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# Global Opportunity Index: Global Investors' Growing Focus on Asia

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ACCESS TO CAPITAL

MILKEN INSTITUTE

# EXECUTIVE SUMMARY

As part of the Milken Institute's mission to improve access to capital, the Global Opportunity Index (GOI) has been developed as a statistical tool for assessing the attractiveness of certain countries as potential investment opportunities. While the following white paper focuses on countries in Asia, the full global ranking of countries can be found at [www.globalopportunityindex.org](http://www.globalopportunityindex.org). This year's focus on recent developments in Asia builds on our past research efforts examining capital markets and financial intermediaries in this region and provides perspective into the recent inflow of capital that helped spur Asian equity markets to rally by 23 percent in 2017 (year to date).[1,2] The following summarizes some of our key findings:

1. Four Asia-Pacific economies—Hong Kong, Singapore, Australia, and Japan—rank in the top 10 of the most attractive countries for investment globally, and ten of the region's 25 economies rank in the top 50.[3]

2. Hong Kong and Singapore maintained their top regional positions as the two most desirable countries for investment. In part, they have been recipients of a growing supply of funds looking for investment opportunities because of improving growth in Europe and Asia. In addition, more investment funds have come from Chinese investors, who have increased their search for investment opportunities abroad.[4]

3. Emerging Asia's attractiveness is predominantly linked to investors' perceptions of the cost of doing business, and the region's business-friendly institutions and standards. Differences in the business environment and property rights are key in explaining both intra-regional variations and deviations from the rest of the world.

4. Both Japan and Thailand are showing upward momentum as recipients of foreign investment. These improvements are mainly driven by better perceived costs of doing business, growing international trade connections, and stronger domestic demand from fiscal stimulus.

# EXECUTIVE SUMMARY

This white paper outlines the key characteristics of the GOI, analyzes the underlying factors behind Asia's growing attractiveness to global investors, and focuses on two of the region's best performers, Japan and Thailand.

**Table 1. Global Opportunity Index 2017, Asia-Pacific**

| Country | Move | Global Ranking | Institutional Framework | Economic Fundamentals | Financial Services | Business Perception | International Standards and Policy |
|---|---|---|---|---|---|---|---|
| Hong Kong | ● | 1 | | | | | |
| Singapore | ● | 3 | | | | | |
| Australia | ▲ | 4 | | | | | |
| Japan | ▲ | 7 | | | | | |
| South Korea | ▲ | 15 | | | | | |
| New Zealand | ▼ | 18 | | | | | |
| Malaysia | ▼ | 20 | | | | | |
| Thailand | ▲ | 29 | | | | | |
| China | ▲ | 41 | | | | | |
| Kazakhstan | ● | 49 | | | | | |
| Vietnam | ▲ | 61 | | | | | |
| Mongolia | ▼ | 62 | | | | | |
| Indonesia | ▲ | 67 | | | | | |
| Azerbaijan | ● | 69 | | | | | |
| India | ▲ | 75 | | | | | |
| Sri Lanka | ▼ | 80 | | | | | |
| Philippines | ▼ | 82 | | | | | |
| Kyrgyzstan | ▲ | 86 | | | | | |
| Bhutan | ▲ | 87 | | | | | |
| Tajikistan | ▲ | 88 | | | | | |
| Cambodia | ● | 97 | | | | | |
| Nepal | ▼ | 116 | | | | | |
| Pakistan | ▼ | 120 | | | | | |
| Bangladesh | ▼ | 122 | | | | | |
| Laos | ▲ | 133 | | | | | |

# METHODOLOGY

The global economy is rebounding: global GDP growth rate is expected to rise in all regions for the first time since 2008.[5] Improved growth performance in both emerging and developing economies make it difficult to identify regional or local investment opportunities based on macroeconomic performance alone.

The Milken Institute's Global Opportunity Index (GOI) assesses investment opportunities by including considerations that go beyond economic and financial factors. It incorporates qualitative influences based on reviews of key business, legal, and regulatory policies that are critical for ensuring successful foreign investments. The GOI measures the potential for foreign investment in key countries using 51 variables aggregated into five categories that are important for investors when they decide on where to invest:

- Economic Fundamentals (EF) indicate the current economic strength of a country vis-à-vis the global economic outlook. This factor focuses on the country's macro-performance, trade openness, quality and structure of the labor force, and modern infrastructure.
- Financial Services (FS) measure the size and access to financial services in a country by looking at the country's financial infrastructure and the business community's accessibility to credit.
- Business Perception (BP) measures explicit and implicit costs associated with business operations such as tax burden, corporate transparency, corruption, etc.
- Institutional Framework (IF) measures the extent to which an individual country's institutions provide a supportive business environment.
- International Standards and Policy (ISP) reflects the extent to which a country's institutions, policies, and legal system facilitate international integration by following international standards.

The final country rank is based on the average score of the five categories. Each variable is normalized from zero to 10. Within each category, the normalized variables are given equal weight and aggregated, resulting in a normalized category score with 10 indicating the most favorable conditions for investment, and zero signaling the least favorable. Table 1 reports the index ranges for key emerging markets in Asia and the rest of the world.

# LOOKING BACK TO LOOK AHEAD—DRIVING FACTORS OF THE REGION

An important advantage of the GOI not found among other investment climate measures is its ability to monitor countries using a broad spectrum of factors known to be important for global investors. Yet, the overall rank is heavily influenced by a handful of underlying factors that explain most of the variation in the overall ranking.[6] As expected, the actual set of explanatory factors tends to differ for emerging and developed countries, as well as by region.[7]

The superior performance of the Asian-Pacific emerging markets in the GOI is closely linked to the perceived ease of doing business there. The high scores on the security of contractual agreements and legal resolution from effective "rule of law" are shown in the data as specific factors represented by the *time to resolve insolvency* and the *time required to enforce contracts* variables. Such considerations are crucial to investors that often are wary of investing in regions or countries without legal certainty (e.g., certain contract enforcement).

By contrast, cross-border investment into emerging markets outside the region is more dependent on currency risk and assessment about counterparty risk. Consequently, the exchange rate regime and information related to recipient firms' credit quality explain most of the emerging market performance outside the region.

Important global considerations that influence cross-border investment into emerging market countries include currency risk and assessment about counterparty risk. Consequently, the exchange rate regime and information related to recipient firms' credit quality explain most of the countries' performance.

Investors take as given the efficacy and high stature of the legal framework found among the advanced economies in the Asia Pacific region. Consequently, the region's track record of relatively low and steady inflation and a growing trade sector (measured as a share of GDP) are often cited as additional reasons for investing in Asia.

By comparison, for other more developed emerging markets, investors continue to measure the efficacy and efficiency of their regulatory and legal frameworks. Often mentioned as hindrances for global investors in many otherwise developed emerging market economies are the large variations in the implementation and enforcement of regulations among national securities exchanges, as well as challenges in obtaining finality in dispute resolution and settlement (e.g., contract enforcement), and in bankrupcy recovery.

# AHEAD OF THE GAME–JAPAN AND THAILAND

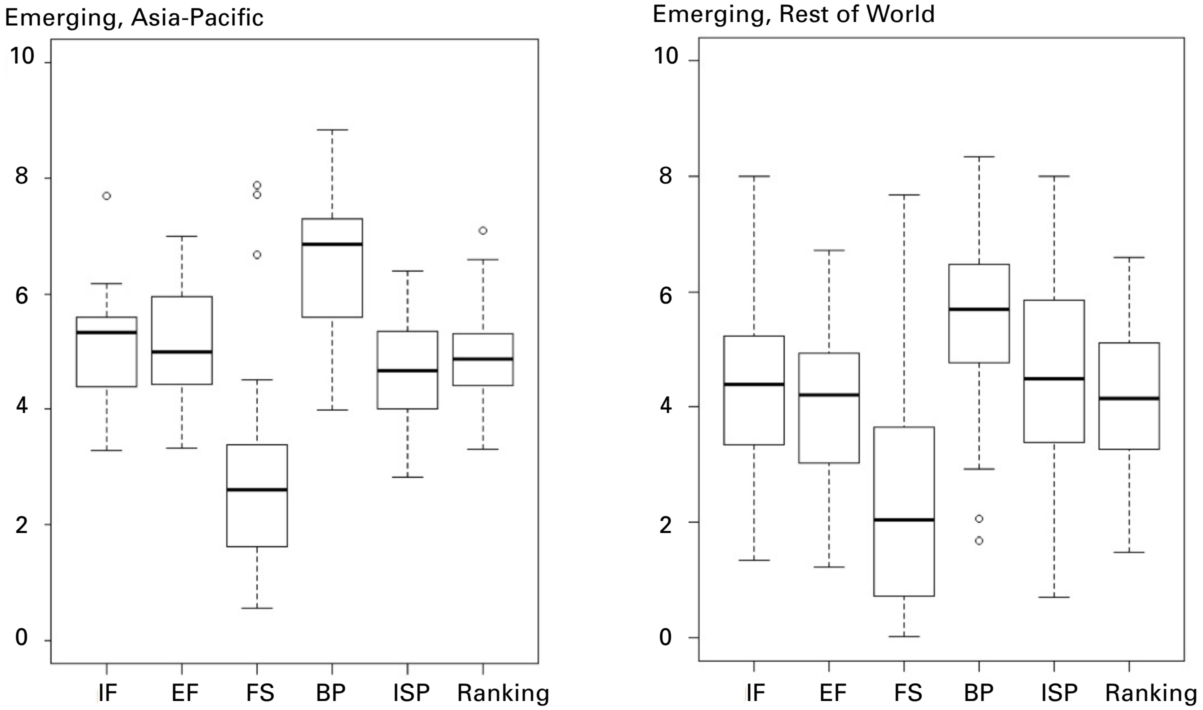
Japan and Thailand are the two best-performing countries among Asian developed and developing countries, respectively when compared with the 2016 GOI. Japan moved up four ranks and is in this year's top 10, while Thailand moved up 15 ranks to 29th.

Japan's performance is directly linked to the boost to GDP growth from its recent fiscal stimulus, as well as its sustained integration into the global value chain of production.[8] The fiscal stimulus, approved in late 2016, has helped to increase consumption and raised this year's growth forecast. However, the impact of fiscal stimulus likely will be temporary, and without continued stimulus, the improved growth momentum may wane. Japan's increased participation in the global value chain - a longer term policy designed to expand Japanese production across many ASEAN countries- is fostering the region's GDP growth and a growing trade sector in Japan and other Asian countries, as Japan's international trade with the rest of Asia continues to rise.

In particular, Japan's success relies on strategically outsourcing activities to ASEAN countries. Thailand, for example, has become an integral part of the technology-intensive supply chain of Japanese companies. Consequently, Japanese authorities and firms support a variety of programs to develop skills for workers that are tailored specifically to the needs of their companies. At the same time, as Thailand labor costs are growing and labor shortages emerge (Thailand's unemployment rate is close to 1%), Japan has increasingly relocated labor intensive stages of the production process to neighboring countries—the so-called *Thailand-Plus-One* strategy.[9] The creation of special economic zones in ASEAN countries has been an additional incentive for foreign direct investment and has facilitated extending Japan's supply chain further. Consequently, Japan's investment in the ASEAN region has more than doubled since 2010, reaching $600 million in 2016.[10]

Thailand itself is set to continue recent growth fueled by a competitive business environment, in part due to spillover effects of the Japanese developments. Since 2014, Thai authorities have been focused on ensuring a competitive environment that will foster foreign investment. Among numerous new reforms, two are especially important.[11] First, in 2015 a Royal Decree on Review of Laws and Regulation was passed to ensure that all regulations are up-to-date and are not creating unnecessary business obstacles. In an economy that is heavily based on complex licensing arrangements, this reform is key for trade liberalization and increased accessibility for foreign investors. Second, a new Trade Competition Act has passed to strengthen the enforcement of rules to promote competition. While regulatory reform is ongoing, early results can already be seen as business perception is at a historic high.

**Figure 1. Global Opportunity Index 2017, Distribution**



# ENDNOTES

1. Adams-Kane, Lopez, and Wilhelmus (2016).
2. MSCI International Asia Pacific ex Japan Index, referenced on 8/17/2017.
3. Due to data limitations, not all countries are represented in the Index.
4. The continued growth of Chinese investments for merger and acquisitions is discussed in Adams-Kane (2017).
5. IMF, April 2017.
6. A factor analysis model was used to help identify these key influences. This methodology is discussed in classic business cycle studies by Sargent and Sims (1977).
7. Each factor is driven by specific variables, for more details see Jolliffe (2002).
8. OECD (2017).
9. Predominantly Vietnam, Laos, Myanmar, and Cambodia.
10. Bank of Japan.
11. Santiprabhob (2017).

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# ABOUT US

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