

STRATEGIES FOR ENERGY INVESTMENTS: IS THERE A CASE OF FOREIGN COUNTRY BIAS? CASE OF SWITZERLAND

Yuliya Karneyeva, Chair for Management of Renewable Energies,
University of St. Gallen, +41789128500, yuliya.karneyeva@unisg.ch

Overview

This paper investigates the determinants of cross-border investment flows in energy projects by exploring investors risk perceptions and return expectations for domestic versus foreign power generation projects. The analysis focuses on the companies registered in Switzerland.

The choice of the Swiss case for the analysis comes from several empirical observations. In 2011 companies from Switzerland planned to invest 6.8 billion CHF in renewable energy until 2020, and two thirds of these investments were planned abroad (Windisch, 2011). Many of these plans became reality. For example, the portfolio of one of the traditional Swiss utilities includes only 4% of the new renewable energy plants (small hydro, solar, wind) in Switzerland, and the rest – abroad (Alpiq 2015). A significant amount of these plants are located in Bulgaria (24%) and Italy (66%); among fossil fuel energy plants there were no plants constructed in Switzerland at all (Alpiq 2015). Other Swiss utilities invest in Germany, Italy, Spain, and Romania (BKW, Repower, Axpo, EBL). Institutional investors, such as funds, insurances and banks, also invest abroad a lot (Susi Partners, Swiss Re, Credit Suisse, UBS).

International investment literature suggests that investors tend to do business in their home-countries rather than abroad, calling this phenomenon ‘home bias’ (Ahearne, Grier, & Warnock, 2004; Huberman, 2001; Tesar & Werner, 1995). Home bias is assumed to be the result of investor-choices rather than institutional constraints (French & Poterba, 1991; Tesar & Werner, 1995). It can, for example, be caused by familiarity of the local investment opportunities (Huberman, 2001). Less research was done on the cases, when investors allocated more investments abroad than at home (Beugelsdijk & Frijns, 2010; Chan et. al., 2005).

The main research question of the paper is: What are the risk and return expectations of Swiss investors for domestic compared to foreign energy projects?

Methods

First, a set of energy investments initiated by Swiss companies between 2012-2015 using database search and company reports is identified. Then, these investment trends are compared to the ones in 5 EU countries. This allows identifying recent trends in energy investments and establishing, whether the foreign country preferences in investment strategies is only a characteristic of the Swiss investors.

Then, three most common types of large-scale projects in Switzerland and abroad are identified. These three types of the large-scale projects are presented as investment options during the interviews with 10 decision-makers of large utilities. The results of the interviews are analysed using the verbal protocol analysis (VPA) technique.

Verbal protocol analysis technique requires that interview partners choose between several investment options and ‘speak-out-loud’, while making their decision (Ericsson & Simon 1980). This allows gathering in-depth qualitative data illustrating the decision-making process. The gathered data about the factors affecting the investors’ decision-making is then coded and quantified based on the time spent on the discussion of different factors. VPA does not restrain the interview partners to conform to the researcher’s expectations phrased as survey questions and was successfully used in management research (Chambers 2013).

To validate the results, a focus group discussion at the St. Gallen Forum for Management of Renewable Energies in 2016 was organized.

Results

The results demonstrate that return expectations for foreign projects very significantly depending on investor type – from 3% till 16.3% among the interview partners. While institutional investors prefer low risk-low return profile investments, utility companies choose projects with expected double-digit return rates. These returns are typically combined with the higher risk levels, associated with the impact of exchange rates and electricity market price volatility. Some companies apply universal WACC to all their investments; some differentiate expectations depending on the destination country and the type of energy.

However, the common for both institutional and utility investor types seems to be the higher sensitivity to risks in home country compared to the risks abroad. This could be explained by the fact of both investor-types being better informed about local compared to foreign policy-making.

Conclusions

In order to attract more private finance into the renewable energy sector, including both finance from institutional and utility investor-types, it is crucial to provide for a policy stability in order to minimise expected policy risk. While risks in foreign destinations might be even higher than domestic ones, the higher sensitivity for the local risk results in decreased investment amounts.

In the particular case of Switzerland, the practical implication of this finding would be not only the need to reduce the actual risks associated with project development, such as, for instance, administrative barriers to wind projects implementation, but also the need for an appropriate information policy to reduce the risk perception.

References

- Ahearne, A. G., Grier, W. L., & Warnock, F. E. (2004). Information costs and home bias: an analysis of US holdings of foreign equities. *Journal of International Economics*, 62(2), 313-336.
- Beugelsdijk, S., & Frijns, B. (2010). A cultural explanation of the foreign bias in international asset allocation. *Journal of Banking & Finance*, 34(9), 2121-2131.
- Chambers, L. (2014). Growing a hybrid venture: Toward a theory of mission drift in social entrepreneurship (Doctoral dissertation, University of St. Gallen).
- Chan, K., Covrig, V., & Ng, L. (2005). What determines the domestic bias and foreign bias? Evidence from mutual fund equity allocations worldwide. *Journal of Finance*, 60(3), 1495-1534.
- Ericsson, K. A., & Simon, H. A. (1980). Verbal reports as data. *Psychological review*, 87(3), 215.
- French, K. R., & Poterba, J. M. (1991). Investor diversification and international equity markets. *American Economic Review*, 81(2), 222-226.
- Huberman, G. (2001). Familiarity breeds investment. *Review of Financial Studies*, 14(3), 659-680.
- Tesar, L. L., & Werner, I. M. (1995). Home bias and high turnover. *Journal of International Money and Finance*, 14(4), 467-492.
- Windisch, R., Friedrich, E., Wanner, A., Wüstenhagen, R. . (2011). 9,7 Milliarden Franken für strom aus erneuerbaren Quellen: Analyse der Investitionsstrategien Schweizer Energieversorger bei der regenerativen Stromproduktion. *Schweizerischer stromkongress / Congrès suisse de l'électricité, Bulletin 12s / 2011*.
- Wuestenhagen, R., & Menichetti, E. (2012). Strategic choices for renewable energy investment: Conceptual framework and opportunities for further research. *Energy Policy*, 40, 1-10.