in Africa, insufficient job security, large gap between the rich and the poor, low level of education, poor public security management, there is high frequency of occurrence of violent crimes and terrorist attacks. It not only directly affects the personal safety and property safety of Chinese enterprises' employees, but also largely reduces the quality of China-Africa economic and trade cooperation.

4.3.2. Equations

African countries in recent years in the investment legal environment is not stable, African labor laws have a strong customary law color; environmental protection laws continue to improve, but there is also the phenomenon of frequent changes. Second, the origin of the law, due to historical reasons, the African law both civil law and common law system characteristics, customary law, religious law, civil law, common law and mixed law system coexist. This led to the origin of the law complex and complicated, fragmented and unpredictable legal provisions. The law thus is fragmented, cumbersome and unpredictable.

The backwardness of legislation and law enforcement can also lead to the factors of social instability and internal unrest mentioned above. Although some African countries are actively implementing legislation, there is still a lack of market enforcement, confusion in the implementation process, and vague descriptions of the legal provisions in certain areas. These factors can easily make the protection measures unsatisfactory, which in turn can increase the risk of their countries.

5. Conclusions

After entering the 21st century, Chinese enterprises' investment in Africa is generally characterized by the increase of flow stock, the expansion of the scope of investment destinations, and the diversification of projects. Therefore, this paper analyzes the scale and distribution of China's direct investment in Africa, and discusses the categorization and assessment of the country-specific risks of the investment in Africa, and selects the three levels of political, economic and social risks in the African region which have a higher degree of influence to analyze the country-specific risks of non-direct investment. The three levels of political risk, economic risk and social risk in the African region with a high degree of influence are selected to analyze the country-specific risk of non-direct investment. As Africa is an important economic and trade partner of China, rationally assessing the risks of direct investment in Africa and proposing effective solution strategies are conducive to the improvement of the quality and sustainable development of China-Africa economic and trade cooperation.

References

[1] Zhao Ancun. Political Risks of Chinese Enterprises Investing in Africa. French Studies, 2020(01):43-49.

[2] Liu Huihao. How to Prevent Risks of Enterprises' Investment in African Countries under the "Belt and Road" Initiative. International Financing, 2020(06):16-17.

[3] Zeng Jie, Song Binling. Preventive Mechanism of Chinese Investment Expropriation Risks in Africa. Journal of Xiangtan University (Philosophy and Social Science Edition), 2022, 46(03):57-61.

[4] Yu Wenhua. Country Risks of Private Enterprises' Outward Foreign Direct Investment and Their Countermeasures. SAR Economy, 2008(08):138-139.

[5] Liu Kangning. Research on Country Risks in China's Direct Investment in African Countries. Capital University of Economics and Business, 2020.

[6] Zhang Ailing. Political Risk and Prevention of Chinese Enterprises' OFDI to Africa. International Economic Cooperation, 2016(09):47-52.

[7] Gao Lianhe. Dilemma Response and Risk Prevention of China's Overseas Economic and Trade Cooperation Zone Upgrading in Africa. International Trade, 2021(03):11-18+43.

[8] Zhang Di, Wang Libin. Research on the Legal Problems of China's Enterprises' Investment in Africa. Foreign Economic and Trade Practice, 2022(04):79-82.

[9] Li Na. "Research on Country Risks of Xinjiang Enterprises' Outbound Investment in the Context of "Belt and Road". Economic Forum, 2018(06):107-110.

[10] He Qizhi, Xia Pingfan, Li Bo, Liu Jiabao. Evaluating Investors Recognition Abilities for Risk and Profit in Online Loan Markets Using Nonlinear Models and Financial Big Data. Journal of Function Spaces, vol. 2021, Article ID 5178970, 15 pages, 2021.

[11] Li, X. T., Wang, J, & Yang, C. Y. Risk prediction in financial management of listed companies based on optimized BP neural network under digital economy. Journal of Manufacturing Processes. 2022. (https://link.springer.com/article/10.1007/s00521-022-07377-0)